| | | |
|---|---|---|
| | Response Template for<br><br>Independent Review of Retirement Income: Consultation Paper<br><br>24 November 2014 | Deadline<br>27 February 2015 |
| Name of Respondent: | Jackie Wells | |
| Organisation of Respondent: | National Association of Pension Funds | |
| Email: | Jackie.wells@napf.co.uk | |
| Date | 27th February 2015 | |
| Disclosure of responses: | Please indicate if your responses should be treated as confidential: | Public |
| | Please follow the following instructions for filling in the template:<br><br>⇨ Do **not** change the numbering in the column "reference".<br><br>⇨ Leave the last column empty.<br><br>⇨ Please fill in your response in the row immediately below the question. If you have no response to a question, keep this row empty.<br><br><br>Please send the completed template, in Word Format, to Marilyn.Parris-Bell.1@city.ac.uk | |

| Reference | Comment | |
|---|---|---|
| Q1 | (a) What should be the primary aims of a ‘good’ DC scheme? Please explain.<br><br>(b) If the provision of a predictable income should be a primary aim of a ‘good’ DC scheme, how should this be defined?<br><br>(c) If value for money should be a primary aim of a ‘good’ DC scheme, how should this be defined? | |
| | The IRRI rightly begins the debate about retirement income products with a question about the primary aim of a good defined contribution (DC) pension scheme. The NAPF would argue that we perhaps need to take a further step back and confirm what the primary role of pension savings is more broadly following the introduction of Freedom & Choice. While the flexibilities inherent in Freedom & Choice are to be welcomed, they do raise questions about the purpose of pension savings. Defining what a good outcome looks like in the world of freedom and choice is an essential step. The NAPF believes that a good outcome should begin with the premise that a pension, first and foremost, is designed to deliver an income in retirement. This is, after all, what people say they want from their pension savings (in a recent NAPF survey of consumers 82% chose a secure income in retirement over flexibility[1]). Without agreement on what a good outcome looks like for DC pension savers, all other debates are ineffective and trustees and providers are left trying to design a system with no clear goal.<br><br>The NAPF believes that the aims of providing an income in retirement and value for money are in fact complementary objectives rather than alternatives. However, the idea that a DC scheme can provide an income that is predictable throughout the savings period would seem counter-intuitive. Predictability of income can only be achieved by removing one of the key concepts of a DC scheme, namely, the predictability of contributions from employer and employee. While predictability may be very attractive to a saver, the delivery of predictability can only be achieved in another type of scheme, either DB or shared risk. Even collective DC, as currently envisaged, can | |

[1] NAPF (2015), Understanding Retirement, wave I

| Reference | Comment | |
|---|---|---|
| | only target an income, it cannot achieve predictability throughout the saving period. Furthermore, unlike a lifetime annuity, cannot provide absolute predictability through retirement. What is important in a DC scheme is that the investment strategy is designed to meet the needs of the members, that the investment governance is strong and that costs are reviewed in the light of what constitutes value for the members. Well-governed investment strategies, which reflect member needs, can make retirement incomes more predictable – to the extent that predictability is important to the membership – even if they cannot provide absolute certainty.<br><br>What also matters is that savers are helped to understand what possible level of income (perhaps banded income) their savings might generate in retirement and the boundaries of 'reasonable' unpredictability about that. Framing DC savings as an income in retirement rather than a pot of savings will be an important tool in ensuring that savers think about their pension as a mechanism for generating a retirement income rather than a pot of money to be spent as a lump sum. As the recent work of the FCA has shown, decisions at retirement are shaped by the framing of the benefits of a pension[2]. Framing DC pensions as an income rather than a pot of money will help to encourage and endorse the social norm of associating pension saving with a retirement income.<br><br>The NAPF has been at the forefront of driving up standards in DC pensions, in part through the Pension Quality Mark (PQM). PQM was set up in 2009 and is wholly owned by The National Association of Pension Funds (NAPF), a not-for-profit organisation. PQM is given only to DC schemes that have passed independent checks in three areas: contributions should be at least 10% of earnings, that the scheme has high standards of governance, and excellent and regular communication with members.<br><br>PQM is currently undertaking a strategic review of how best to support DC schemes in a world of Freedom & Choice. | |

[2] FCA (2014), Retirement Income Market Study, Does the framing of retirement income options matter?

| | | |
|---|---|---|
| Q2 | (a) Do you agree with the breakdown of risks listed in the Introduction?<br><br>(b) Are there any important risks we have not identified?<br><br>(c) To deal with political risk, would it make sense to have an independent Pension Commission to set pension policy (similar to the independent Monetary Policy Committee)? | |
| | The list of risks set out by the IRRI is comprehensive but, as the paper suggests, some are more capable of being managedor mitigatedthan others. Some are applicable to the accumulation phase, some crystalise at the point of making a decision at retirement while others play out during retirement. Some apply at all stages. The NAPF advocates a more detailed mapping of the risks against potential interventions to identify those which should take priority in terms of policy responses.<br><br>Perhaps the most significant risk for pension savers in this new world of Freedom & Choice is that they end up making decisions that result in their not having any supplementary income in retirement or at a time that they can no longer work, leaving themselves and their dependents in relative poverty. The risks exposed by behavioural biases should perhaps be elevated to the top of the list of risks.<br><br>In terms of retirement income decisions, investment risk could perhaps be expanded to explore the added risks that volatility and timing present to those deciding how best to secure an income. The timing of investment decisions and the volatility of assets can be critical to the sustainability of retirement income and are worthy of further exploration.<br><br>Dealing with the existing and new risks for pension savers will require a mix of approaches: regulation; education; scheme design; investment design and exploration of new ways of pooling risk. However, from the perspective of trust-based schemes, delivering good outcomes to savers may also require some safeguards for trustees such as safe harbour solutions to which they can direct or 'nudge' their members . Without those safeguards, schemes may feel unable to help their members find the best solutions available in the market and savers may find themselves drawn to unsuitable solutions.<br><br>The success of automatic enrolment in getting people to save more for their retirement, or to save for the first time, is testament to the | |

