NAPF

Securing the future of pensions

# Pension Freedoms: Breaking the deadlock

## Understanding Retirement: Wave II Interim Report

An NAPF Research Programme

## About the Understanding Retirement series

Working lives are changing, retirement is changing, pensions are changing. In July 2014 the NAPF launched a major research series examining the nature of retirement, its impact on pension savers, pension schemes and other retirement savings as well as employers.

The purpose of the series is to inform both public policy and the design of private sector pension and retirement income products, as well as helping to shape the guidance and help that is needed as retirement approaches at the point of retirement and beyond.

Wave 2 of the research, commissioned in February 2015, with initial fieldwork in March / April 2015, is examining the experience and consumer journey of those aged 55-70 who are able to access the newly introduced pension freedoms.

- How do consumers view the new pension freedoms?
- How do savers plan to access their savings under the new pension freedoms?
- What is their experience of navigating the new pension freedoms?
- Are suitable retirement income solutions emerging and are savers finding their way to them, and if not, what are the barriers?
- What can be done to lower or eliminate the barriers to good retirement income outcomes.

This interim report presents interim findings from Wave 2 – with a full report to be published in November 2015.

**Acknowledgements**

The NAPF would particularly like to thank Steve Pick, James Hopkins and Nick Williams from Critical Research who undertook the quantitative research that fed into this report.

We would also like to thank all of our members and other participants who took part in this research. For further information about this report or the wider research programme, please contact Liz Spratt on 020 7601 1734 or by email *Elizabeth.Spratt@napf.co.uk*

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# Foreword

2015 has been a year of great change for the pensions industry. Following the Chancellor's shock announcement in the 2014 Budget, savers have, in theory at least, been granted the freedom to access their pension savings in a way that suits them. Fully flexible drawdown and taking cash lump sums are just two of the new options open to savers but there is still a long way to go before these changes live up to their early promise.

As our research reveals, consumer expectations in the lead up to the introduction of the reforms were high. Savers were enthused by the prospect of accessing their pension 'like a bank account' and the press was filled with proclamations of a new dawn for retirement saving. At the same time, pension providers were rushing to make the necessary changes in place in the face of very tight time constraints and without any clear idea of likely consumer demand.

Now, four months into the new flexibilities, the story appears on the surface at least to have been less 'freedom and choice' and more 'frustration and captivity', with media headlines suggesting that savers have struggled to access the freedoms promised. Our latest research suggests that large numbers of consumers remain unsure of their course of action or are waiting for the market to develop, while the risks and costs of putting fully designed retirement solutions in place without a clear view of consumer demand are just one of a host of factors preventing schemes and providers from creating new retirement income solutions. The market appears to have reached a deadlock.

We believe that understanding consumer demand and identifying the barriers facing schemes is the key to breaking the pension freedoms deadlock. Here, we build on the first wave of our *Understanding Retirement* research to explore how the first cohort of retirees under Freedom and Choice are experiencing these reforms. Drawing on insights from across the demographic spectrum, this research offers an early insight into the consumer journey under the new freedoms. Based on this evidence, the NAPF has formulated three key recommendations for government to break the stalemate and unleash the full potential of the new market:

- Monitor the market for barriers to innovation
- Develop and disseminate quality standards for in-retirement products
- Enable trustees and providers to signpost effectively

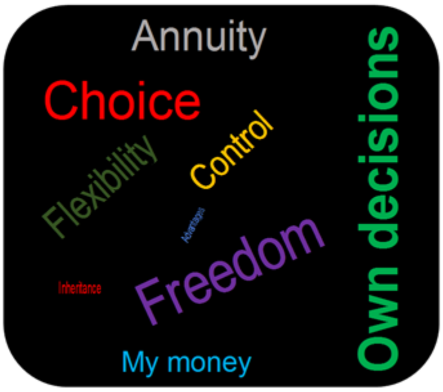
Only by tackling the barriers facing schemes and fully understanding consumer needs can we help pension savers get the most out of their retirement savings. The NAPF looks forward to working with government and the industry to achieve this.

***Joanne Segars***

# Executive Summary

The unparalleled extension of choice promised by the new pension flexibilities offers many opportunities for consumers and pension schemes. However, the NAPF's research reveals that uncertainty of demand, concerns around consumer protection and an unstable regulatory environment are preventing schemes and providers from bringing new solutions to their members. This is leaving some savers frustrated and others uncertain of how best to realise an income from their savings. Drawing on insights from across the demographic spectrum, our research offers an early insight into the consumer journey and the solutions being offered by schemes.

### *Pension savers expect a lot of pension freedoms*




Pension freedoms have been largely welcomed by savers. Of the consumers we surveyed, 81 per cent thought that the freedoms were a great or a good idea, with just 11 per cent considering them to be not such a good idea.

We estimate that there are 3.7 million individuals aged 55-70 in the UK with pensions not yet in payment, of which there are approximately 2.2 million with £175 billion in defined contribution (DC) pension savings[1]. The NAPF surveyed this cohort of Defined Benefit (DB) and DC pension savers, the first to have access to pension freedoms.

The survey revealed very little appetite for transfers from DB to DC with only 3 per cent of those with DB expressing a clear desire to move their savings; a view supported by our DB pension scheme members who believed that only a small proportion would choose to transfer (typically 2 per cent of active members and 8 per cent of deferred).

Most DC savers (56 per cent) aged 55-70 have yet to make a decision about how they would like to access their retirement savings or are waiting to see how the market develops. Only 17 per cent were planning to access their pension savings under the new freedoms in 2015.

Among this first cohort of DC pension savers to have access to pension freedoms, 70 per cent of those who expressed a preference wanted to leave all or some of their savings invested and draw a regular income from their investment (drawdown), with two-thirds expecting to access this through their existing provider or scheme. Just under half (48 per cent) wanted to take some or all of their savings as cash. There remains some appetite for annuities, with 24 per cent of respondents telling us that they would like to purchase one with all or some of their savings. Those looking to take their money in the short term were more attracted to the concept of cash than those further off retirement or taking their pensions.

[1] NAPF estimate based on ONS population statistics and ONS Wealth & Assets survey table 6.8

Of those looking to cash in their savings, the majority (63 per cent) wanted to save or invest it, and spend it gradually. A quarter (26 per cent) planned to spend in on a holiday, car or another one-off purchase, with just under a quarter keeping the money for their own future health or care needs.

The survey reveals some worrying misconceptions surrounding the new freedoms. Of the savers we surveyed who expressed an interest in drawdown, 53 per cent believed that this option would offer them a guaranteed income in retirement, with a quarter believing there were no risks involved. Although many of the cohort surveyed mentioned a financial adviser first and foremost when asked who they would seek advice from, previous NAPF research has shown that most savers are unwilling to pay for advice: in our work place pension survey 57 per cent of the savers surveyed were not willing to pay anything at all for advice, with only 3 per cent willing to pay over £200[2].

### *Schemes face considerable challenges in meeting member expectations*

Schemes are acutely aware that their members need support; nearly all funds (96 per cent) with DC schemes thought that their members would need either a lot or a moderate amount of support to navigate the new pension freedoms. Most schemes or employers provide some support to members at retirement, help that is now reinforced by Pension Wise.

However, the vast majority of schemes are not able to offer the full range of freedoms. While 51 per cent will offer access to some form of encashment in 2015, far fewer have the resources, or indeed the profile of members, necessary to offer fully flexible drawdown.

### *The pension freedom deadlock*

While bringing many benefits, pension freedoms have also created a very real tension between allowing members to do what they want with their retirement savings, including making mistakes, and protecting savers from everything from outright scams to poorly informed decisions. This has put trustees and providers in an invidious position, exacerbated by a lack of clear signals from the consumer market and a constantly shifting regulatory environment.

**Consumer demand is uncertain.** The majority of consumers have yet to decide how to convert their pension pot into a retirement income or are waiting to see how the market develops. Schemes and providers remain unsure of the shape of long-term demand in the market, with difficult choices to make around what products should be developed.

The extension of trustees' fiduciary responsibilities into retirement presents significant risks. **Trustees and providers are concerned about consumer protection and future liability.** Members face detriment on a number of different fronts, with access to the new flexible options potentially impacting upon their entitlement to means-tested benefits and on any dependents they may be

[2] The NAPF's *Workplace Pensions Survey May 2014* can be accessed at: http://tinyurl.com/WPSsept14

responsible for. The appropriate balance between full freedom on the one hand, and member protection on the other, needs to be more clearly elucidated by policymakers.

