PENSIONS AND LIFETIME SAVINGS ASSOCIATION

AGEING POPULATION & FINANCIAL SERVICES: CONSULTATION RESPONSE

"CHANGE IS REQUIRED TO ENSURE GOOD MARKET OUTCOMES FOR SAVERS"

April 2016

PENSIONS AND LIFETIME SAVINGS ASSOCIATION

INTRODUCTION

We're the Pensions and Lifetime Savings Association; the national association with a ninety year history of helping pension professionals run better pension schemes. With the support of over 1,300 pension schemes and over 400 supporting businesses, we are the voice for pensions and lifetime savings in Westminster, Whitehall and Brussels.

Our purpose is simple: to help everyone to achieve a better income in retirement. We work to get more money into retirement savings, to get more value out of those savings and to build the confidence and understanding of savers.

The UK is in the midst of significant demographic change. Increasing life expectancies are driving profound shifts in the composition of the population and reshaping the structure of society. According to projections by the ONS more than one in 12 people in the UK will be aged 80 or over by 2039.[1] Our own research with Club Vita has shown that the life expectancy of pensioners in DB schemes has improved by 2.3 years during the past 10 years.[2] While the advances that have enabled these trends, including medical innovation and improvements in healthcare, are to be welcomed, these changes also present significant challenges for public policy.

Part of this challenge will be in ensuring that public services, markets and products remain reflective of the needs of older people. For many, retirement is a time for relaxation, travel and spending time with family and friends. Many elderly people will enjoy a high quality of life free from long-term health conditions or sickness. However, others will have a different experience. This cohort has a set of distinguishing characteristics: they are more like to be experiencing the effects of cognitive decline, more likely to be digitally isolated, and more likely to suffer from long-term health conditions such as dementia. Accordingly, they have specific needs that need to be reflected in the design and accessibility of products and services.

This is particularly true in financial services. In the realm of long-term savings, decisions made by individuals can have a profound and often irreversible impact on quality of life in retirement. However, many individuals will approach retirement without ever having engaged with their retirement savings and without a clear roadmap. Alongside this, increasing life spans mean that individuals will be forced to manage their savings for longer than ever before. This fusion of factors presents significant risks for the consumer unless suitable action is taken to mitigate them.

In light of these challenges, and in recognition of our aim of securing better incomes for all in retirement, the Pensions and Lifetime Savings Association is pleased to

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[1] ONS National Population Projections: 2014 link;
[2] NAPF Longevity Model November 2014 link;

respond to the FCA's wide-ranging discussion paper. Our response will focus on the at-retirement market and how it can be reformed to deliver better retirement outcomes for an elderly population, as well as commenting on some broader parallels that can be drawn for other sources of retirement income.

ACHIEVING GOOD RETIREMENT OUTCOMES FOR AN AGEING POPULATION

The face of retirement has changed. Often in the past retirement could be pinpointed to a specific date with the purchase of an annuity. Now, individuals are likely to continue working beyond normal retirement age and may gradually wind down into retirement rather than stopping abruptly. Consequently, they are more likely to expect to manage their long-term savings flexibly over the course of their retirement. Furthermore, pensions are not the only source of retirement income for many individuals. Lifetime savings, in the form of property, equity release and ISAs are playing an increasingly important role. Our research has shown that there is no more normal as individuals choose to cash out their savings or place them into drawdown, whether advised or non-advised.

The discussion paper refers to an aspiration of working towards 'good' market outcomes for an elderly population in this new world. Since the freedoms were announced in April 2014, the Association has been arguing that these 'good' outcomes demand clearer definition from government and regulators in order to measure progress towards achieving them.

Understanding what savers want from their savings offers a good starting point. However, it is clear that without support the majority will struggle to realise these aspirations. We have identified four underlying problems leading to this disconnect: savers' unwillingness to access advice and guidance, behavioural biases, financial literacy and the complexity of decision-making.

