REFORM

Beyond April 2015: the long view on UK pension reform

Tuesday 10 February 2015
09.00-12.15

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09.00-09.30	Registration and refreshments	
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09.35-10.45	**Session 1: International trends and consumer behaviour**	This session will consider what the UK can learn from other countries with similar "freedom and choice" private pension systems, including the trends that are visible in these countries and how challenges have been addressed. It will draw on what these observations might mean for consumer behaviour in the UK and how that could change over time as the reforms become established.
09.35-09.45	Keynote speech	**Andrew Reilly, Pension Analyst, Social Policy Division, OECD**
09.45-10.05	Panel debate	**Chris Curry, Director, Pensions Policy Institute** **Ben Franklin, Senior Research Fellow, ILC-UK** **Teresa Fritz, Member, Financial Services Consumer Panel** **Michelle Cracknell, Chief Executive, The Pensions Advisory Service**
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11.00-11.10	Keynote speech	**The Rt Hon Lord Hutton of Furness, Former Secretary of State for Work and Pensions**
11.10-11.30	Panel debate	**Mark Hoban MP, Former Financial Secretary to the Treasury** **Paul Johnson, Director, Institute for Fiscal Studies** **Caroline Abrahams, Charity Director, Age UK** **Stephen Lowe, Group Director, Just Retirement**
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12.10-12.15	Summary and closing remarks	**Andrew Haldenby, Director, *Reform***

Held in partnership with:

justretirement

The *Reform* team: setting the agenda

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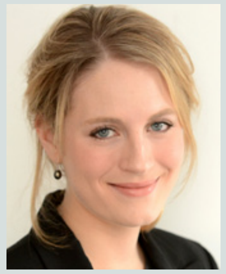

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In the 2014 Budget the Government announced major changes to the UK retirement landscape, with the aim of increasing choice for people with defined contribution pension savings. In his Budget speech the Chancellor stated: "Pensioners will have complete freedom to draw down as much or as little of their pension pot as they want, anytime they want." From 2015 savers will have more flexibility over how they access savings, with amounts individuals draw down taxed at marginal income tax rates and the 25 per cent tax free lump sum still in place.

The process of converting pension savings into income, particularly the purchase of annuities, had been under increasing scrutiny. A central concern was that inertia and low levels of engagement meant that consumers were not making the most of the options available to them, leading to poorer outcomes. The review of consumer behaviour published alongside the Financial Conduct Authority review found high awareness of the right to shop around (at 91 per cent), but that 60 per cent of people still arranged their retirement income through their incumbent pension provider. Poor annuity rates in recent years have also reduced the income from pension pots that might otherwise have been expected.

Giving consumers greater freedom over their financial decisions at retirement will mean greater individual responsibility. This challenge is all the more notable given the effect of significant improvements in life expectancy, with consumers tasked with managing their retirement income over a longer period than past generations. Recent *Reform* research showed that the chance of a person who retires aged 65 spending 30 years in retirement will have increased from 16 per cent in 2010 to 26 per cent by 2035. In addition consumers must consider their changing needs over this period, for example long term care.

Alongside the reforms it is therefore important to consider how consumers are supported as they make decisions at retirement. The Government's proposed "guidance guarantee" service, recently unveiled as Pension wise, will have an important role in building engagement, and familiarising retirees with their options so that users can make informed choices. This engagement will have to overcome the inertia that often characterises savers' behaviour so that retirees understand their options, the benefits and risks of each, and how these options relate to their own circumstances and needs. A key challenge is the growing disconnect between this phase, which requires informed and engaged decision making in the face of a range of choices, and the phase of building up savings, where auto-enrolment has harnessed inertia.

As government, industry and regulators prepare for the reforms to go live on April 6 there are concerns that the current plans will be insufficient to support consumers. In light of these concerns there are ongoing debates around how to help consumers avoid detrimental decisions and scams, and how to give them integrated information about their pensions – including state and private – through a type of "pensions dashboard". Yet the overall impact of the "freedom and choice" reforms will only become clear over time. Taken together with the abolition of the default retirement age, the continued roll-out of auto-enrolment and reforms to the state pension, the reforms have the potential to change retirees' experiences markedly.

In exploring the impact of the reforms, useful insights can be taken from countries where there is already greater freedom at the decumulation phase, such as Australia, New Zealand and the USA. The articles which follow set out some of the key challenges in these systems, including how people manage their savings and the lack of certainty over the incomes people can expect during retirement.

The pensions reforms being implemented are transforming the retirement landscape for consumers, who face complex and difficult decisions. As individuals, policymakers and the financial services industry get to grips with the reforms, *Reform* is delighted to contribute to this debate to explore some of the challenges facing retirees and the key considerations for pensions and retirement policy for the next Government and beyond.