Finally, **the regulatory landscape remains uncertain**. A number of reviews are currently taking place in tandem across the FCA, TPR and HM Treasury. Developing new products in this environment is challenging, with pension providers naturally exercising caution about committing resource when the terms of operation might be subject to change.

The market has reached a stalemate. Urgent action needs to be taken by the Government to break the deadlock and ensure that savers are able to take advantage of the full freedom and choice promised to them.

### *Solutions and Recommendations*

The NAPF is recommending three steps to break this stalemate. In order to stimulate supply in the market, the Government needs urgently to **review and seek ways to remove the barriers to innovation**. This would help to smooth the route to market for new products and solutions, allowing a greater range of accredited products and increasing consumer choice.

We need **clear, recognisable quality standards for retirement income solutions that consumers can trust.** This will allow savers to better navigate the new choices, while schemes and providers would be able to demonstrate quality.

Once these products have entered the marketplace consumers need to be able to compare and contrast to select an option that best suits their needs. **Pension providers and trustees must be able to signpost their members to good quality solutions with confidence.** The ability to signpost to good quality products will enable employers and pension scheme providers to support savers effectively through the tricky process of selecting a retirement income solution.

Taken together, these steps will help to realign the interests of pension providers and savers and fulfil the full promise of Freedom and Choice.

# Pension freedoms : consumer choices

Wave 1 of NAPF's *Understanding Retirement* research revealed that nearly three quarters of savers aged 50-70, who were not retired and had a good DC pension, wanted to have a secure income in their retirement; a smaller proportion (two-fifths) wanted a pot of money that they could dip into when they needed it[3].

Despite the media frenzy around pension freedoms, this critical finding suggests that those saving for retirement are still concerned about financial security first and foremost. Although freedoms were introduced to provide savers with greater flexibility around their retirement product choices, this has also resulted in more complex choices for those with DC pensions.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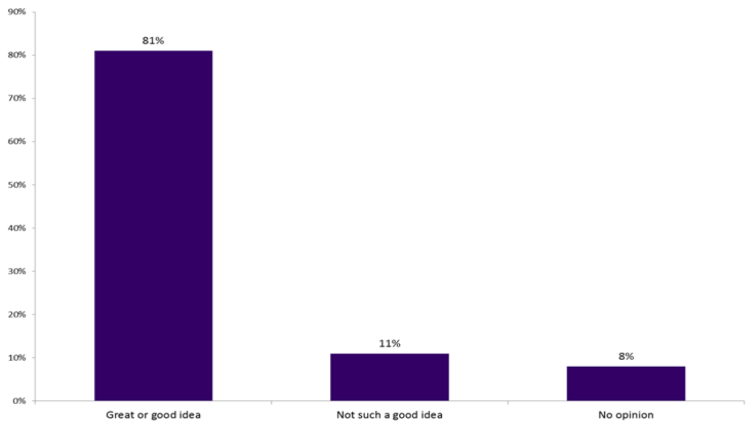
**Source:** Daily Mail, Tuesday 14th October 2014

With the NAPF estimating that there are 2.2 million individuals aged 55-70 with approximately £175 billion in DC pots which are not yet in payment in the UK – a large potential market for the new freedoms - what do savers really think of the new freedoms and how would they like to use these flexibilities[4]?

### *Attitudes to pension freedoms largely positive*

Pension freedoms have been received positively by those aged 55-70 years and eligible to access their savings under the freedoms – with 81 per cent thinking that freedoms were a great or a good idea, and just 11 per cent considering them to be not such a good or bad idea.

**Figure 1: What are your thoughts on pension freedoms?**




**Base:** All consumers aged 55-70 with a pension yet in payment (1,042)

[3] The full report from Wave 1 of the Understanding Retirement programme, *The unpredictability of retirement* is available to download at: http://tinyurl.com/Wave1UR
[4] Findings taken from quantitative fieldwork among 1042 pension savers aged 55-70 with at least one DB or DC pension not yet in payment

> ***Consumer view on pension freedoms:***
>
> *"I think it is a great idea. People with small pensions are now able to take the money they have saved out and use it however they want to. Individuals who have saved up all their life are more likely to make sensible decisions and spend their pensions wisely. Furthermore, due to individuals having the freedom, individuals are not being put into a position where they are having to take an annuity. By taking an annuity people are being forced to give money to insurance companies."*
>
> *With a SIPP, Female, 65,*

Savers surveyed had high expectations about the opportunities that pension freedoms would bring for them. As well as just over half of savers believing that all providers must offer the freedoms and a third believing that their pension would work like a bank account, it was generally thought that freedoms were introduced to provide a greater variety of retirement products to choose from, and to prevent people from having to buy an annuity (86 per cent and 81 per cent respectively).

When mentioning pension freedoms, savers most often reflected that having control and choice over how to spend or invest their savings was incredibly positive. It also prevented savers being forced to take an annuity, which they perceived as providing low returns.

Others saw benefits around inheritance; if they took the money in cash they would be able to pass it onto their families' tax free. Equally some considered that those in poor health may not get the best value out of an annuity, so having the ability to access their savings as cash was of huge benefit, rather than "losing their money to an insurance company".

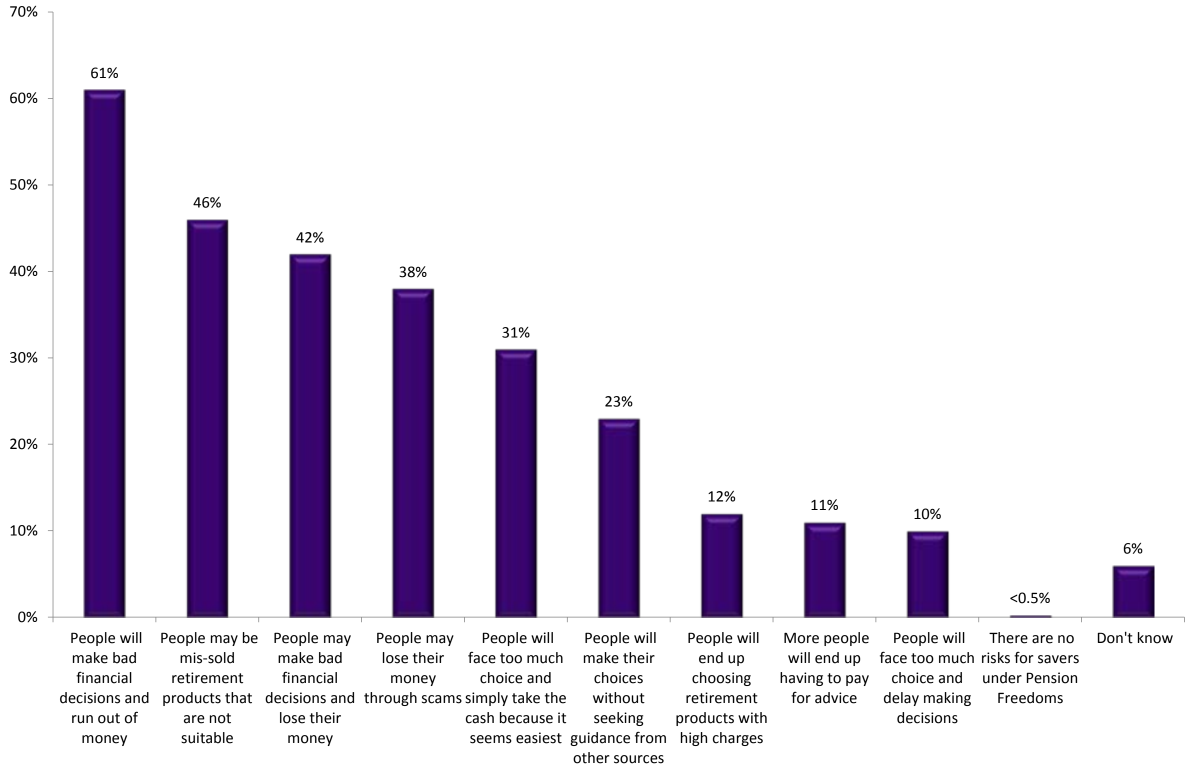
### *No such thing as a bad decision?*

This is not to say that savers were not aware of the potential risks that they could face through accessing their savings through the new flexibilities; 74 per cent of those with access to freedoms believed that there would be at least some drawbacks to accessing their savings under the freedoms.

> *"Many people are not financially literate enough to be able to make an informed and sensible decision, so it's likely that there will be a small number of people who run out of money during their retirement. Additionally, there will doubtless be some unscrupulous advisors who will provide poor advice or use the rule change to their advantage and to the detriment of the person retiring. Could this be the makings of the next financial scandal?"*
>
> *DC saver, Male, 58,*

When asked what risks people would face, the greatest proportion (61 per cent) thought that people may make bad financial decisions and run out of money before their retirement ended, with nearly half believing that people may be mis-sold retirement products that would not be suitable for their situation and just over two-fifths concerned that people may make bad financial decisions and lose their money.