| | | |
|---|---|---|
| | importance of building pensions policy on independent, objective evidence and consensus in order to achieve successful outcomes. Future pensions policy needs to be developed according to these same principles, to ensure the long-term interests of savers, the economy and wider society are appropriately served.<br><br>The NAPF manifesto, Pension Possibilities, published in October 2014, called upon the next Government to establish an independent Retirement Savings Commission. The NAPF believes that this is the best way to ensure that eyes remain focused on the long term, on the overall pensions and savings landscape rather than its component parts, and fundamentally, on the interests of savers. The Commission would define target retirement outcomes (what "good" looks like), measure progress towards them, make recommendations for change and provide impact assessments of Government proposals for change. It would analyse ongoing longevity and demographic trends, assess levels of current and forecasted savings activity and monitor the evolving at-retirement market, identifying those who may be losing out or "falling through the gaps". It would be accountable to Parliament with a statutory requirement to undertake a full annual review and report, producing its first in time to coincide with the planned 2017 review of automatic enrolment. | |

| | | |
|---|---|---|
| Q3 | (a) Do you expect products with longevity insurance (e.g., a lifetime annuity) to remain an essential component of a well-designed retirement programme?<br><br>(b) How should those individuals who continue to buy lifetime annuities be assisted to obtain the best value products for their circumstances?<br><br>(c) If individuals do not purchase lifetime annuities, how does an individual hedge their longevity risk in retirement? | |
| | NAPF research among pension savers, both qualitative and quantitative[3], reveals that the majority of savers want to use their DC pension to generate a regular income in retirement. In response to a question that gave them a (forced) choice between a regular lifetime income and flexible access to a pot of money that might not last their whole retirement, 82% chose the former. However, the research also highlighted, in common with several other studies, the poor perception of annuities. The NAPF supports measures to improve the functioning of the annuity market, including the recommendation by the FCA to require FCA regulated firms to provide their customers with a comparison of their annuity rate with the open market, showing not only the annual difference but also the estimated lifetime difference[4].<br><br>We therefore anticipate that some form of longevity insurance will remain attractive to many reaching retirement, whether in the form of lifetime annuities or some other form of deferred insurance. The NAPF supports the development of new retirement income solutions that can deliver value for money to those with modest pension savings while providing some protection against investment performance, volatility and longevity risks. The NAPF also hopes that the insurance market embraces the opportunity to develop innovative solutions for managing later life longevity risk. | |

[3] Understanding Retirement, wave I
[4] NAPF response to FCA Retirement Income Market Study

| | | |
|---|---|---|
| Q4 | (a) Where annuities are purchased later in retirement, what are the most effective and efficient products for providing income in the period between retirement and the age at which the longevity insurance comes into effect?<br><br>(b) Should such products have a maximum recommended level of income withdrawal?<br><br>(c) If so, how should that level of income be determined? | |
| | The NAPF supports the development of retirement income solutions that deliver flexibility in the early to middle years of retirement, the delivery of a regular income and the protection afforded by later life insurance against longevity risk. A good solution should also contain regular communication to the member on the projected sustainability of the income and risk alerts if the risks of running out of money exceed a certain level of probability. On the subject of the level of income, care should be taken in setting a social norm which is not balanced by an understanding of the risks of running out of money. It is all very well to secure a later life income at age 80, only to run out of funds at the age of 78 and have two years without an income. These are risks that anyone using a new flexible drawdown account must be informed of. | |

| | | |
|---|---|---|
| Q5 | What are the advantages and disadvantages of scheme drawdown (i.e., where the scheme provides an income to the retired member prior to the purchase of an annuity)? | |
| | From the perspective of a pension saver, the benefits of staying in the same pension scheme and drawing down from that scheme could be significant. In particular, scheme drawdown would reduce significantly the frictional costs of transferring funds from an occupational pension scheme to a contract-based scheme.<br><br>However, it is evident from NAPF surveys of its membership and from other reports[5], that most trust-based pension schemes do not intend to develop a drawdown facility (at least in the short to medium term). The majority of schemes do not have the scale necessary to cost-effectively deliver drawdown. The consequence of this is that members wanting a drawdown product will need to transfer to the retail market unless schemes can transfer members at retirement to another trust-based scheme. As discussed below, the NAPF is calling for the Government and regulators to make it clear how and when trustees can transfer members (with their approval) to another scheme that can provide savers with the flexibilities they require, including access to their funds should they wish it.<br><br>The NAPF is pleased to see evidence that the cost of retail drawdown products appears to be falling but remains concerned that savers will need to incur considerable transfer costs, including advice costs, to move from accumulation to a regular income solution. | |