New options, familiar needs: delivering security throughout retirement

Stephen Lowe

Rarely is an agenda seized as comprehensively as UK pensions policy was by the Chancellor in his 2014 Budget. To parliament, industry, consumers and the media the new framework set out for UK private pensions was as bold as it was surprising.

In a policy area where major reforms have tended to emerge from years of consultation and consensus, the Chancellor's convictions will be tested from April 6 when the first wave of retirees gains access to "freedom and choice". While the new system will offer unprecedented choice and flexibility, the key question for policymakers and retirees is whether the reforms will deliver improved outcomes for people in retirement.

Ensuring the reforms deliver improvements is especially important for two reasons. First, there is an urgent need to set the heightened interest and momentum generated by the reforms against the inertia, disengagement and distrust that still characterises too many consumers' interactions with pensions and retirement planning. Though the Pension wise guidance service will provide welcome support to retirees, policymakers and regulators will need to monitor outcomes to ensure decision-making and purchase processes properly reflect consumers' needs and circumstances.

Second, the timing of the reforms is significant given where we are in the transition from defined benefit (DB) pension provision to defined contribution (DC) becoming the norm. Analysis by the Pensions Regulator shows the number of active DC scheme members passed the number of active DB members for the first time in January 2015. With auto-enrolment expected to add up to 10 million eligible workers by 2018, the pace of this shift will continue and increase the importance of DC pension savings to retirees.

So while April 6 is an important calendar date the full impact of the reforms will only become clear over time. As one of this report's contributors points out, in 20 to 30 years most of those individuals making retirement decisions in 2015 will be reaching average life expectancy and facing a wide variety of outcomes. This makes clear how decisions made in the immediate term will need to work for consumers next year, ten years on and potentially for many years thereafter.

Having worked previously for a leading Australian pension provider I am keenly aware of recent findings from a high level review of the Australian retirement system. The Murray Review concluded that superannuation pension assets are not being efficiently converted into retirement incomes because of a lack of risk pooling and over-reliance on drawdown-style pensions. It identified a mis-match between many people's stated desire for an "income that lasts a lifetime" and actual outcomes that have reduced their standards of living.

These risks could materialise in a similar way in the UK if the new freedoms encourage people to use pensions assets too quickly. This is certainly a problem in Australia, where around a quarter of people with superannuation funds at age 55 had depleted those funds by age 70. The report suggests Australians' standards of living would be improved through greater risk pooling. It recommends developing guaranteed lifetime income solutions that allow retirees to manage longevity and investment risk more effectively, giving them confidence to spend their pension money without worrying about it running out while also retaining some flexibility.

As the UK gears up for its own experiment with pension freedom, there is clearly a lesson to learn from the Australian experience and countries with similar systems. While the early trends for withdrawal and secured income may become apparent from April, the real question facing individuals and policymakers remains – how best to maintain standards of living over the decades that follow?

Stephen Lowe, Group Director, Just Retirement

The long term outlook for UK pensions

Rt Hon Steve Webb MP
Liberalising pensions

When we entered into the Coalition Government in 2010, it gave us the first opportunity in almost a hundred years to implement liberal and sustainable long term reforms to a pensions system created by the great reforming Liberal Government of the early twentieth century.

One of the very first acts of the Coalition Government was to fulfil the Liberal Democrat manifesto commitment to introduce the triple lock guarantee to increase the Basic State Pension by whatever is highest out of: CPI inflation, average earnings or 2.5 per cent. We also restored the earnings link to pensions, which was abolished in 1980.

We have made once-in-a-generation reforms to simplify the state pension and make it fairer, introducing a Single-tier State Pension to replace the complicated current two-tier system. From April 2016, this will provide clarity about what individuals can expect as well as benefit many women, self-employed people and the low-paid. The full level of the state pension will be set above basic means-tested support, so people will have greater confidence in the value of saving into a private pension.

We are helping millions to save more through their own workplace pension with the roll-out of automatic enrolment. Over 5 million people are now in and we are expecting to enrol around 5 million more people in the coming years. To help them to save with confidence we are bringing in a cap on charges on default funds in defined contribution pension schemes.

Finally, the ground-breaking pension freedoms we introduced in the last Budget should give people the freedom to choose how they spend their pension pots – money that they have earned and responsibly saved over their working lives. We are helping people make these big decisions with clear impartial guidance from Pension wise.

At the heart of a liberal pension system lies the belief that the best person to look after your money is you. This is why we have taken the major step of releasing savers from the effective requirement to purchase an annuity with their pension pot.