### Figure 2: What are the biggest risks for savers under pension freedoms?




**Base:** All consumers aged 55-70 with a pension yet in payment (1,042)

In addition to the risks that savers were asked about directly, savers cited a number of additional drawbacks to the freedoms - although they generally expected that these risks were for other people, rather than themselves:

- the additional burden that would be placed on state benefits if people ran out of money – with emotive language used around the importance of responsibility.
- mistrust in the financial industry and the Government's motives for introducing the freedoms.
- concerns about the tax ramifications of accessing money under the freedoms.
- the challenge of managing money 'responsibly', financial capability and the ability to plan effectively for the long term.
- the importance of being able to access the right advice, and have enough information to make the right decision about getting the best out of savings.
- The unpredictability of the future – especially longevity and health care needs.

*"I think it is inevitable that many foolish people will spend, spend, spend and go bust leaving themselves dependent on the state. Why offer kids the cookie jar when you know they WILL dip into the forbidden contents?"*

*DC saver, Male, 64*

- the potential for pension firms to charge high fees for accessing money under freedoms.
- the risk of taking too little, and living out your retirement with a lower standard of living due to the fear of overspending.

*"The information being provided can be confusing and misleading, e.g. while you can take a tax-free lump sum this money is viewed as income in that year so will actually be taxed through your regular income tax…"*

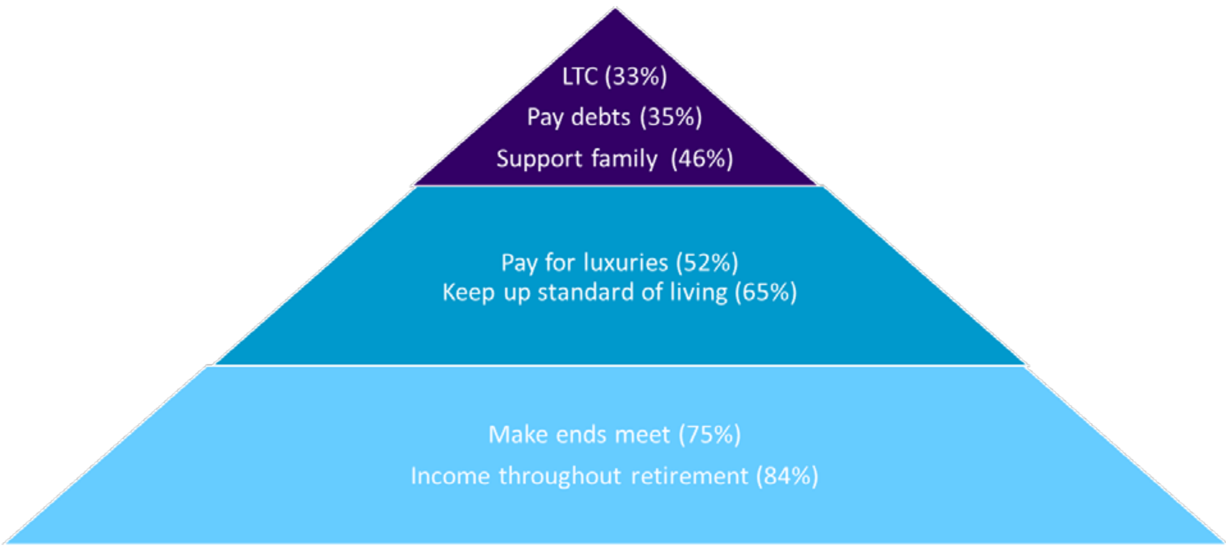
*DC saver, Male, 56*

It is worth noting that despite the concerns about tax and some lingering misconceptions, the majority of savers (81 per cent) *were aware* that they could not take all of their money out of their pension savings cash free, with 83 per cent aware though that they could take out 25 per cent of their savings tax free.

### *Hierarchy of pension needs*

Savers' expectation of what their pension should provide, demonstrates that a key consideration is ensuring that they have money to live off of throughout their retirement. 84 per cent of savers wanted to ensure they had an income throughout retirement, followed by three quarters ensuring that they could make ends meet. Only a third thought their pension should pay for long term health needs, with 35 per cent believing a pension should be used to pay off debts.

**Figure 3: Hierarchy of pension needs**




**Base:** All consumers aged 55-70 with a pension yet in payment (1,042)

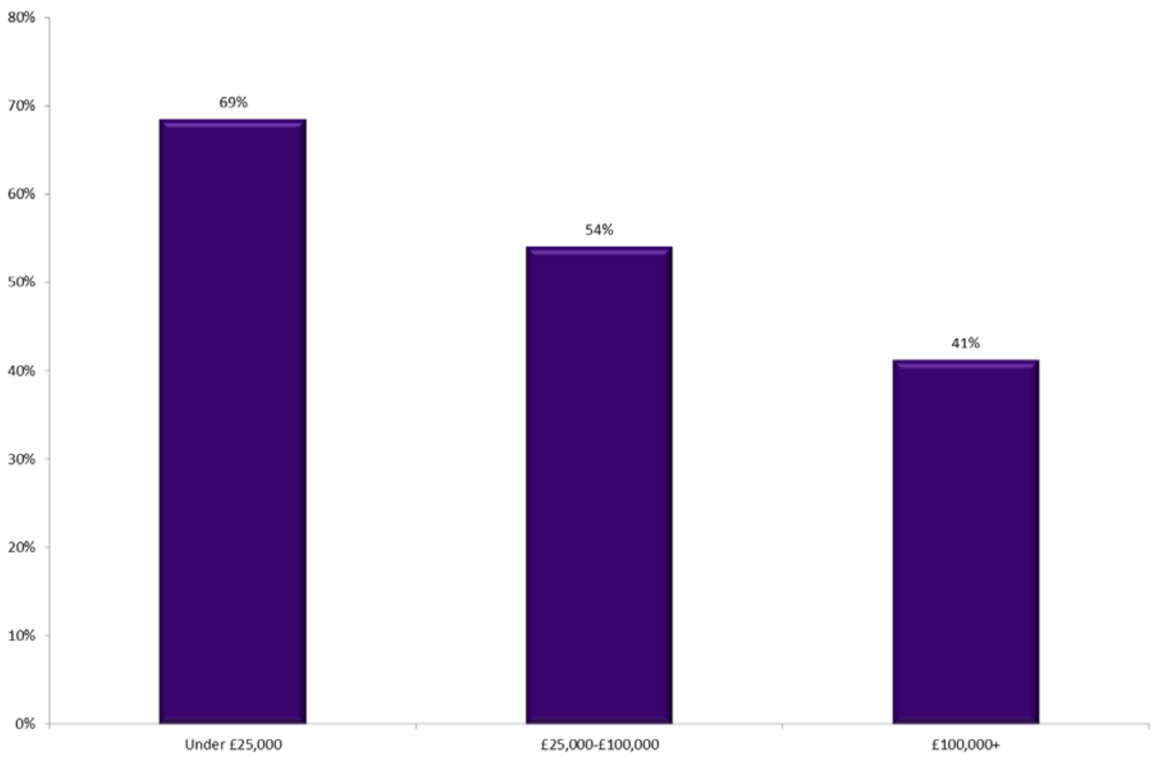
## *Are DC savers clear on what they will do?*

Although savers are positive about the introduction of pension freedoms, for the majority there is still a large degree of uncertainty about how they will access their savings. 56 per cent of savers surveyed still were undecided about the route they would take – this is an estimated 1.2 million who are yet to make up their mind. Typically those with smaller pots and those more than five years away from retiring were less certain about how they would access their money. However, uncertainty about where to go for good quality guidance on choices makes the decision making process even tougher.