It is the Association's view that significant changes will need to be made to the at-retirement market in order to help savers navigate this new landscape and reap the benefits of pension freedoms. Our recommendations are as follows:

- The introduction of **product standards for at-retirement products** to give savers the reassurance that their decumulation product has been independently assessed and is of good quality;
- Allowing trustees and providers **to signpost their members to these quality-assured products** to help smooth the journey from accumulation to decumulation and avoid consumer detriment.

We believe these solutions would preserve the spirit of pension freedoms while also connecting people directly to the income in retirement they say they want and reducing the chances of them making irreversible, life-changing mistakes.

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UNDERSTANDING THE SAVER'S PERSPECTIVE

As part of our *Understanding Retirement* research we examined what savers were looking to achieve from their retirement savings ahead of the new freedoms coming into force. This research found that nearly three quarters of savers wished for a secure income in retirement while around two-fifths were looking for a pot of money that they could dip into when they needed it.[3]

To understand how these expectations translated into action, the Association conducted the first major market-wide survey of who did what and why in the first six months of pension freedoms. The results of this revealed that the majority of the 2.8 million savers eligible to take advantage of the freedoms had not taken action. For those taking action, there was evidence that the traditional norms of at-retirement behaviour had broken down leaving savers to make decisions in new, uncharted territory.

From this we were able to identify three groups of savers who were approaching pension freedoms with different aspirations and varying levels of pension wealth and levels of financial confidence. These three groups can be categorised as follows:

- **The actioners –** 400,000 individuals who have accessed their retirement savings in the first six months. Beyond taking the tax-free cash, drawdown was the most popular option with 43% of actioners opting for this. 32% purchased an annuity and 23% took some or all of their pot as cash lump sums.
- **The investigators –** 1.8 million individuals who have started to actively consider how they would take their pension under the freedoms. This group are DC dependent and often lacking both experience and financial confidence, with limited experience of drawdown and the risks involved.
- **The inactives –** 630,000 individuals who have not taken any action with their savings since the introduction of the freedoms. This group are the most vulnerable, with the lowest levels of financial confidence and DC pension wealth of all the three groups.

This early snapshot offered some interesting insights into savers' expectations and behaviour under the new freedoms.

In terms of the ease of the journey, although most actioners found accessing their pensions very or fairly easy, those entering a drawdown product found the process a little less easy than those purchasing an annuity. Our results showed that just under half found the terminology used challenging and one in three felt that there was too

[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

much information to process. As these actioners are typically more financially confident than the other groups, these figures might be expected to increase when investigators move to access their retirement savings.

We also unearthed some worrying misconceptions surrounding the new freedoms, with 53% of those interested in drawdown believing it to offer them a guaranteed income in retirement. A quarter of respondents who were interested in drawdown believe that there were no risks at all involved in this option.

Coupled with this, only 21% of the actioners sought help from Pension Wise when making a decision. Among those still exploring their options, 73% have not sought help from a financial adviser and only 10% have used Pension Wise. These figures underline the fact that while advice and guidance will have an important role to play in the at-retirement market, they are unlikely to be the full solution for the majority who are off put by the expense, their perception of the industry or other concerns. This suggests that new solutions may be required to complement the work of the new pensions guidance service and financial advice in supporting savers as the take decisions surrounding their retirement income.

It is important not to place too much weight on the experience of the early adopters. This cohort is more affluent, more financially confident and more likely to cash out some or all of their pension savings than the generation that will follow them. However, the actions and steps taken by the investigators are telling of the likely experience of future generations as they approach retirement. This suggests that government, industry and regulators should focus their efforts on meeting the needs of this majority. We believe this support can be delivered by reform on two fronts: the design of products and the consumer journey.