The Liberal Democrat manifesto for the 2015 General Election will continue to build the foundation of a more secure and sustainable future for pensioners. This is why we will make sure pensioners can benefit from our plans to increase the income tax threshold to £12,500, and to write the Triple Lock into law, to ensure that pension rises also match or exceed increases in living costs. Senior citizens' bus passes would also be protected, while to help balance the books, the wealthiest five per cent of pensioners would no longer be entitled to free TV licences and winter fuel payments.

We also intend to look further into introducing a single rate of tax relief for pensions, designed to be simpler and fairer and which would be set more generously than the current 20% basic rate relief, which most people currently receive.

I believe that this is a proud record of action, which demonstrates the difference which Liberal Democrats participating in government can bring.

Rt Hon Steve Webb MP, Minister of State for Pensions

Rt Hon Lord Hutton of Furness
A nation of savers

Pensions and retirement saving are experiencing a quiet revolution. Driven by unprecedented increases in life expectancy, every aspect of the pensions landscape is undergoing profound change. In this context, it is becoming more and more important to ensure that people are saving enough to ensure they can enjoy an adequate lifestyle in retirement. This is the explicit logic behind the 2005 Turner Commission report. Tax payers can no longer assume the prime responsibility for this – individuals will need to take on the job of ensuring financial sufficiency for their retirement.

So it is crucial that we have a retirement savings policy that works for savers. That encourages them to save more for their retirement years, provides confidence in long term saving and ensures that old age does not become synonymous with being poor. It is by no means clear that this is the case.

With so much change going on, achieving these outcomes presents a particular challenge. Reforms to the state pension, auto enrolment, the possible introduction of new risk-sharing DC schemes, ending the requirement to purchase an annuity, and now the introduction of a new pension guidance service all add up to the most significant changes for over a hundred years. Change can bring confusion. But with the right information about what savers want and need we can hopefully ensure we get these reforms right. So policy needs to be informed from the bottom up with a clear insight into what consumers need and expect in retirement. Populism is not a good enough proxy for hard intelligence about what consumers are telling us about their retirement needs.

At such a time, policymakers, savers and financial institutions need to understand the impact of all of this change. The key goal must surely be to encourage more people to save more for the time they give up paid employment and that when they do retire, that they have enough to live on for the whole period of their retirement. This is a big challenge, made more difficult by much of the adverse media coverage of recent years, the end of defined benefit pensions and the consequent overall reduction in levels of retirement saving in recent years. In short, we need to become a nation of savers. We must constantly keep this end point at the front of our minds.

If we are to become a nation of savers, we need to know what savers are telling us about their own priorities. And here, one thing stands out to me. All the evidence suggests that people want a secure, reliable retirement income covering the whole of their retirement years. I continue to believe that annuities can and will play an important role in securing this outcome and policymakers should do nothing to undermine confidence in annuities as a primary mechanism for achieving income security in retirement.

We also know how confusing people find the whole system and how critically important it is that savers get the right advice about their best options – both during the period they are saving and when they approach retirement. Getting the right advice is a first order priority and this is made even more important given the nature of the recent reforms. So we should treat very seriously the growing evidence that many people don't intend to take up the new offer of free guidance about what to do with their pension pot when they retire. Equally serious is the fact that only a small proportion of people with defined contribution pots currently plan to take any professional advice about their retirement options.

We cannot ignore the implications of these findings. Laissez faire will not be enough to avoid a possible retirement income shortfall for hundreds of thousands of people. We may have established the right policy framework to encourage long term saving, but we must continue to track progress very carefully indeed. We cannot ignore any evidence of policy failure here – if we do we will be laying the foundations for serious long term economic problems.

Rt Hon Lord Hutton of Furness, Former Secretary of State for Work and Pensions

Mark Hoban MP
A twenty first century savings model

The reforms announced in George Osborne's 2014 Budget gave savers new freedoms. They marked the end of a paternalistic system, where the Government dictated how your money was used in retirement, and completed a shift in responsibility for pension savings and retirement income from the state and the employer to the individual.

This, however, comes with risk and complexity. With the move from final salary to defined contribution schemes, employees and not employers bear investment and longevity risks. The end of compulsory annuitisation means that people can choose to cash in their pension pot, invest their money in funds, or stick with annuities. Auto-enrolment and job mobility mean that, on average, you could end up with 11 different pension pots, according to the Department for Work and Pensions. We need a step change, therefore, in the support available to help people navigate their way through a minefield of complex products and choices.

In a paper I published with *Reform*, I have set out proposals for a RetirementSaverService that builds on Pension wise, the guidance service to be offered by the Government. The RetirementSaverService would provide two complementary elements: a single view of your wealth, aggregating all your pensions and savings, even if they are with different banks, insurers and asset managers; and a suite of tools to help people convert their aspirations for retirement into a plan for saving. The RetirementSaverService would empower everyone to make better decisions about saving and retirement across their lifetime.