*"I am not sure how we will decide what to do if we take all the money as cash. How much advice will there be so that we don't fritter the pot away?"*

*DC saver, Female, 60*

**Figure 4: Percentage of respondents' undecided about how they plan to access their pension pot, by pension pot size**

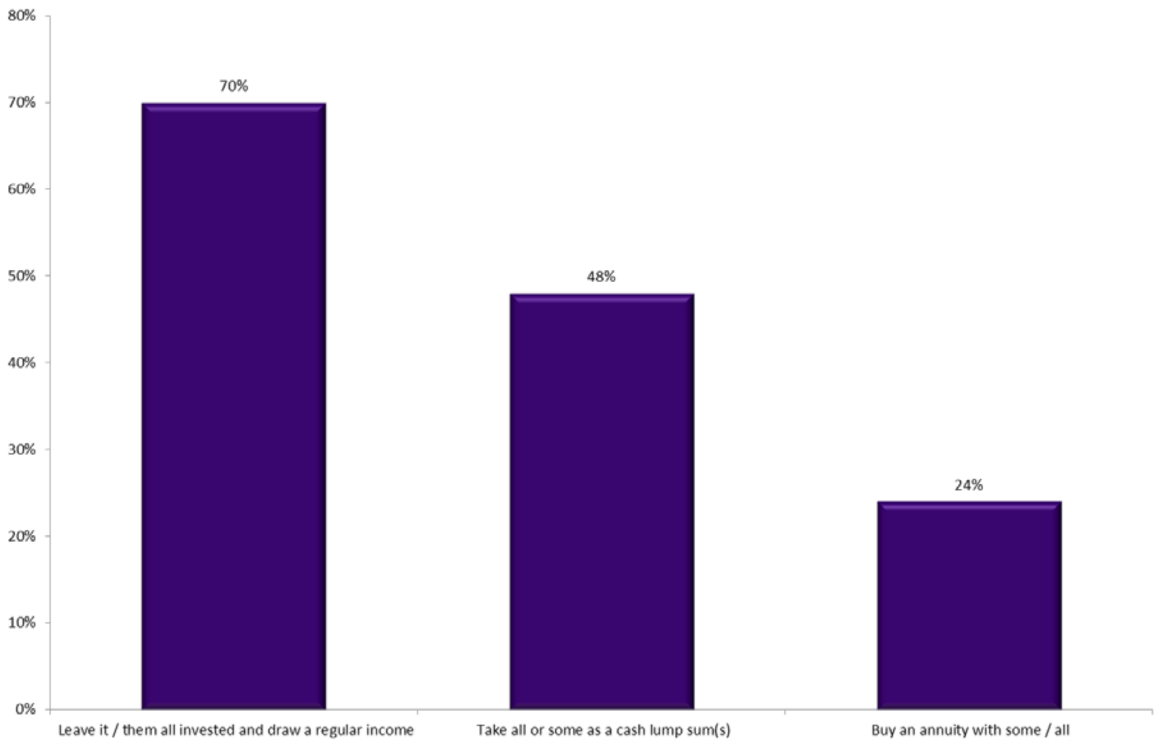



**Base:** All DC savers who knew the size of their pension pot (584)

## *Crystal clear decisions?*

There were an estimated one million savers with DC pension pots who had a clearer idea about how they would access their pensions pot – and although drawdown was clearly a popular concept (with 70 per cent considering leaving their money invested and drawing a regular income), just under a quarter were still looking to purchase an annuity. Nearly half wanted to take some or all of their savings as cash. Notably nearly 40 per cent of our DC savers who had a preferred way of taking the cash wanted to opt for a combination of these three options.

**Figure 5: How would you like to access your pension savings?**




**Base:** with DC pensions not yet in payment, with a preferred option about how they planned to access their pension pot (335)

Even with so many savers keen to explore the new options available to them, it is important to note that only 17 per cent, or an estimated 300,000, were planning to access their pension savings under the new freedoms in 2015. Although there is interest in exercising rights under the freedoms, retirement timelines means savings appear unlikely to be drawn in a frenzy of activity in 2015.

## *What about those with DB?*

*Understanding Retirement* Wave 1, also introduced us to 'Satisfied Sarah's', those savers with good DB benefits – who had slightly less complex decisions to make than those with DC pensions. Those with DB pensions can still opt to transfer their benefits to a DC under pension freedoms. However, our research has revealed that most savers with DB benefits are not looking to transfer - with only 3 per cent planning to take this option; although a further 21 per cent of those with DB (aged 55-70) are yet to decide whether to stick with a DB pension or move their funds. Those within one year of retirement were twice as likely to say that they would switch to DC (6 per cent) whereas those who have accrued more than 20 years of DB benefits were much less likely to say that they would switch (1 per cent) and much less uncertain (only 15 per cent say that they have yet to decide).

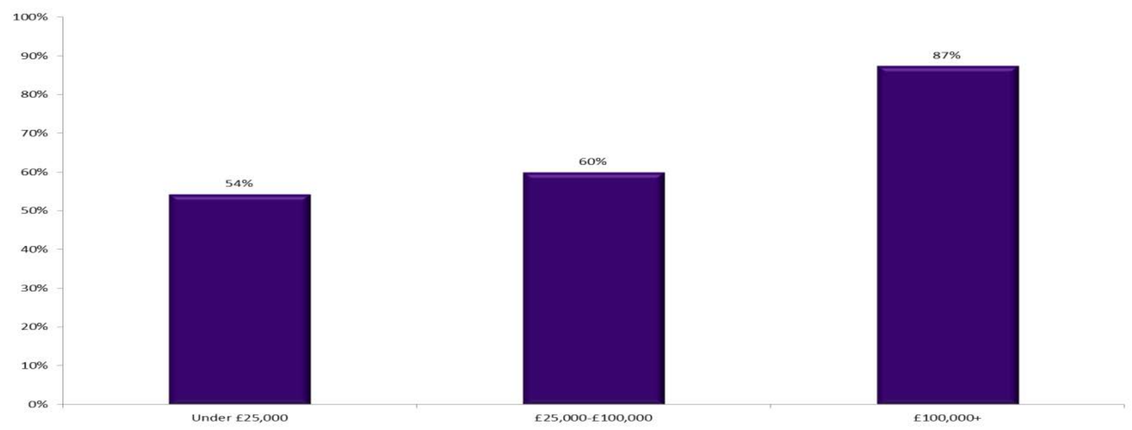
# Profiling and sizing the pension freedoms market

Using data from our survey, we have estimated the potential size of the market for the three main ways of taking retirement income, both in terms of the population[5] and the potential value of the market[6]. These estimates have been applied only to the estimated 2.2 million individuals currently aged 55-70 with £175bn in DC pension not yet in payment. Approximately 12 per cent of these (or just below 300,000) consider themselves to be within one year of retirement or taking their pension, whereas over a million do not expect to retire for 5 years or more. On average, somewhere between 200,000 and 300,000 of these savers will be making decisions on how to access around £20bn in funds (in today's value) each year for the next ten years or so.

### *Drawdown*

70 per cent of 55-70 year old DC savers who express a preference are attracted to the idea of drawdown. It is important to note that savers do not use the expression drawdown and the option presented to them was 'leaving their money invested and taking an income'. Extrapolating to the entire population of DC savers in that age group implies an estimated 1.5 million savers with an estimated £50bn-£100bn (in today's value) to be invested (after they have taken their tax free cash). Uncertainty about how much they will put into drawdown causes us to be cautious about the range available. There also remains uncertainty about precisely when this money could flow into the market.

**Figure 6: Those with a preference for drawdown by estimated DC pension pot size**




**Base:** savers with DC pensions not yet in payment, with a preferred option for accessing their pension (283)

[5] Grossed up population estimates were calculated by estimating the proportion of those aged 55-70 with a pension not yet in payment using the ONS' *Wealth and Assets Survey* and ONS population estimates for this age band. Population estimates for each type of retirement product are based on the assumption that those surveyed who did not have a plan for how to take their retirement income would take their income in the same proportions as those with a plan.

[6] The value of the market was calculated by taking estimated population accessing their retirement income via each method, and grossing up using the average value of DC pensions for those choosing that option.

Although the concept of drawdown has widespread appeal among savers – its popularity was more pronounced among those with larger savings in their DC fund.

So what is the appeal of drawdown? The most frequently stated reason for selecting drawdown (by nearly three quarters of savers) was that it provides greater flexibility than other retirement products, whilst three fifths see an opportunity to ensure their investments continue to grow.