THE DESIGN OF PRODUCTS

The changing face of retirement has been reflected in changes to the accessibility and use of retirement products. Income drawdown – previously the preserve of the affluent– is now a viable option for the majority. Our research supports the conclusion that the financial profile of those investing in drawdown has changed. One third of the first actioners we identified who invested in drawdown reported having pension wealth of less than £30,000 with two thirds stating that the product would be their main income in retirement. Alongside this, individuals are no longer instinctively seeking advice or guidance on the products they purchase. Figures from the FCA have revealed that 42% of drawdown customers have purchased the product without the assistance of a regulated adviser. It does not appear that guidance has been used to plug this gap with the same data showing that only 8% of drawdown customers have used PensionWise[4].

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[4] FCA Retirement Income Market Data January 2016 link;

With the extension of income drawdown to the mainstream the risks faced by consumers have increased. The new purchasers of drawdown are more likely to have been in their scheme's default fund in the accumulation phase and may not have a solid grasp of different types of investment risk and how they should react to them. Areas where they are likely to need support include investing of assets, rates of withdrawal, understanding charges and managing market volatility.

Providing members with this support at retirement offers new challenges for trustees, many of whom are fearful of crossing the line into regulated advice. One means of steering consumers towards good drawdown vehicles would be the creation of a standards regime. The Pension Quality Mark (PQM) is bringing forward a new Retirement Quality Mark (RQM), a set of standards for retirement products. This is intended as a first step in a discussion about quality in decumulation products. PQM currently offers employers and savers the reassurance that their pension scheme has been independently assessed and is of good quality. Our research has shown that 85% of consumers valued this accreditation[5]. Similar standards in the decumulation space would provide savers with peace of mind and help to demystify the new retirement landscape. Product standards would assist those savers we identified in our *Understanding Retirement* research who were struggling with the volume of information provided and the terminology used surrounding drawdown. By setting out what "good" looks like a quality mark could also help to drive standards up and support trustees in helping their members make informed decisions.

We believe that standards should focus around the governance and communications of the at-retirement offering.

Governance

Strong governance standards would involve assessing whether a product operated in a consumer's best interests throughout its operation, and not just at the point of sale. In addition, standards would ensure that the default investment options were well governed and appropriately designed, providing reassurance for savers who are less familiar with the investment landscape. Depending on their design, good governance measures might also help to ensure that the effects of cognitive decline are accounted for in the design of a product and provide reassurance that the proposition represented value for members overall.

Communication

Savers' communication needs will change between the accumulation and decumulation phases as the risks they are exposed to shift. An RQM accredited-product could highlight the risks particularly pertinent to drawdown products: the

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risk of running out of money, the risks surrounding investments and any tax implications. Good communications could also support savers in determining a suitable rate of withdrawal, as well as providing alerts if they are drawing down too much and encouragement if they are drawing down too little in a clear and engaging way.

Beyond this, a RQM could also help tackle some other tricky questions surrounding decumulation products. For example, the appropriate level of charges for a drawdown vehicle.

The Pensions Quality Mark is currently considering responses to its recent consultation on establishing a RQM and will publish its conclusions in due course.

THE CONSUMER JOURNEY

Strong product standards will be one part of the solution. But in isolation they will not be enough. More needs to be done to understand the influences that shape the consumer journey in order to help consumers locate and access suitable products.

This requires a re-examination of consumer decision-making. Historically there has been a well-documented lack of consumer engagement in product purchases at retirement with 60% of annuity customers staying with their existing pension provider[6]. Attempts to move this figure by encouraging shopping around have met with limited success in the past.

We believe the factors driving this inertia are: financial literacy and the complexity of decision-making, the perceived cost of advice and behavioural biases including present bias, loss aversion and a desire to seek the path of least resistance. The process of shopping around for a retirement product can be complex and time-consuming, and there can be a huge volume of information to assimilate. The losses in terms of time and the cost of comparing options outweigh the gains in the mind of the consumer, a form of loss aversion. Consumers are often reluctant to seek advice or take up guidance, with many off-put by the perceived cost or perception of the industry as our *Understanding Retirement* research has shown. As a result, individuals are inclined to fall back on their own biases and seek to avoid stressful decisions. This has been exacerbated by the pension flexibilities which have complicated further the process of shopping around by introducing new longevity and product risks into the mix.