This will force a decisive shift away from old patterns of doing business, where consumers had to track each of their pensions and savings accounts, while battling against a blizzard of paper. We should be using leading-edge digital technology to put the customer, and not their bank or insurer, in charge of their savings.

This is already happening across Europe. Minpension is an online service that all Swedes can use to track the value of their state and private pensions. The Pensions Dashboard helps the Dutch do the same thing. Here, banks can provide a snapshot of all your savings with them, and IFAs can do this for their clients. The RetirementSaverService would make a broader and deeper offer, by giving the same service to everyone – and for all their savings, private pensions, and state pensions. Using this information and a new suite of digital tools, the RetirementSaverService would enable people to work out their desired lifestyle and income in retirement, and then how much they need to save to achieve their aspirations. These tools would address issues like longevity, risk appetite, and investment preferences.

The RetirementSaverService will need to marry the sharpest insights in financial services with the consumer engagement skills of world-leading online services to empower people to take control of their money. It will provide the tools and information people need to make the best use of their new-found freedoms and responsibility; giving them security and dignity in retirement.

Mark Hoban MP is a former Financial Secretary to the Treasury

Baroness Drake CBE
Choices and consensus?

The Pension Schemes Bill and the Taxation of Pensions Act introduce unprecedented choice for the pension saver, which has been widely acclaimed. But choice is not enough to ensure consumers experience good outcomes.

It is important that individuals are well placed to make decisions in their interests. We know the challenges to achieving this are provider behaviour; product design, asymmetry of knowledge and understanding; complexity; and savers' behavioural biases and financial capability. The guidance guarantee, Pension wise, is intended to help people navigate the complex retirement options arena from April 2015. The FCA has confirmed it will expect providers to check whether a customer has used the guidance guarantee service and encourage them to do so if not.

Empowering the saver is very important but with around 400,000 consumers expected to take advantage of the new pension freedoms in 2015, the Government is also dependent on market behaviour to ensure their success.

Recent FCA reports on retirement income markets have been hard hitting and to the point. They observed annuity sales practices contributed to consumers missing out on a potentially higher income; consumers' tendency to buy from their existing pension provider weakened competition; consumers will be poorly placed to drive effective competition; the retirement income market is not working well; and the introduction of greater choice will reduce consumer confidence and weaken the competitive pressures on providers to offer good value.

Therefore the recent announcement by the FCA, that from April 6 rules will be introduced to provide what is popularly called 'a second line of defence', was welcome. Pension providers must ask consumers seeking to access their pension savings about key aspects of their circumstances and give relevant risk warnings in response to the answers, in direct and simple language. A second line of defence is not a total solution to the risk that consumers make poor decisions, but it will make an important contribution.

It is unclear where the consensus on private pension policy currently lies. There is now a separation of tax advantaged pension saving from any requirement to secure an income stream in retirement. The effect of that decision could be profound.

For many millions of workers the biggest challenge remains building an adequate pension pot, however there has been little debate about how these reforms will help the next generations save more. The roll out of auto-enrolment has been a success. But on the current statutory minimum contribution of 8 per cent, the size of the pension pot of a median earner after say 30 years of persistent saving will still be modest.

It was anticipated that over the long term many schemes would attract a more generous employer contribution, but how the new freedoms will impact employer behaviour is uncertain. The Government's message, 'your money, your choice', glides over the contribution of tax relief and in many cases employer contributions to the value of the pension pot, while the focus on early access to pension savings does not sit easily with the need to work and save for longer.

Employers are integral to the success of workplace pensions providing the employees' route to saving: they are a major influence on the level of contributions and the quality of the workplace schemes. But now pension pots are for people to do with as they choose, there are no reservations on securing an income. The premise upon which employers were compelled into a contingent pension contribution under auto-enrolment has therefore shifted – how this will affect employer attitudes to contributions is not yet known.

Historically the advantaged tax treatment of employer and employee pension contributions supported retirement incomes which benefited the pensioner and society. Tax relief should be reformed to deliver a fairer distribution, but if private pension policy is now spend it as you choose, then a focus on more radical reform may follow. The Institute for Fiscal Studies has already questioned whether contributions to a DC pension should now continue to be so tax privileged. For the coming generations of pension savers who are not the high earners, will the incentive to save for the long term for retirement income be reduced?

Baroness Drake of Sheen CBE, Former Member of the Pensions Commission

Paul Johnson
Quiet revolutions, risk and uncertainty

Thirty years ago pensioners were much more likely to be poor than any other population group and had income well below the average. Since then, year after year pensioner incomes have grown faster than those of non pensioners. Pensioners are now less likely to be poor than are those of working age and, on some measures, average pensioner incomes are higher than average incomes among the working age population.