*"I can draw down as and when I want, invest it as I want and balance tax with the need to boost income. I am very careful with my money and so feel confident I can manage the funds available.*

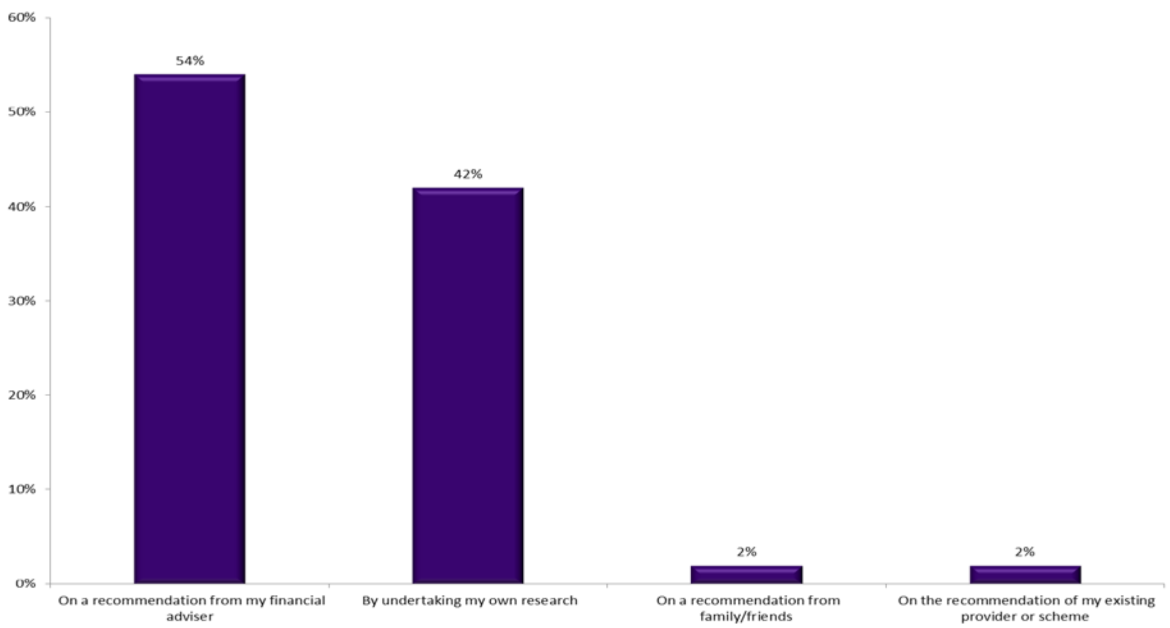
*DC and DB saver, Male, 57*

However there were several misconceptions about drawdown with the majority (53 per cent) of those who opt for drawdown agreeing that it would provide a guaranteed income in retirement and a quarter believing there were no risks to leaving their money invested and drawing an income.

There were also high expectations of schemes and providers - two-thirds of savers considering drawdown were looking to access this with their current scheme provider; if they could not access drawdown with their current provider, 69 per cent would then look to find a new provider offering drawdown (instead of considering other options).

Savers were asked how they would find their new provider – with the majority (52 per cent) stating this would be on a recommendation from a financial adviser, whilst just over 40 per cent would undertake their own research to select a new provider. The remainder would either depend on advice from family and friends or a recommendation from their current provider (2 per cent for both respectively).

**Figure 7: And how are you most likely to decide on your new provider or scheme?**




**Base:** savers with DC pensions not yet in payment, who plan to take drawdown with their current provider (85)

## *Take the cash!*

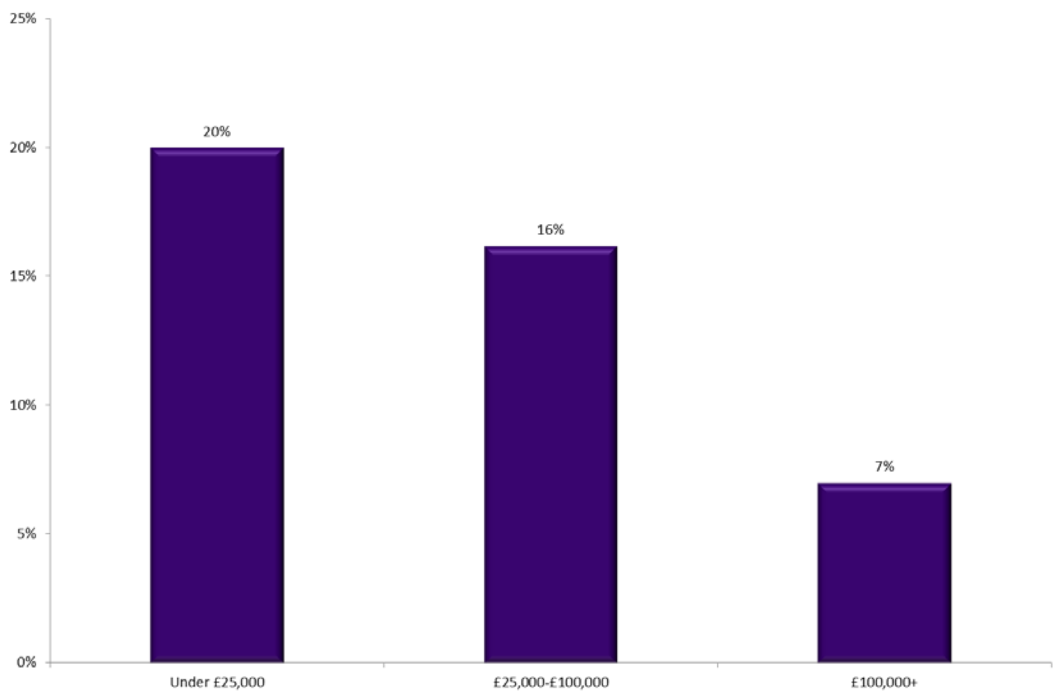
Taking cash was the second most attractive option under pension freedoms, with just under half (48 per cent) of those who stated a preference choosing this. 13 per cent of those who expressed a preference for taking all of their money as cash and a further third wanting to take some as cash (some of these might turn out to be satisfied by the tax free cash). Those who expected to take action in 2015 were considerably more likely to choose cash than others.

We estimate that approximately 100,000 55-70 year old DC savers will take all of their funds as cash with a further 360,000 taking some in cash. If these plans are realised for all 55-70 year old DC savers then approximately £20bn - £30bn (in today's value) could be withdrawn in this way.

Taking cash was particularly likely where savers had small pots (the opposite to drawdown), but also higher among:

- high income households;
- those whose partner's pension was the main source of income in retirement;
- women;
- those who also had good DB benefits;
- those with no other savings or investments;
- those with lower levels of financial confidence.

**Figure 8: Those with a preference for taking as cash by estimated DC pension pot size**




**Base:** savers with DC pensions not yet in payment, with a preferred option for accessing their pension (283)

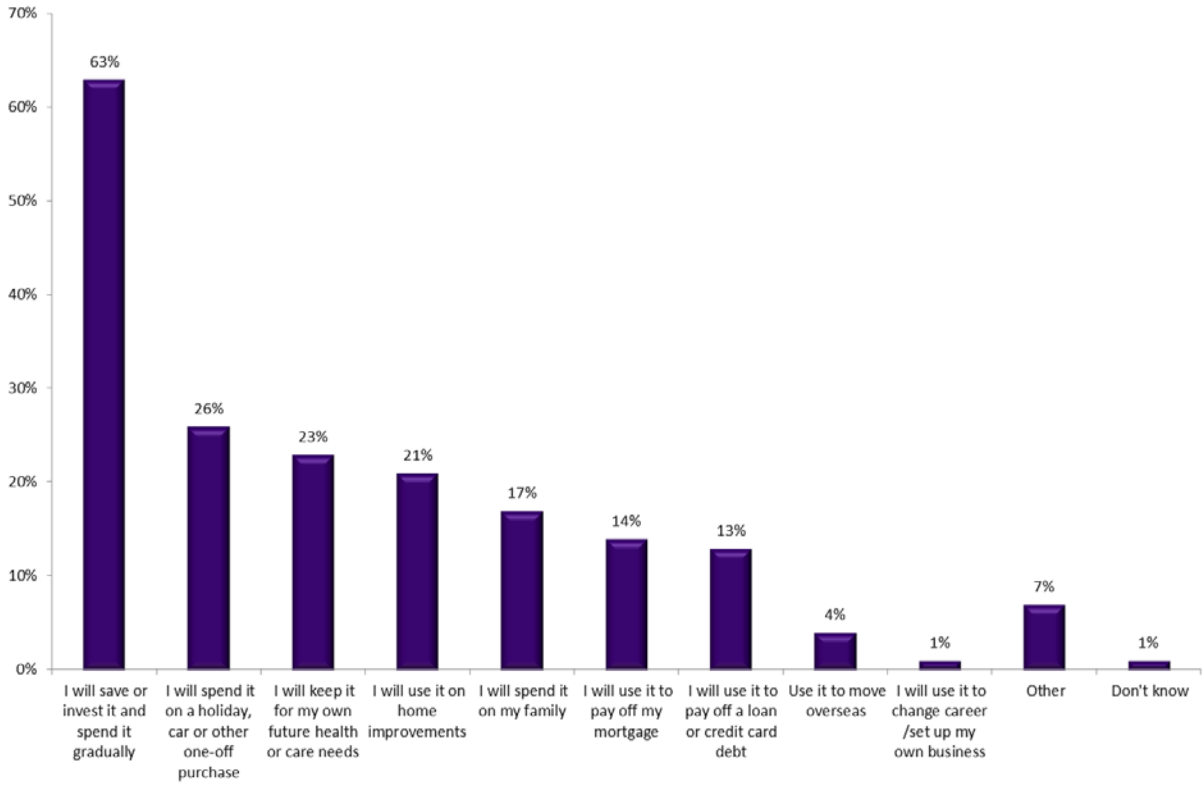
*"I need the cash now to pay off debts, much more useful than the dwindling value that seems to be in my pension".*

*DC saver, Female, 58*

Taking the cash is popular for similar reasons to drawdown, the most common reason (for 50 per cent of savers) being that savers wanted to have control over their finances.