[5] An NAPF survey of fund members 2014 revealed that fewer than half expected to implement any flexibilities with less than one in ten expected to offer drawdown or flexible UFPLS (survey conducted in November 2014, sample of 72 NAPF fund members). Similar results were reported by a survey of funds by Xaffinity

| | | |
|---|---|---|
| Q6 | (a) Should decumulation default products provided by, say, large-scale master trusts, be subject to the same trustee-based governance and quality standards that apply to the accumulation default fund?<br><br>(b) Where decumulation products are offered by contract-based schemes, should they be included in the requirements for the new Independent Governance Committees to provide governance and quality standards and to assess value for money? | |
| | The NAPF supports the development of well-governed 'institutional' style solutions for drawdown, whether developed by the large-scale master trusts or by insurers or fund managers. Good governance, good communication, low charges, managed drawdown programmes and well-designed investment and longevity solutions will be critical to ensure that pension savers are protected to the extent that they can be. It remains unclear whether it will be possible or appropriate to develop true defaults for retirement income in the same way as for accumulation. The decisions are much more individual in nature. Having said that, schemes should be able to develop a solution, either within or without of their scheme that they can present to members as an income solution designed to deliver specific benefits.<br><br>In a trust-based scheme, the high standards of governance applied in the accumulation phase should be built on for the income phase. TPR will need to to develop and consult on further guidance for trustees engaged in overseeing a drawdown arrangement. It seems wholly appropriate that similar requirements should be imposed on IGCs in relation to drawdown products offered by FCA-regulated firms to those coming out of workplace schemes. | |

| | | | |
|---|---|---|---|
| Q7 | (a) What could be the typical total expense ratio (TER) for a default drawdown product provided by a large-scale master trust?<br><br>(b) How might this TER compare with individual drawdown products sold in the retail market?<br><br>(c) Can you give any examples of TERs for retail drawdown products? | |
| | Since the full set of regulations, rules, codes and guidance for trust-based drawdown products has yet to emerge, it is not yet possible to determine what the costs of running a scheme are and therefore what an appropriate level of TER is likely to be, and indeed the level of any potential charge cap. However, it would seem reasonably to expect that there would be :<br><br>• on the one hand higher costs than during the accumulation stage, driven by the adminstration costs of generating an income, additional communication / reporting and potentially higher governance costs, but<br><br>• on the other, economies of scale when compared to retail drawdown products driven by the more structured approach to drawdown amounts or levels and the reduced need for individual advice.<br><br>The NAPF anticipates that the costs of large-scale drawdown will move towards the charge-cap on default funds rather than towards the generally higher charges on retail drawdown but are unlikely to be below the current charge cap, at least until the regulatory environment is settled. | |

| | | |
|---|---|---|
| Q8 | (a) Should scheme default drawdown products be subject to the charge cap?<br><br>(b) Should this be the same as for accumulation (i.e. 0.75%) or is there a case for a higher cap? If higher please explain why and what the difference might be? | |
| | See response to Q7 | |

| | | |
|---|---|---|
| Q9 | Retail drawdown products will be sold via regulated advice and they will be purchased via non-advice (execution-only). Is there a case for:<br><br>(a) Higher quality controls and consumer protection in relation to risk and costs? Explain.<br><br>(b) Making retail products subject to a charge cap? Explain. | |
| | The NAPF supports and hopes to play an active role in developing voluntary standards for any drawdown scheme that wishes to meet high standards of governance, communication and charges. There is no reason why these retail products meeting the standards should not be included in any voluntary scheme.<br><br>It will be critical for the FCA to set clear rules and controls on the sale of all retail retirement income products while not excluding pension savers from the retail market should they wish or need to engage with it. While low charges are important, evidence from other initiatives to impose charge caps (e.g. stakeholder) might suggest that they can both drive down costs but at the same time exclude many from the market. Furthermore, it is necessary for the regulatory environment to settle further before any analysis of the costs of running and advising on / selling retail or institutional drawdown products can commence. | |

| | | |
|---|---|---|
| Q10 | What is the optimal investment strategy in scheme drawdown prior to the introduction of longevity insurance? | |
| | | |

| | | |
|---|---|---|
| Q11 | What are the advantages and disadvantages of institutional annuitisation (i.e., where annuities are provided on a bulk basis either by the scheme (self annuitisation) or by an insurance company, rather on a retail basis as currently)? | |
| | | |

| | | |
|---|---|---|
| Q12 | Could institutional annuitisation deal with the individual underwriting of annuities and still encourage competition from providers in the open market to maximise consumer outcomes (e.g. in the case where a retired member has a medical condition which reduces their life expectancy)? | |
| | | |

| | | |
|---|---|---|
| Q13 | (a) Would a market for advanced life deferred annuities be viable?<br><br>(b) What is the likely demand for advanced life deferred annuities? | |
| | | |

| | | |
|---|---|---|
| Q14 | Is there likely to be demand for inflation protection? | |
| | NAPF qualitative research undertaken as part of its Understanding Retirement suggested that pension savers would like inflation protection for their retirement income. However, evidence from the sale of annuities suggests that most are reluctant to pay the price required in terms of a lower income at the start of their retirement. The NAPF does not anticipate an increase in demand for inflation protected income products. There will however remain significant demand from DB pension schemes for instruments that can provide them with inflation protection, whether RPI or CPI. | |