That represents a quiet revolution in policy and outcomes. Over that period all elements of income for pensioners have been rising – state pensions, means-tested benefits, private pensions, and earnings. At the same time longevity has risen dramatically. So all this has come at a cost, both in terms of public spending and lower earnings for those of working age. Why the latter? Because so much money has had to be ploughed into occupational pension schemes to pay for promises for today's pensioners which turned out to be vastly more expensive than expected.

Government and private sector have, belatedly, responded. Defined benefit occupational schemes are essentially dead outside the public sector. Auto-enrolment will bring millions more into some form of pension saving. State pension ages are set to rise. State pensions for future generations will be less generous than planned as a result of the new single tier reforms. Increasingly retirees will be dependent on defined contribution pensions which, given recent reforms, need not be turned into a stream of income via an annuity. Individuals are also responding by working longer, a trend which has gradually been reversing the sharp drop in average retirement ages which occurred in the 1970s and 1980s.

These trends are set to continue. By 2030 average retirement ages will be higher than now, state pensions beginning to fall, occupational pensions becoming gradually less important for former private sector workers, and savings in DC schemes, including through auto-enrolment, more important.

Will the rise in pensioner incomes continue? Recent work at IFS, based on known characteristics of those currently in their 50s, suggests that over the next decade or so incomes will continue to rise. A significant part of this will be driven by increases in incomes from earnings. Many of those in their 50s, especially in their late 50s, still have substantial occupational pension rights. State pension rights will remain relatively high.

The longer term outlook is more uncertain. Lower occupational pension provision is sure to affect many. The high point of state provision will fade further into the past. And younger cohorts are actually seeing their earnings drop below those of older cohorts at the same age. This is a very unusual pattern. In addition home ownership levels among those born in the 1970s and after are substantially lower than was the case for their parents' generation.

Beyond uncertainty over levels of future provision these trends create one big additional challenge – how to share risk. Increasing dependence on defined contribution pensions means that all the risk sits in the hands of the individual – not the employer, not the government, not future generations. A system of pension provision without more risk sharing is unlikely to be robust into the long term.

Paul Johnson, Director, Institute for Fiscal Studies

Dr Yvonne Braun

Taking a long term view

The real impact of decisions that savers and retirees make in 2015 may not become apparent for two, three or four decades. Policy decisions now should consider what the pension landscape could look like then.

The savers who are now being auto-enrolled will be approaching retirement. If they stay the course and continue to save, even lower earners should have built up pots above today's average. For this generation, having any defined benefit entitlement will be the exception and not the norm. There will be more pressure on taxpayer funding for the ageing population, including the State Pension, as the number of pensioners continues to increase. Defined contribution pensions will be an ever more important component of their total assets.

Twenty to thirty years from now, most of those who are making retirement decisions in 2015 will be reaching average life expectancy and facing a wide variety of outcomes. Some will inevitably have no defined contribution pension left. Others will have been recklessly conservative. Others still will have put assets aside, to pass on or to pay for their care needs. Many will be getting by on a small income.

The current Government has not said what makes a good retirement outcome – it's your money, your choice. So to consider how to improve retirement outcomes for the next generation requires a value judgment about what is "good". For the individual, this is highly personal and will change over time; for society, this is likely to mean a sustainable income that enables wellbeing and participation in society, and does not add a burden on the state.

Many of today's retirees will not get the retirement they had hoped for, not because of their retirement decisions but because they did not save enough. The essence of retirement products may not be dramatically different from today, offering a choice or combination of guaranteed income, potential for growth and access to funds.

To improve outcomes, we need to increase the amount that is saved. For the future, engagement must be a goal for the market and for policymakers, and that also means building trust and transparency. But pensions need to work for those who do not engage at all, and this year we will consider the behavioural tools available to the industry and policymakers.

There will be highly engaged individual investors and millions in workplace pensions who rely on defaults; but there will also be an evolving middle space where engagement can increase. The desire to see all funds and other assets in one place through a pension dashboard or similar is likely to gather pace.

We will continue to see increasing online engagement and new forms of information and support, with Pension wise hopefully becoming part of the furniture. Regulation needs to match; we are already seeing the FCA encouraging innovation and experimental approaches but more work is required before we have regulated advice that is widely accessible and affordable. And in some cases a decisive break in regulation may be needed – for example, the point at which electronic rather than paper-based disclosure becomes the norm.

Priorities for future policy include completing near-term homework; finishing the roll-out of auto-enrolment; implementing the 2015 reforms; and closing the door firmly on scams.

There is also broad agreement on focal points for the next Parliament: drive increased contributions, look again at tax relief and ensure we have clear regulatory boundaries.

It would be optimistic to expect stability, but a return to cross party consensus and a long term view on long term savings, which takes account of other policy areas – work, health, care, housing – is essential.