As such, we believe a second intervention which goes with the grain of consumer behaviour would help to ease the journey from accumulation to decumulation and help savers locate good value products. To achieve this, trustees and providers should be able to signpost their members to solutions that meet an agreed set of quality standards. Trustees and providers would base the products they signpost members to

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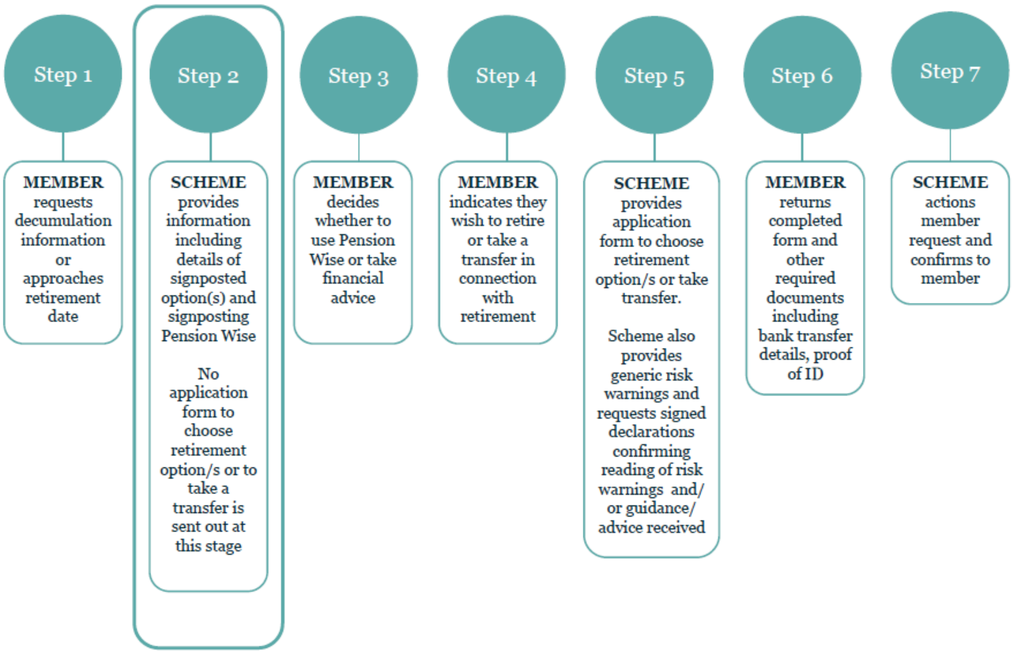
[6] FCA Thematic Review of Annuities February 2014;

on those which have been accredited and which would also be suitable for their membership as a whole. Members would retain the ability to choose exactly what they want to do with their savings and could choose to ignore a signpost at will.

The Pensions Regulator published its essential guide to communicating with members about pensions flexibilities in April 2015. This included a good practice guide to retirement communications. Using this as a template an adapted customer journey including signposting is shown below.

Figure 1: TPR's retirement comunications good practice process under sign-posting



Source: TPR Essential Guide to Communicating with Members about Pension Flexibilities April 2015

Under this scenario, trustees would send out details of any signposted options once a member had requested decumulation information or was approaching their retirement date. This would accompany the material trustees are already mandated to supply about Pension Wise and its services. Importantly, no application form to choose a retirement option or to undertake a transfer would be provided at this stage; the signposted options would provide a helpful steer and inform the saver's decision-making process as they consider their options.

The Association believes that, in combination with product standards, this solution would help develop smoother, easier pathways from accumulation into decumulation and avoid consumer detriment.