| | | |
|---|---|---|
| Q15 | What are your views on the proposals by HM Treasury to allow annuities to have more flexible payment terms by:<br><br>(a) allowing lifetime annuities to decrease<br><br>(b) allowing lump sums to be taken from lifetime annuities<br><br>(c) removing the ten-year guarantee period for guaranteed annuities<br><br>(d) allowing payments from guaranteed annuities to be paid to beneficiaries as a lump sum, where they are under £30,000? | |
| | | |

| | | |
|---|---|---|
| Q16 | What are your views on U-shaped or J-shaped annuities? | |
| | | |

| | | |
|---|---|---|
| Q17 | Should DC retirement products and decumulation strategies be linked to the single tier state pension? If so, how? | |
| | Until such a time as every individual is likely to receive the full single tier state pension, it is difficult to see how this can be achieved in a workplace scheme or large scale drawdown vehicle. For the short to medium term, too many savers will receive less than the full state pension to make this feasible. | |

| | | |
|---|---|---|
| Q18 | What other retirement products do you expect to become available? Please provide details if possible. | |
| | | |

| | | |
|---|---|---|
| Q19 | Is there a case for designating certain retirement products as 'safe harbour' products? Explain. | |
| | The opening up of retirement choices through the Freedom & Choice agenda seems to create so many risks for such an ill-prepared group of savers that it is crying out for the creation of defaults to accompany the explosion of choice and the increased complexity of those choices.<br><br>It is clear from NAPF's Understanding Retirement, wave I research that pension savers will face an increasingly complex set of decisions as they reach retirement age that they, and their normal support networks, are ill-prepared for and for which pension schemes and the open market are not adequately equipped. The NAPF takes the view that Freedom & Choice has moved us from a place where shopping around was the route to a better outcome to one where, at least in the short to medium term, shopping around may well lead to worse outcomes for some, perhaps many, than sticking with the solutions offered by the existing scheme.<br><br>Shopping around could increase the risk of exposure to scams, high cost products and inappropriate investment solutions. Good financial advice can help to overcome this but, in the short term at least, we envisage that this will not be available to all and many consumers will be unwilling to engage with the advice market. Until such a time as the market has evolved, encouraging good default solutions that afford a safe harbour to both savers and trustees could provide the answer. To minimise the risk to a growing pool of savers approaching retirement, this needs to happen soon.<br><br>In the face of complexity, we know that consumers often fall back on the simplest or easiest route available, often described as the default. In some cases, this may mean doing nothing (which may or may not be a good outcome). In others, perhaps due to a lack of understanding of pensions, a lack of trust in the sector or encouraged by those who wish to get their hands on the money in one way or another, the simplest thing may seem to be to take the money out of the pension plan. For trustees and providers of pension schemes, this presents [something of] a dilemma. On the one hand, they may want to or feel duty bound to encourage their members to shop around and to embrace the world of freedom and choice. On the other, they may recognise the risks of doing so.<br><br>The development of safe harbours would permit trustees (and potentially IGCs) to direct their pension savers to a solution that met certain agreed standards without fear of misselling claims further down the road. To be effective, safe harbours should be defined in law. Without such an approach, trustees would remain concerned about future liabilities and, in particular, decisions of the | |

Ombudsman.

The NAPF believes that Freedom & Choice would work much more efficiently, enable better choices and deliver a greater sense of freedom if savers were presented with a default retirement income option (or maybe a very small number of alternative options) when they turn to their pension scheme and say 'I want my money'. The simple insertion of a default option, selected by trustees and, possibly, Independent Governance Committees acting in the interests of the saver, would greatly improve the journey through Freedom & Choice and reduce the potential for decision paralysis and detrimental choices.

The choice of default should be the responsibility of governing bodies, based on knowledge of their own membership. That choice might be made within parameters set by Government covering features familiar from the regulation of pension schemes – charges, communications, governance. Governing bodies might choose to use annuities or simple cashout plans as defaults, but many are likely to look to more sophisticated choices which seek to give members a degree of flexibility coupled with the certainty of income stream which research consistently demonstrates savers value above all else.

In Australia, where policymakers are seeking to mend a market where longevity protection barely exists, the 2014 report of the Financial System Inquiry (the Murray Review) describes just such an approach:

> "The pre-selected option should be a comprehensive income product for retirement (CIPR) that has minimum features determined by Government. These features should include a regular and stable income stream, longevity risk management and flexibility. CIPRs would be low-cost and include a 'cooling off' period. Their design could vary with the member's known characteristics, such as the size of their superannuation benefits, and take account of the possibility of cognitive impairment at older ages." [1]

Critically, members are unlikely to be well-served if pathways only exist within the schemes they have saved in. There are over 30,000 DC schemes in the UK; it is impractical to think that any but a small minority are likely to be able to develop high-quality solutions of their own at a reasonable price. For pathways to work effectively, trustees must be able to build them across schemes and facilitate straightforward transfers from scheme to scheme.