Dr Yvonne Braun, Director of Long Term Savings Policy, Association of British Insurers

International trends and consumer behaviour

Professor Kevin Davis

Retirement incomes policy reform in Australia

International comparisons (such as the Melbourne-Mercer Global Pension Index) rank the Australian retirement income system highly based on three broad criteria of adequacy, sustainability and integrity. However, despite that endorsement, there are a number of shortcomings which were highlighted by the recent Financial System Inquiry (FSI) or "Murray Inquiry".

The main focus of the FSI in the areas of superannuation and retirement income was on improving efficiency in the accumulation phase and increasing risk-pooling in the retirement phase. These have the potential to increase retirement incomes substantially, and reduce age pension related government budgetary pressures. The recommendations of the FSI, together with other recent reforms, should enhance sustainability and adequacy.

Compulsory superannuation for eligible employees was introduced in Australia in the early 1990s in the form of employer contributions on behalf of employees into defined contribution (accumulation) funds. While most employees can choose a preferred fund, employers select a default fund for those not exercising choice, generally from a limited list of funds specified in industrial awards. An increasing number of individuals have elected to establish self-managed superannuation funds. Superannuation contributions and earnings attract significant tax concessions, including (generally) no tax on earnings or withdrawals from individual accounts which are in retirement mode.

Despite substantial growth in superannuation assets over the past two decades, a large majority of retirees are expected to remain at least partly dependent upon the universal, but means tested, government age pension.

One fundamental problem identified by the FSI is a lack of member-driven competitive pressure to induce lower fees and costs and improve efficiency in institutional funds, particularly for default funds. Consequently, the Inquiry recommended that the effect of recent regulatory reforms on efficiency and competitiveness be reviewed before 2020. Absent significant improvements, consideration should be given to introducing a formal competitive process (such as a tender or auction) for allocating new employees into default funds. (Those recent reforms sought to introduce a cost effective, simple default fund product, improve transparency and governance and streamline administrative arrangements.)

Another major concern is that superannuation assets are not being efficiently converted into retirement incomes due to a lack of longevity risk pooling and overreliance on account-based pensions. Evidence suggests that the major worry among retirees and pre-retirees is exhausting their assets in retirement. An individual with an account-based pension can reduce the risk of outliving their wealth by living more frugally in retirement and drawing down benefits at the minimum allowable rates (which a majority of retirees do).

The Inquiry also noted that many retirees find it challenging to navigate the transition to the retirement phase of superannuation. The task of managing multiple financial objectives and risks in retirement is complex and the quality of financial advice can vary significantly.

Accordingly, the Inquiry recommended that institutional super funds be required to offer their members a "pre-selected" comprehensive retirement income product which, where appropriate, includes a regular and stable income stream, longevity risk management and some flexibility. A product involving some mix of an account-based pension and deferred annuity is one such example, and the longevity risk pooling provides an opportunity for higher consumption streams for participating retirees. There is, of course, no free lunch, as beneficiaries receive lower inheritances from residual super balances. This is consistent with another of the Inquiry's recommendations to shift the focus of the system from tax-preferred wealth accumulation and estate planning to provision of retirement income by setting clear objectives for the system.

Offering a "pre-selected" product was preferred to a system where individuals are "defaulted" or mandated into a specified product. This maintains consumer sovereignty, while positively influencing retiree choice towards taking up products that include some longevity insurance. A default solution also faces practical complications given retiree diversity.

Professor Kevin Davis, Professor of Finance, University of Melbourne; Research Director, Australian Centre of Financial Studies; and Professor, Monash University; and Member of Australian Financial System Inquiry Panel (the "Murray Inquiry")

David John
New UK annuity reforms are a step too far

After nearly a decade where the UK has been the gold standard for retirement savings policy, it is about to take a step that it may regret. In theory, the new pension freedoms sound good. And there were serious problems with annuities that needed to be addressed.

However, American experience strongly suggests that the UK is taking a step too far. There is no required annuitisation in the US, and very few Americans buy annuities. Even those in traditional DB pension plans usually take a lump sum if they are allowed to do so.

The reason is simple. Most people assume (often wrongly) that they can manage their own money as well as anyone else. Others greatly overestimate how long their savings will last. As for annuities, retirees see themselves spending a huge amount of money for a comparatively small monthly payout and decide not to act.

As a result, many of them spend unwisely, trust the wrong financial advisor, or make other financial mistakes. A recent survey found that in one state 78 per cent of those near retirement and 67 per cent of those at retirement would be likely to outlive their financial assets. Lower income workers and those with no pension benefit were most at risk.