But what were savers planning to do with their cash? The majority (63 per cent) wanted to save or invest it, and spend it gradually. A quarter (26 per cent) planned to spend in on a holiday, car or another one-off purchase, with just under a quarter keeping the money for their own future health or care needs.

**Figure 9: In which of the following ways do you think you will use your pension cash?**




**Base:** savers with DC pensions not yet in payment, taking some or all of their pension as cash (176)

Of those who planned to take their cash and invest it elsewhere (63 per cent of DC savers), over half planned to put some of their money in a cash ISA, and just under half planning to put some money in a savings account.

Although savers seemed aware of many of the potential pitfalls of taking all their money as cash (for example 54 per cent were aware they may be offered fraudulent products), a quarter were still not aware that they had to pay tax if they withdrew more than 25 per cent of their money, and nearly a quarter saw no risks associated with cashing in their pension at all.

## *Annuities*

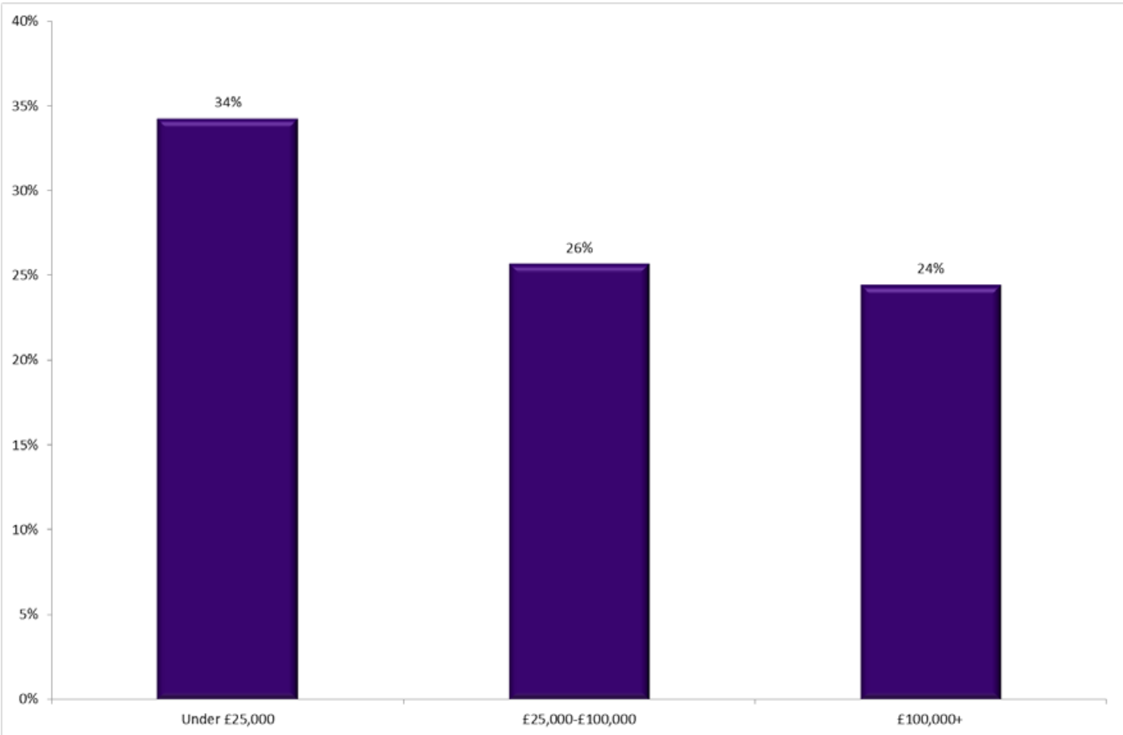
Despite the introduction of pension freedoms, nearly a quarter of savers would still like to have the security of having an annuity. More importantly half of savers interested in annuities would like all their DC savings to be put towards an annuity.

If all 55-70 year old DC savers behaved in this way would imply sales in the next few years of around 500,000 annuities worth around £30billion in today's money.

*"I'm buying an annuity... [pension freedoms are] great for personal choice but [there] will always conditions".*

*DC saver, Male, 58*

**Figure 10: Those with a preference for taking an annuity by estimated DC pension pot size**




**Base:** savers with DC pensions not yet in payment, with a preferred option for accessing their pension (283)

The appeal of annuities is still very much in the security that they provide – overwhelmingly savers thought annuities would provide them with long term security, with over three quarters considering purchasing an annuity stating this to be their main reason.

The most likely method for purchasing an annuity was through a financial adviser that they already had a relationship with (for a third) and for a fifth of those looking to buy an annuity by shopping around on the internet.

# What are schemes offering?

Savers are broadly in two categories – those uncertain and needing guidance and support, and those that have a clearer idea about which option to take. This section examines what schemes are currently able to offer to support their members.

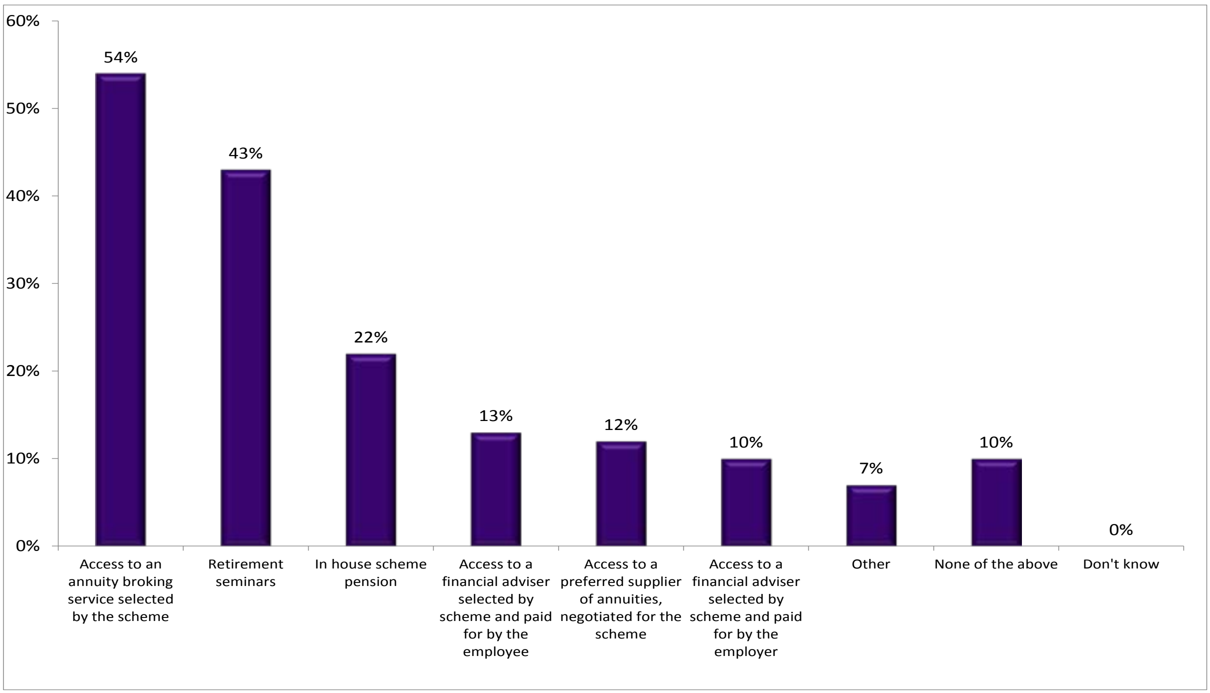
> *"There is a danger of people not necessarily taking the right advice and making the right choices for them so they are worse off in the long run. Mis-selling is a major risk for all members in particular DB members. There is a lack of readiness in the market in the short term so there may not be good enough products readily available to get the best out of their money".*
>
> *Fund member, with DB and DC schemes*

### *Support for members*

Pension schemes were acutely aware that there were members who would need support; nearly all funds (96 per cent) with DC schemes thought that there members would either need a lot or a moderate amount of support to navigate pension freedoms. Schemes offered a variety of different types of support to their members, although these had not significantly changed since before the introduction of pension freedoms.