Returning to the theme of what a pension is for, the NAPF advocates a set of standards around 'safe harbour' retirement income solutions that encompass the governance of the scheme, communication with members in particular risk alerts if the member is taking a level of income that appears unsustainable, investment strategies and managed income strategies that afford some protection against

| | | |
|---|---|---|
| | running out of funds, later life protections for longevity and cognitive ability risks, value for money charges and the ability to transfer and access remaining funds at any time.<br><br>Trustees should then feel confident in presenting savers with a single solution or limited range of solutions (whether or not these are in their scheme) that they have assessed as meeting the needs of their scheme members, without fear of future repercussions from regulators or the Pensions Ombudsman. | |

| | | |
|---|---|---|
| Q20 | Following the impact of the Budget 2014 tax changes on annuity providers, do you have any concerns about supply-side contraction or other developments in the annuity market that might make it less competitive? | |
| | The NAPF is concerned that Freedom & Choice will reduce the supply of annuities to those wishing to secure a lifetime income with their DC savings. This may inevitably lead to a less competitive market and it will be important for the FCA to continue to monitor the market and to re-evaluate the value for money afforded by those who do continue to offer annuities. | |

| | | |
|---|---|---|
| Q21 | (a) What is the best way to deal with stranded pots? Explain.<br><br>(b) Two approaches have been put forward to date: 'aggregator' and 'pot-follows-member'. Do you have preference for one over the other? Explain.<br><br>(c) Would 'scheme-follows-member' be feasible? Explain | |
| | The proliferation of small, stranded pots is a problem that the NAPF recognises needs to be addressed over the short to medium term and which needs to be done in a way that protects members and keeps implementation and ongoing costs to a minimum. The NAPF has a number of strong concerns about whether the Government's policy of pot-follows-members automatic transfers does enough to on either of these fronts.<br><br>This policy was developed by Government 3 years ago, before the new charge cap, rules on transaction costs, before automatic enrolment had even begun and before the freedom and choice reforms were developed. These developments are changing the pensions landscape rapidly and alter the assumptions on which the policy is based – for instance that most people will want to consolidate pots to buy an annuity. Therefore the next Government should review the case for auto-transfers, and develop an approach that fits with the new reforms and the new landscape, which is likely to de dominated (particularly when considering smaller pots) by a small number of large-scale low-cost master trusts. | |

| | | |
|---|---|---|
| | The NAPF does not support the concept of 'scheme follows member'. Such an approach, applied in the UK market, would undermine existing employer-sponsored schemes and auto-enrolment. Auto-enrolment needs to be kept as simple as possible for employers – especially small and micro employers. Forcing employers to pay contributions into a whole range of schemes will be too complicated and expensive for employers and will reduce the benefits of scale for savers. Damaging the link between employers and their chosen schemes could also have unintended consequences in terms of reducing generous employer contributions and employer subsidies to scheme running costs. | |

| | | |
|---|---|---|
| Q22 | It is now recognised that many people face a number of behavioural barriers which prevent them behaving optimally. When it comes to decumulation, what are the key barriers? | |
| | Several research projects point to the potential for poor outcomes for individuals when it comes to choosing how to employ DC savings. The recent work of the FCA[6] in this field summarise these succinctly. However, it is important to recognise that there are also supply side barriers to good outcomes, driven in part by conflicts of interest between pension saver and provider or adviser. In the short term, from April, there will also be barriers created by the lack of suitable new products due to the speed at which the regulations have been pushed through which have not allowed schemes or providers time to develop new solutions. | |

[6] FCA (2014) Retirement Income Market Study

| | | |
|---|---|---|
| Q23 | We need to recognise that retirees: have different expenditure needs during different phases of their retirement; need to pace their spending throughout retirement in order to optimise the use of their lifetime assets and income and their ability to make intended bequests; and need a choice architecture that reflects the market segment to which they belong.<br><br>(a) What is your understanding of the regulatory consumer market segmentation and is this appropriate in relation to the needs of DC retirees?[7]<br><br>(b) What nudges and choice architecture do people need to deal with these issues and overcome the behavioural barriers they face? | |
| | [See above re. Default pathways] | |

[7] Traditionally, the UK market was segmented into the mass market, the mass affluent market and the high net worth market, but this is changing.

| | | |
|---|---|---|
| Q24 | (a) What lessons from auto-enrolment in the accumulation phase can be brought to the decumulation phase?<br><br>(b) Given the importance of income security for the elderly and the existence of longevity risk, is there a case for defaulting people into buying longevity insurance via auto-enrolment (i.e., drawdown with longevity insurance becomes the default retirement strategy)? Consider the advantages and disadvantages of such a strategy.<br><br>(c) What would be the likely annualised cost of such products for individuals?<br><br>(d) How could the default principle, upon which the success of auto-enrolment is predicated, be best reconciled with the individual freedoms for DC decumulation introduced in the 2014 Budget? | |
| | Automatic enrolment has proved successful in driving up pension scheme membership and savings. To date, the exercise has shown clearly that defaults can address inertia and change behaviour in a positive way. Removing some of the complexity about decision making in pension accumulation could also be played out in the retrement income space, albeit that decisions are more individual in nature. We have set out above our thoughts on pathways for retirement income. | |

| | | |
|---|---|---|
| Q25 | What are the implications of the Chancellor's announcement in September 2014 effectively ending the 55% tax rate on inherited pension pots? | |
| | | |