Just advice is not likely to help. A number of US studies show that literally every minute that passes after general advice is given reduces the chance that the consumer will act on it – even when they have decided to do so. And even a significant number of those who consult with a financial planner fail to act on that guidance.

What does show promise is income illustration. In a 2014 survey, 85 per cent found estimates of the income they could anticipate from their retirement savings useful, and 40 per cent said that they would save more. More importantly, income illustrations change the framing of retirement saving and annuities from gross amounts to retirement income. Annuity-like products become insurance against running out of money, something Americans are increasingly concerned about.

Two other potential developments may help. One is the longevity annuity, which provides income only after a set age. Because it is deferred, one can buy much more income for a lower amount, and the retiree is protected against running out of money. In 2014, $50,000 would buy $275 a month at age 65 or $1200 a month starting at age 80.

Another idea is an automatic enrolment trial annuity. As developed by Brookings Institution colleagues and I, new retirees would automatically use part of their savings for a two year annuity. After that, they could continue it by doing nothing or take a lump sum. The retiree would always have complete control, but would be nudged towards the best choice. The mechanism would also work for longevity annuities.

The UK press' annuity horror stories show a definite need for change, but too many are likely to run out of money under the coming reforms. A step back to automatic guidance or a longevity annuity would help to protect them.

David C. John is the deputy director for the Retirement Security Project at the US public policy organisation the Brookings Institution, and senior strategic policy advisor at the American Association of Retired Persons (AARP)

Associate Professor Susan St John
Decumulation policy in New Zealand

The New Zealand retirement income framework has been widely acclaimed internationally for its simplicity, fairness, and effectiveness in addressing elder poverty. New Zealand Superannuation, a universal, flat-rate, non-contributory, taxable pension at age 65 is the foundation of this framework. The net rate is at least 33 per cent of the net average wage per married person with higher rates for single people.

Unlike other countries with complex and expensive tax incentives, New Zealand's tax treatment of occupational savings schemes since 1990 has been aligned with that of saving via a bank account. Defined benefit schemes declined sharply from that time. In 2007, following a concern that New Zealanders were not saving enough to supplement the state pension and that existing workplace schemes had poor coverage, the Government introduced KiwiSaver, the world's first national auto-enrolment, opt-out, fully portable private savings scheme.

It is also open to all, not just workers, and its minimal incentives are well designed to limit regressivity. The uniquely comprehensive, simple and transparent retirement income framework is of interest as a working model in international comparative pension analysis.

Nevertheless, while low-income earners do well, replacement rates decline as income increases more quickly in New Zealand than in most other OECD countries because of the flat rate nature of the basic pension. While the longevity risk is partially addressed by the provision of a universal state pension middle-income people face the risk of outliving their supplementary capital.

There are no rules around the use of the lump-sum savings from KiwiSaver, which are generally accessible only at the age of 65. New Zealand does not have a tradition of annuitisation and the annuities market is virtually non-existent. Under current tax rules and the lack of government support including inflation indexing or long-term bonds, a viable annuities market is unlikely to emerge. Indeed the collapse of the annuities market in New Zealand shows that with no active state participation market failure is the reality.

The New Zealand experience also shows the danger of setting up a tax-subsidised scheme without attention to decumulation. Although KiwiSaver rules and conditions have been changed regularly since its inception, it would be difficult now to gain acceptance of compulsory annuitisation when people joined on the understanding they would have full access to their lump-sums. Some private sector guaranteed income plans and home equity release schemes are beginning to emerge but are likely to provide, at best, a partial solution.

New Zealand now has a unique opportunity with a tax neutral regime for accumulation, to design an attractive annuity with few of the disadvantages of traditional tax incentives. One possibility explored by the Retirement Policy and Research Centre is the state provision of a voluntary, limited value, inflation-adjusted, gender neutral annuity to supplement the state pension, purchased out of lump-sum savings and a suitable share of home equity if required. Well-designed subsidies to reflect the social gains from annuitisation could make the annuity attractive and further social gains might be achieved by incorporating cost-effective insurance for long-term care.

Associate Professor Susan St John, Co Director, Retirement Policy and Research Centre, University of Auckland

Chris Curry
The UK retirement market: Lessons from abroad

Until the announcement of the Budget reforms in March 2014 around 75 per cent of people with DC savings generally purchased an annuity or an income drawdown product. The number of annuities purchased each year from 2004 to 2013 ranged between 300,000 and 400,000.

Since March 2014, annuity sales have dropped significantly. In the third quarter of 2014, just over 40,000 annuities were purchased, compared to over 90,000 in the same quarter of 2013 – a fall of over 50 per cent. Will the use of annuities fall further?