Just over half are still providing access to an annuity broking service and just over two fifths providing retirement seminars.

**Figure 11: What support do schemes offer?**



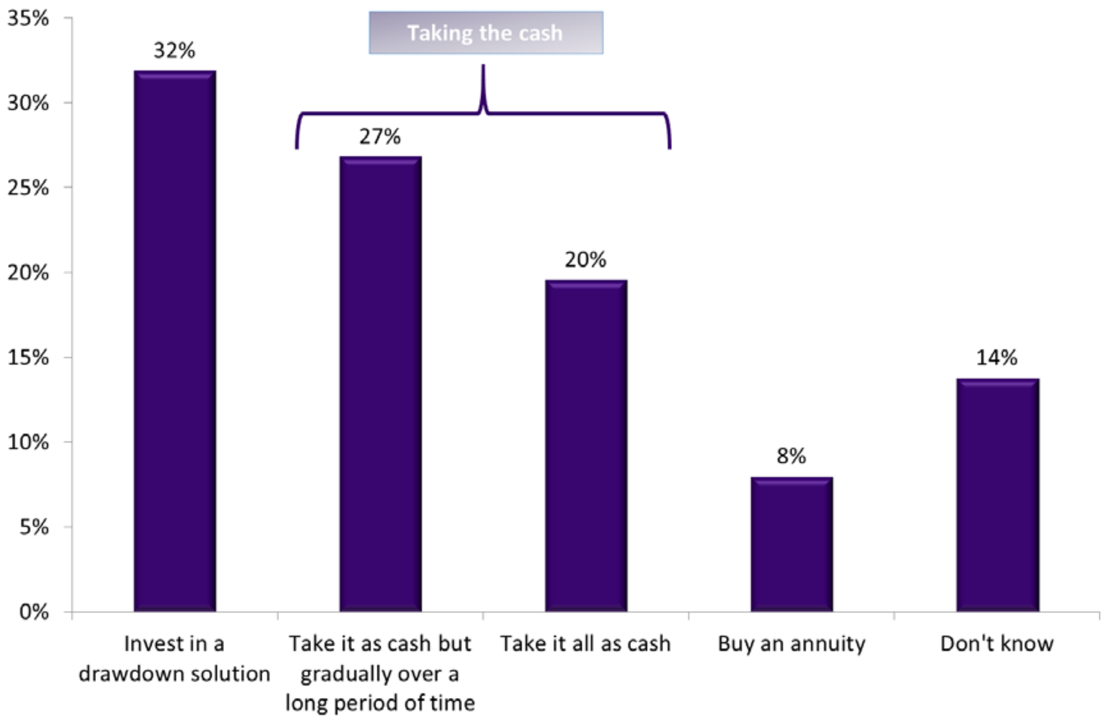

**Base:** all DC schemes (138)

## *Products for consumers*

Schemes are typically not expecting that most eligible members will seek to access their pension pots under pension freedoms this year.

NAPF fund members with DC schemes were asked what actions they thought the majority of their scheme members were likely to take. Nearly a third of schemes thought the most popular option would be to invest in a drawdown solution; however in total nearly half (47 per cent) thought that members would take their pension as cash – although marginally more thought that this would be gradually over a long period of time, rather than to take it all in one go.

**Figure 12: What do schemes think members will do?**




**Base:** 138 DC schemes

Although schemes have some knowledge of the possible demand among their members, based on their own intelligence, the speed at which the changes have been brought about means that pension funds have been playing catch up to ensure they are able to offer their members the range of products that they have anticipated. Schemes have faced a lack of information on the detail around new legislation and regulation. They are still trying to assess what their members may choose to do, and communicate to the members the complexity of these changes.

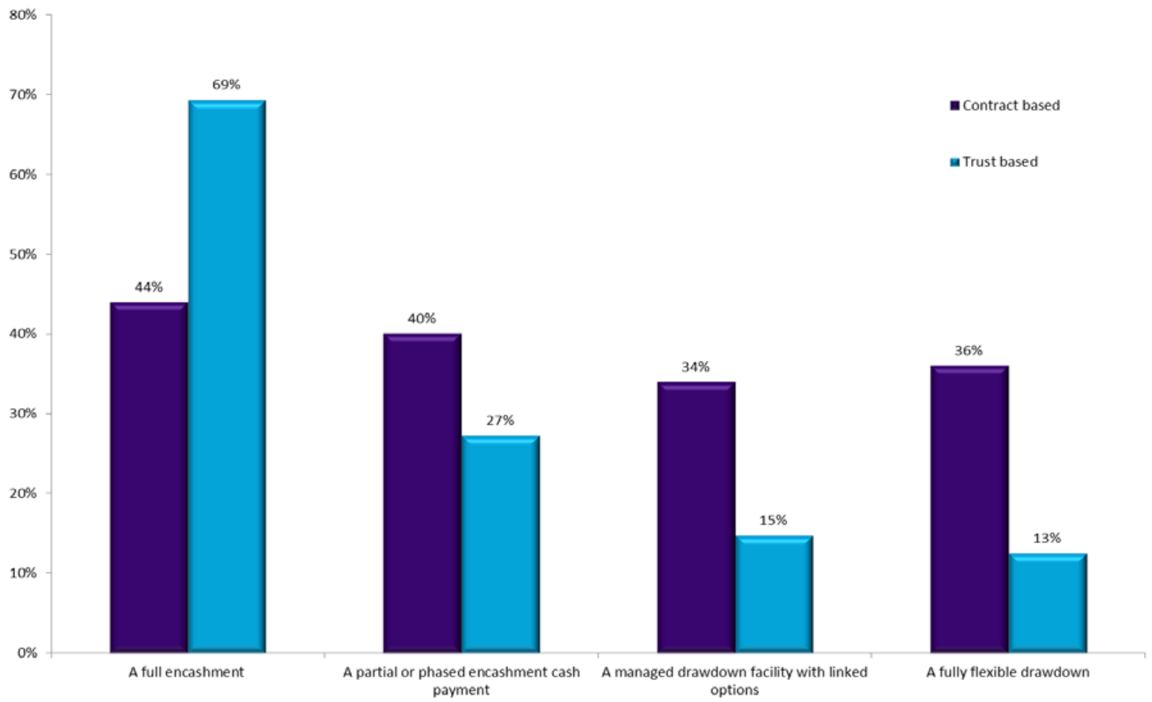
*"…The shortness with which this legislation has come through and the lack of guidance until the last minute…has been a big challenge. It is a matter of re-sourcing and understanding the impact for both members, the trustee and the company. A change in the investment strategy is now needed for the DC scheme to cater for the flexibilities".*

*Fund member, with DB and DC schemes*

Equally they have been trying to ensure that their schemes are fit for purpose – indeed two thirds had reviewed their default fund on approach to retirement to ensure that it is suitable for the new pension freedoms. Many have moved away from lifestyling, introduced new options to their default fund and changed investment strategies to ensure the most appropriate options are available for their members.

51 per cent of DC schemes expected to be able to offer access to some form of encashment in 2015 compared to around 15 per cent of schemes who will be offering draw down (either partial or full drawdown) in 2015. However, this second statistic should be treated with some caution since the majority of these will not be offering this within their scheme but via a product offered by provider of their bundled services. Verbatim evidence from schemes suggests that many are either waiting to develop products to be sure of demand, or to see what products may be developed by administrators, platforms and insurers.

**Figure 13: What will schemes offer in 2015?**




**Base:** DC schemes trust based (88) SC schemes contract based (50)

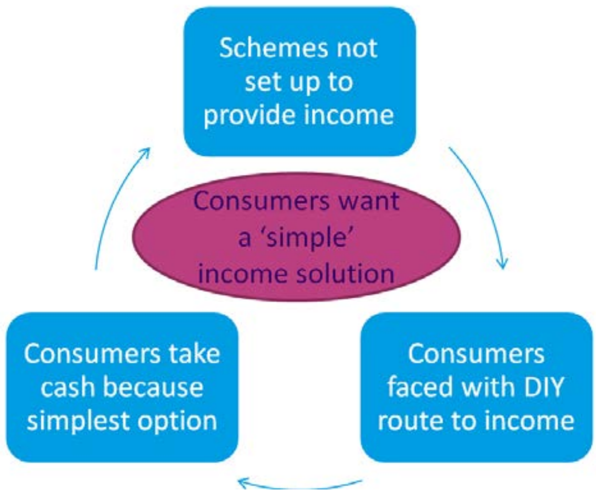
With schemes challenged by the speed that pension freedoms have been introduced and uncertain of market demand from consumers, and savers looking to have access to a suite of pension freedoms - and variable understanding of the outcomes, there is a deadlock that needs to be broken.