| | | |
|---|---|---|
| Q26 | What are your views on the guidance guarantee and how effective it will be? | |
| | It is too soon to comment on the guidance service Pension Wise nor to have a clear view on how effective it will be. However, it is clear that what will be in place on April 6th, should only be seen as the start of developing the service, not the end game.<br><br>The NAPF will be conducting research over the summer to track how those aged 55-65 will be experiencing Freedom & Choice and what outcomes emerge. | |

| | | |
|---|---|---|
| Q27 | (a) Will other forms of guidance and advice be needed?<br><br>(b) For DC savers who prefer to make their own decisions, what is the best way to build on the guidance guarantee to help individuals avoid buying retail products that are inappropriate (e.g., in relation to risk) and/or poor value (e.g., in relation to price)? | |
| | Schemes are working hard to redesign their communications with members to flag the new choices and the risks that individuals face in accessing their pension savings. Many NAPF members also support members through the provision of advice or broking services, all of which are being re-designed to fit with the new choices available.<br><br>A sector-wide agreement on the terminology to be used to describe the new options would be a great step forward. The FCA's further review of disclosure to be announced shortly will be critical in researching and shaping how best to communicate to members. | |
| Q28 | (a) What specific risks should regulatory safeguards aim to address in relation to financial decisions made at retirement?<br><br>(b) At what point does individual choice cease to be a regulatory concern/responsibility? | |
| | See comments above | |
| Q29 | Some DC customers might draw down all their pots in the early years of retirement, a decision they might subsequently regret. What is the most effective way of assisting DC customers to act in their best long-term interests? | |
| | See comments above | |

| | | |
|---|---|---|
| Q30 | (a) What is the best way of ensuring that any DB-to-DC transferees only undertake such a transfer when it is in their best interests?<br><br>(b) What are your estimates of the number of DB-to-DC transferees (deferred and also active) and size of assets involved?<br><br>(c) Is the requirement for regulated independent advice for such transferees adequate?<br><br>(d) Can/will the guidance guarantee process cope with DB active/deferred members who seek help in considering their options? | |
| | The Pensions Regulator has always been quite clear that "it is likely to be in the best financial interests of the majority of members to remain in their DB scheme". The NAPF called for a requirement that individuals with accrued benefits in excess of £30,000 considering transferring from DB to DC from April 2015 should be required take advice in order that they have an opportunity to understand the value of benefits they may be giving up. This approach strikes the right balance between enabling people to access the freedoms while ensuring that they have been given professional advice on the impact of such a decision.<br><br>It is difficult to assess the number of DB members who will request a transfer from April 2015. Furthermore, the number that request a transfer may turn out to be a poor indication of the number who effect a transfer. It is, as yet, unclear what the appetite for giving such advice by the regulated advice community. The cost of advice may also present a barrier to some. Furthermore, it is not evident whether those wishing to transfer to DC will always be able to find a home for their savings. Providers may be reluctant to accept some DB transfers if they suspect that the funds may be withdrawn in a short space of time or they may seek to recover their set-up costs for the transfer through exit charges that make the transfer less effective for the member.<br><br>We have limited ways of assessing how people will respond to the new freedoms and how many may be encouraged to access their cash by third parties looking to turn a (legal or illegal) profit from such activity.<br><br>If the number of transferees is small we anticipate the impact on most DB schemes to be minimal as they will have sufficient cash flow/liquid assets to pay the transfers. However, if there are significant numbers (and/or the scheme is relatively small) then this could impact on the scheme's funding position and investment strategy by increasing the need to move to more liquid assets and ultimately a | |

| | | |
|---|---|---|
| | change in strategy all together to reflect the new liabilities. Too many transfers could also destabilise the funding of the scheme, especially if the CETV paid out is close to a technical provisions basis (and sometimes above depending on the age of the transferee). This is why the NAPF called for Government to retain trustee powers to reduce CETVs in circumstances where they are worried about the ongoing funding of the scheme and we have welcomed TPR's recent draft guidance on this. | |

| | | |
|---|---|---|
| Q31 | Are there other ways of supporting pension savers to make the right choice at retirement for them and their family? | |
| | | |

| | | |
|---|---|---|
| Q32 | What evidence is there of individuals' ability to reliably estimate how long they are going to live? | |
| | Managing longevity risk is a complex issue. Research consistently shows that individuals typically underestimate their lifespan, which can lead to the risk of over-spending in the early years of retirement. A recent report supported by NAPF found that men aged 50–60 underestimate their life expectancy on average by around 2 years and women by 4[8]. Perhaps more significantly, people tend to make point estimates of their longevity and find it difficult to comprehend the range of possible outcomes. | |

| | | |
|---|---|---|
| Q33 | How easy is it for individuals to quantify longevity risk? What evidence is available on this question? | |
| | See response to Q34 below. | |