BROADER PARALLELS

As has been discussed, in the new world of decumulation pensions may form part of a broader retirement portfolio. Other assets individuals may be in possession of, and choose to rely on in retirement, may include property and ISAs. In light of this, the Chancellor's announcement of a new Lifetime ISA for individuals between 18 and 50 is a welcome complement to the existing workplace pension system.

However, it will be important to ensure that all at-retirement products meet equivalent quality standards on governance and communications. Extensive efforts in the workplace pensions sector have guaranteed high quality default funds, strong governance and low prices. These standards must be replicated across other offerings, including equity release and the new Lifetime ISA, if good retirement outcomes for all savers are to be achieved.

ANSWERS TO QUESTIONS

QUESTION 1: DO YOU HAVE ANY VIEWS ON THE IDEAS SET OUT IN THIS DISCUSSION PAPER AND CAN YOU SUGGEST AREAS OF FOCUS THAT WOULD IMPROVE FINANCIAL MARKETS FOR OLDER CONSUMERS?

As discussed above, we believe changes to the at-retirement market would help to ensure that older people are able to get the most out of their retirement savings.

QUESTION 2: ARE THERE SPECIFIC PRODUCTS, SERVICES OR DISTRIBUTION CHANNELS THAT ARE PARTICULARLY ASSOCIATED WITH POOR OUTCOMES FOR OLDER PEOPLE?

As outlined previously, we believe that without reform the at-retirement market has the potential to result in poor outcomes for older savers.

QUESTION 3: WHAT IS THE ROLE OF INDUSTRY AND OTHER STAKEHOLDERS (COLLECTIVELY AS A MARKET OR AT AN INDIVIDUAL FIRM LEVEL) IN ADDRESSING THE ISSUES IDENTIFIED?

We believe the industry has a responsibility to help savers navigate this new landscape. As such, we are calling on government to allow trustees and providers to signpost their members to independently accredited products that are likely to be a good fit for majority of the membership to help improve the consumer journey.

QUESTION 4: DO YOU HAVE ANY EVIDENCE OF EFFECTIVE APPROACHES TO MEETING THE NEEDS OF OLDER PEOPLE THAT YOU HAVE ALREADY DEVELOPED AND TESTED, OR THAT YOU HAVE OBSERVED IN OTHER MARKETS (UK AND INTERNATIONAL)

We are aware that other countries, such as Australia and South Africa, are considering the role defaults and signposting could play in the decumulation market. In Australia, the Murray inquiry has recommended that trustees be required to pre-select a comprehensive income product for their members' retirement. Members would be free to exercise choice and access their benefits in another way but this fall back option would ease the pathway into retirement for those who "choose not to choose"[7].

Similarly, policymakers in South Africa have introduced draft regulations which would require all retirement funds to operate a set of default policies that are in the long-term interests of members rather than of service providers. The regulations also prescribe the conditions that such default policies are required to meet.[8] These efforts have interesting parallels for the UK decumulation market.

QUESTION 5: DO YOU HAVE ANY EVIDENCE OF REGULATORY BARRIERS THAT PREVENT EFFECTIVE MARKETS FOR OLDER PEOPLE?

Currently, trustees and providers are concerned about offering guidance to members for fear of being seen to stray into the territory of offering advice. Our earlier research identified the deadlock that has been created by uncertain consumer demand and questions about future liability which have combined to freeze any development in services to help savers make use of the pension freedoms confidently or fully. The Financial Advice Market Review's recommendation that HMT should consult on amending the definition of regulated advice is welcome and might go some way in clarifying the boundary between guidance and regulated advice. However, we believe further regulatory intervention is required to provide trustees and providers with safe harbour when they signpost savers to good quality products and support them through the tricky process of selecting a retirement income solution. This would help to ensure good market outcomes for all older people.

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[7] Financial System Inquiry Final Report December 2014 link;
[8] South African National Treasury Press Release 22 July 2015 link;