# Breaking the deadlock

Under the new flexibilities, pension savers have more responsibility for their retirement decisions than ever before. In the face of such extensive choice, large numbers of consumers remain unsure of their course of action or are waiting to see how the market develops. Meanwhile, the cost of putting fully designed retirement solutions in place without a clear view of consumer demand is preventing schemes from creating new products. The market has reached a deadlock. Urgent action needs to be taken by the Government to break the deadlock and ensure that savers are able to take advantage of the full freedom and choice promised to them.

While bringing many benefits, pension freedoms have also created a very real tension between allowing members to do what they want with their retirement savings, including making mistakes, and protecting savers from everything from outright scams to poorly informed decisions. This has put trustees and providers in an invidious position, exacerbated by the lack of clear signals from the consumer side of the market.

**Figure 14: The current market**




As our research has revealed, the majority of consumers (56 per cent) have yet to decide how to convert their pension pot into a retirement income or are waiting to see how the market develops. While it is clear that consumers desire a 'simple' retirement income solution that is tailored to their circumstances, this lack of clarity poses a fundamental problem for pension schemes and providers.

**Consumer demand remains uncertain.** Despite media speculation in the run up to the reforms that a mass of savers would use the new freedoms to cash in some or all of their savings, these fears have proven unfounded. However, there is some evidence that those who have taken early decisions have chosen to take the cash. Schemes and providers remain unsure of the shape of long-term demand in the market, with difficult choices to make around what products should be developed.

Several barriers remain for schemes to develop solutions or signpost their members to good products. Few schemes are designed to facilitate drawdown and trustees, schemes and their administrators face very considerable costs if seeking to build drawdown within schemes. Alongside this, the sector lacks people with experience of drawdown who can develop the solutions To justify investment in drawdown or other solutions, those funding the developments have to be confident that their investment will be returned. Against this backdrop, many schemes remain hesitant to bring new products to market.

**Concerns surrounding the future liability of schemes** also play a role**.** The extension of trustees' fiduciary responsibilities into retirement presents significant risks and many schemes remain concerned about being seen to stray into the territory of offering advice. Members face detriment on a number of different fronts, with access to the new flexible options potentially impacting upon their entitlement to means-tested benefits and on any dependents they may be responsible for. The appropriate balance between full freedom on the one hand, and member protection on the other, needs to be more clearly elucidated by policymakers.

*"Members now have the option to take transfer values and park them somewhere where they can take advantage of the new options, we have to tell them about transfer options but we run the risk of liability if their choice is not right".*

*Fund member, with DB and DC schemes*

Finally, **the regulatory landscape remains uncertain**. A number of reviews are currently taking place in tandem across the Financial Conduct Authority (FCA), The Pensions Regulator (TPR) and HM Treasury and the regulators continue to review their rules and codes to ensure that they reflect the new freedoms. Developing new products in this environment is challenging, with employers, schemes and pension providers naturally exercising caution about committing resource when the terms of operation might be subject to change.

As this evidence demonstrates, there is a fundamental misalignment between the incentives for schemes and savers. This threatens to lock both parties into an unsustainable deadlock which may end in poor outcomes for savers. In the light of this deadlock, the fear is that savers will naturally default (more by accident than design) to taking the easiest route to accessing their funds. For many this might mean taking the cash.

***Ending the stalemate***

In order to break the deadlock between consumers and schemes, a market needs to emerge which can provide the 'simple' income solutions that savers need and want. The NAPF believes that this will be best served by the development of a small number of large schemes and providers offering high quality accredited products that will be easy for savers to choose and access, that advisers and guidance services will be able to signpost and trustees and

***On what the government should do in relation to pension freedoms:***

*"They need to give the industry time for [pension freedoms] to embed…we need to make sure safeguards are in place".*

*Fund member, with DB and DC schemes*

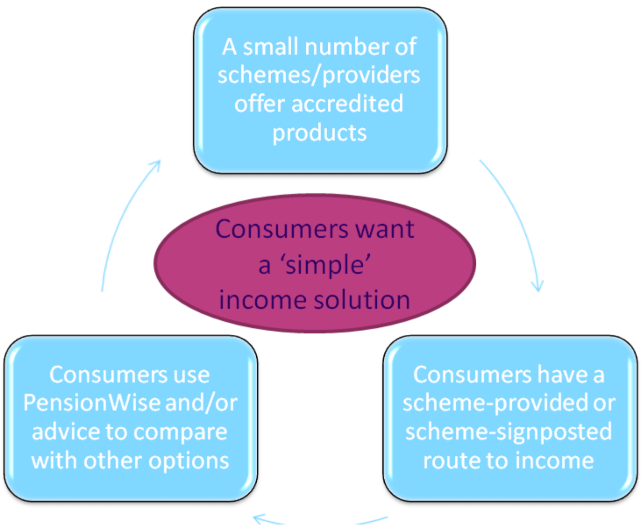
others are given safe harbour to allow them to signpost to savers without fear of being considered to be giving advice.

The NAPF is recommending three steps to break this stalemate. In order to stimulate supply in the market, the Government needs urgently to work with industry to **reflect on the barriers to delivering innovative and appropriate retirement income solutions and facilitate innovation**. By this we do not mean another major review; in fact the opposite. This would help to smooth the route to market for new products and solutions, allowing a greater range of accredited products and increasing consumer choice.

*"We have an issue in that we are not going to offer drawdown in our scheme so when we tell people about drawdown we have to tell them to transfer out but cannot guide them in the right direction. There doesn't seem to be a lot of products available."*

*Fund member, with DB and DC schemes*

**Figure 15: Realignment of the market**




Once these products have entered the marketplace **consumers need to be able to compare and contrast the different options** available to select a product that best suits their needs. Alongside this, **pension providers and trustees need to be able to signpost their members to good quality solutions with confidence.** The ability to signpost to good quality products will enable employers and pension scheme providers to support savers effectively through the tricky process of selecting a retirement income solution.

A key aspect of this will be the creation of **clear, recognisable quality standards that consumers can trust.** Our research has shown that 85 per cent of consumers surveyed thought it was important for a good retirement product to be independently accredited by a third party. The creation of the Pensions Quality Mark (PQM) by the NAPF in 2009 illustrates the benefits of this approach. PQM cuts through the complexities of the pensions landscape and gives a clear message that a pension scheme has been independently assessed and is good quality. By replicating this structure for decumulation products, savers would be able to better navigate the new choices, while schemes and providers would be able to demonstrate quality.

Taken together, these steps will help to realign the interests of pension providers and savers and fulfil the full promise of Freedom and Choice.

# Annex 1: Methodology

In February 2015 the NAPF commissioned quantitative and qualitative research to examine the consumer and scheme experience of pension freedoms. The research aimed to understand:

**Consumers:**

- How consumers view the new pension freedoms?
- How consumers plan to access their savings under the new pension freedoms?
- What is the consumer experience of making decisions about their savings under the new pension freedoms?
- What is a good retirement outcome for today's retirees?

**Schemes**

- What do schemes expect their members to do with the introduction of Freedoms?
- What products will schemes be offering their members?
- What have been the barriers to implementation?

The research is being undertaken by Critical Research. To date the following elements of research have been undertaken, and form the basis of this report:

<u>Consumers: Quantitative research</u>

Quantitative research was conducted in March/April 2015. A phone survey 1,042 adults aged 55-70 was carried out by phone and online; the results are weighted to be representative of the population.

<u>Schemes: Quantitative research</u>

Quantitative research was conducted in April/May 2015. A phone survey was undertaken with NAPF fund members, with 174 interviews achieve.

## *Reporting*

For quantitative results, tables and figures report the base, which refers to the group who were asked the question, weighted to be representative of the UK population; please note that bases vary throughout the survey.

Throughout the report percentages in figures and tables may add to more than 100 per cent due to rounding.

### *Full report*

Our analysis of the complete wave II of Understanding Retirement and some further research among pension schemes and providers is due to report in Autumn 2015. The final research will include additional qualitative research with both consumers and schemes, and a final survey of consumers to be undertaken in September 2015.

For further details about the research, please contact Elizabeth.spratt@napf.co.uk

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