[8] IFS 2012, Expectations and experience of retirement in Defined Contribution pensions: a study of older people in England, funded by NAPF and ESRC

| | | |
|---|---|---|
| Q34 | Is longevity risk a risk that individual savers are able – and should be expected – to manage themselves? | |
| | How long we will live as individuals is unknowable. No individual can possibly predict with any accuracy how long they will need their retirement income to last. The only framing they have is the current average life expectancy of someone reaching age 65 and their own family history, neither of which may be remotely applicable to their own circumstances. Whether or not an individual has adequate funds and the temperament to spend those funds wisely in retirement are other confounding factors in the degree of risk that an individual faces.<br><br>On the one hand, Freedom & Choice, and indeed earlier changes to pension policy, have allowed people to take this risk. Removing those freedoms will be politically difficult. On the other hand, if the risks are not knowable simply informing people that they are now exposed to them may not prove adequate. The development of default pathways described above and that take account of other behavioural biases seems to strike a middle ground between extreme freedom and extreme paternalism. | |

| | | |
|---|---|---|
| Q35 | Where people receive tax incentives to save into pensions, should people be required to secure a minimum lifetime income in retirement? | |
| | The question of tax incentives and pension tax relief is a complex subject, not least the complexities of striking the right balance between those in DB schemes and those in DC schemes and the question of intergenerational fairness. The NAPF is developing further work in this area that it will make available later in the year. | |

| | | |
|---|---|---|
| Q36 | (a) Do you believe that the DC retirement income market could benefit from the introduction of a market in longevity bonds? Explain.<br><br>(b) Do you believe that a market in longevity bonds is viable (in the sense of having sufficient demand to justify its introduction)? Explain. | |
| | Bond issuance and longevity risk in general are central to the prospects for both DB and DC pensions in payment, perhaps even more so now that the options in retirement have been expanded. The NAPF has called upon the Government to do more to help schemes and savers manage this specific risk but this needs to be done in the round by considering the needs of all types of scheme and all types of buyer of those assets in the pension sector, including the life assurance industry.<br><br>With the closure of more DB schemes comes a growing demand for assets that can provide a close match to the run off of liabilities and can provide a more stable cashflow. The demand for index-linked gilts at present exceeds the supply, thus driving down the yield. The reality is that pension schemes will need much higher levels of index-linked gilt issuance if they are to navigate the DB run-off smoothly and manage risk efficiently. The impact of Freedom and Choice on DB schemes may yet bring changes to schemes appetite for gilts but it remains too soon to say exactly what timeframe that will occur over or shape that change may take.<br><br>It also remains very early days to comment on the scale of demand for longevity bonds since much will depend upon the behaviour of DC pension savers in the short to medium term. The NAPF has not provided any further answers to the set of questions below on the detailed design of longevity bonds. | |
| Q37 | Do you have a preferred design for a longevity bond? | |
| | | |
| Q38 | Is there a case for the government to issue longevity bonds? Explain. | |

| | | |
|---|---|---|
| | | |
| Q39 | Are there alternatives to longevity bonds to hedge systematic longevity risk? Explain | |
| | | |
| Q40 | Are there other ways of helping savers to manage longevity risk? | |
| | | |
| Q41 | Should NEST provide retirement income products to its members? | |
| | The NAPF has not provided a response to the set of questions relating to the role of NEST in the retirement income market. | |
| Q42 | (a) Should NEST provide a default decumulation product (e.g., scheme drawdown or annuitisation)?<br><br>(b) If so, what quality standards should apply (e.g., in terms of charge caps, governance)? | |
| | | |
| Q43 | Are there any other ways in which NEST can help savers to access good quality retirement products? | |
| | | |
| Q44 | In an aggregator model for stranded pots:<br><br>(a) Would it be desirable for NEST to act as one of the aggregators?<br><br>(b) Which other schemes could act as aggregators? | |
| | | |

| | | |
|---|---|---|
| Q45 | Could NEST do more in decumulation for the self-employed and workers excluded from auto-enrolment? | |
| | | |
| Q46 | (a) Could NEST become a collective pension scheme? Explain.<br><br>(b) Should NEST become a collective pension scheme? Explain. | |
| | | |
| Q47 | What should ‘collective’ mean in the UK context (e.g., collective in terms of scale and governance, and collective in terms of risk-sharing)? | |
| | | |
| Q48 | What are the main benefits of CDC schemes over individual DC schemes? | |
| | It is not clear that CDC schemes offer significant benefits over a well-governed inidvidual DC scheme operating at scale.<br><br>CDC schemes potentially offer employers increased flexibility and choice in how they can structure pension schemes to benefit members by providing pooled risk, smoothing, and greater certainty. This is to be welcomed. For pension savers, CDC schemes would appear to afford more clearly targeted incomes in retirement but to bring with them challenges for managing intergenerational fairness and facilitating freedom and choice. It remains unclear whether there will be an appetite from employers, trustees or pension savers for these vehicles in a market which is undergoing such fundamental change.<br><br>Defined benefit schemes have operated on a pooled risk basis for many years and have shown considerable innovation in managing this effectively and at low cost. For defined contribution schemes the focus must remain on providing good outcomes for members. CDC may well have a role to play in this, but the fundamentals still apply. Good outcomes for members are built on strong governance, low charges and investment strategies based on members' needs. | |

| | | |
|---|---|---|
| | The real goal here has to be schemes operating at scale. Scale is a necessary precondition for CDC but it also enables a much wider range of member benefits. As a result of automatic enrolment the UK is already seeing the emergence of large pension schemes in the form of master trusts, which are able to offer their members high quality investment strategies and great value for money. | |
| Q49 | What are the main disadvantages of CDC schemes over individual DC schemes? | |
| | See above. | |
| Q50 | CDC schemes may be able to generate incomes that are higher than individual DC schemes as the latter are currently operated.<br><br>(a) Are there reasons why an individual DC scheme could not follow the same investment or decumulation strategy as a CDC scheme?<br><br>(b) Would trustees of an individual DC scheme be willing to accommodate the greater investment risk, given the need to enable members to transfer out and to take their pension pot with them? | |
| | | |
| Q51 | (a) Would a CDC scheme have any additional risk-sharing advantages over a large master trust DC scheme which followed the same investment and decumulation strategies where possible?<br><br>(b) Can the benefits from any additional sources of risk sharing available to CDC schemes be quantified? | |
| | | |
| Q52 | (a) What is your preferred design for a CDC scheme, in terms of targeted benefits?<br><br>(e.g., a CDC scheme that is intended to replace a DB scheme and hence would be earnings-related (specify accrual rate, earnings measure, pre-retirement indexation rule, post-retirement indexation rule); or a CDC scheme that is intended to replace an | |

| | | |
|---|---|---|
| | individual DC scheme and hence would be with-profit and a target return, unit-linked and a target return, etc).<br><br>(b) Explain why | |
| | | |
| Q53 | (a) What is the best estimate contribution rate to achieve the target benefit?<br><br>(b) How should the contribution rate be shared between employer and member? | |
| | | |
| Q54 | (a) Can a CDC scheme work with a planned contribution rate that is fixed independent of a member's age or is an age-dependent member contribution rate required?<br><br>(b) If the latter, is a change to equality legislation required? | |
| | | |
| Q55 | What investment strategy would be appropriate for CDC schemes: (a) in accumulation and (b) near retirement and (c) in decumulation? | |
| | | |
| Q56 | What are the main benefits of a CDC scheme in terms of intra-generational risk pooling? | |
| | | |

| | | |
|---|---|---|
| Q57 | What are the main benefits of a CDC scheme in terms of inter-generational risk sharing? | |
| | | |
| Q58 | (a) Over how many generations should risk be shared?<br><br>(b) Explain why this is optimal | |
| | | |
| Q59 | How should the risk-sharing rules in a CDC scheme be defined? | |
| | | |
| Q60 | How much discretion should a CDC scheme's managers have when it comes to smoothing or adjusting benefits to target benefits, or should the rules be fully transparent? | |
| | | |
| Q61 | (a) If the actual pension is above the target pension, when should adjustments be made?<br><br>(b) How and in what order should the adjustments be made (consider adjustments to pension indexation, pension amount in payment, investment strategy, active member contribution rate, active member retirement age)? | |
| | | |
| Q62 | (a) If the actual pension is below the target pension, when should adjustments be made?<br><br>(b) How and in what order should the adjustments be made (consider adjustments to pension indexation, pension amount in payment, investment strategy, active member contribution rate, active member retirement age)? | |

| | | |
|---|---|---|
| | | |
| Q63 | What mechanisms are needed to ensure that no CDC scheme becomes insolvent? For example, a CDC scheme might try to use a high target return to attract more customers. | |
| | | |
| Q64 | Is it necessary for a CDC scheme to start with or build up a reserve fund to give it credibility? | |
| | | |
| Q65 | CDC schemes in other countries (e.g., Holland) have virtually no flexibility with respect to member choice (e.g. contribution rate, investment strategy, retirement date, form of decumulation (i.e., pension). Do the freedoms and flexibilities introduced by the 2014 Budget render CDC schemes unfeasible or more risky in the UK? Explain why not or, alternatively, how freedom and flexibility would need to be tailored in the context of CDC schemes? | |
| | | |
| Q66 | One of the biggest growth areas prior to the 2014 Budget was the medical underwriting of annuities and the growth of enhanced annuities. But in a standard CDC scheme, everyone gets the same pension irrespective of health status.<br><br>(a) Would it be feasible in a CDC scheme to medically underwrite the pension in retirement?<br><br>(b) Would it be desirable to do this? | |
| | | |

| | | | |
|---|---|---|---|
| Q67 | | How should a CDC scheme best be organised: (a) on a company-wide basis, (b) an industry-wide basis, or (c) a nation-wide basis? | |
| | | | |
| Q68 | | What is the minimum number of members in a CDC scheme to make it viable? Explain this figure. | |
| | | | |
| Q69 | | Effective regulation, governance and quality standards will be crucial, given the absence of member property rights (which apply in standard DC schemes) and also the absence of a sponsoring employer that guarantees benefits (which applies in DB).<br><br>(a) What regulation is required to protect members' benefits?<br><br>(b) What governance mechanisms and quality standards are needed in CDC schemes, especially to ensure inter-generational equity? | |
| | | | |
| Q70 | | Could CDC schemes operate both on a trust basis and a contract basis? Explain. | |
| | | | |
| Q71 | | Could a 'for profit' organisation run a CDC scheme? Explain. | |
| | | | |

| | | |
|---|---|---|
| Q72 | What communication strategy would be appropriate for CDC schemes (a) in accumulation and (b) near retirement and (c) in decumulation? | |
| | | |
| Q73 | What measures should the government take to make CDC attractive to: (a) potential sponsors, and (b) potential members? | |
| | | |
| Q74 | How should transfer values be treated in CDC schemes, both in and out? | |
| | | |
| Q75 | Is it possible for a CDC scheme to work within a charge cap of 0.75%? | |
| | | |
| Q76 | With the remit in mind, please tell us if there is anything else you think we should be considering that is not covered in the sections and questions above. | |
| | | |