A number of research projects have been undertaken since the Budget to try and ascertain how individuals might react to the new choice available to them, but a clear answer is yet to emerge. It may be illustrative to look at the experiences of other countries with well developed DC markets, particularly in respect of the choices savers make about how to use their pension pots at and during retirement, the prevalence of annuitisation, and the cultural, institutional and regulatory features that may drive these choices.

Some countries, such as Switzerland and Chile, have high levels of annuitisation. Despite Swiss savers being permitted unlimited access to their private pension savings (though some schemes restrict access), around 80 per cent of DC assets are put into lifetime annuities. This is attributed to cultural attitudes; Swiss workers are described as being "financially conservative" and "preferring guaranteed incomes for life" over taking lump sums.

However, Swiss annuities are funded by hosting pension schemes and their rates (which are regulated by the Government) are considered to be very generous given the current low interest rates in the Swiss market and low mortality rates amongst annuitants.

Chileans who wish to access their DC pension savings must opt either for a lifetime (deferred or immediate), index-linked annuity or for phased withdrawals from a pension fund. The number of DC savers purchasing an annuity in Chile has risen from 3 per cent of pensioners in 1985 to just under 70 per cent of DC savers for whom annuities were an option in 2007. This equates to around 70 per cent of DC assets.

The high demand for lifetime annuities in Chile is attributed to the restrictions on accessing savings and on the lack of a sufficient universal state pension to fall back on. In addition, fund providers must guarantee a minimum rate of return, which is backed by the Government.

Both Switzerland and Chile offer higher annuity rates than would have been expected given market conditions. Annuities are perceived as a "good deal" for annuitants in these countries.

By contrast, there are very low levels of annuitisation in Australia. Around half of DC assets are paid out as lump sums. The other half provide an income stream; mainly through "pension accounts" similar to Flexible Drawdown. Somewhere between 2 per cent and 10 per cent of DC pension assets are used to purchase a lifetime annuity.

There is low demand from the public for annuity products, but also a clear gap in understanding of longevity, income needs in retirement and how savings can best be used to meet those needs. The recent Murray Review has suggested that in light of a lack of a competitive market there might be a need for some form of compulsory longevity insurance to overcome this gap.

Similarly, the purchase of lifetime annuities is minimal in the USA, estimated to account for less than 2 per cent of pensioner income in 2009. Savers in the USA are permitted to access their DC savings from retirement age without restriction and the lack of interest from consumers in annuitisation is attributed to the lack of bequest options, large fund sizes, "adverse selection" and consumer concerns about developing health problems in later life.

Until 1999 Irish savers in DC pensions were required to purchase an annuity if they wanted to access their saving, similar to the recent situation in the UK. Now, around 30 per cent of those retiring with private pension savings currently purchase an annuity (the majority of which are flat-rate, lifetime annuities), though this figure includes individuals with an occupational DC pension who are still effectively obliged to purchase an annuity. Given the similar starting policy positions, might this give an indication of where the UK market may end up?

International experience suggests that in some countries, people still choose to annuitise even in the absence of restrictions on accessing DC savings.

People's reactions to the Budget changes and their corresponding impacts on levels of annuitisation will depend on several different factors, such as:

- Whether the value of longevity insurance is understood; the role of guidance is likely to be critical
- Whether annuities are seen as good value; this may be more likely at older ages, or with specific medical underwriting
- How the market for alternative products develops; simplifies drawdown products are likely to emerge

It is therefore likely to be a number of years before the UK market settles down and the future of annuitisation in the UK becomes clearer.

Chris Curry, Director, Pensions Policy Institute

Tom Wright CBE
Building financial resilience in later life

How do you plan for a future retirement which could last as long as your working life, during which you could experience major changes in both your personal circumstances and in wider economic conditions over which you have no control?

Last year Age UK set up a Financial Services Commission to explore these issues. We concluded that while the Government's pension reforms might drive welcome change in the financial services landscape, the desire to give people more control and flexibility must be balanced with the need that most people have for a base level of certainty, as well as ensuring transparency and fairness.

In December we also published a discussion paper, Dashboards and Jam Jars, which looked in more detail at the particular issues facing those with more modest pension savings, with a focus on good value, and providing good outcomes for those who know little about financial products.

This paper raised particular concerns about the vulnerability of people who fail to engage, and the consequences of making the wrong decision, which we have used as the basis for our own "eight point plan" for making a success of the reforms. This highlights several issues, including:

- the lack of safeguards – although we are pleased the Financial Conduct Authority has agreed to introduce a second line of defence, there is still more that needs to be done – for example we need to see mechanisms introduced that help people budget and prevent them running out of money.
- the need for suitable defaults – people who do not engage risk losing out substantially without the right defaults. More work needs to be done to establish what these should look like.
- protecting people from scams – even before the reforms, £495 million has been lost in total to pension scams. We recommend nominating a strong lead agency to act quickly and robustly in response to emerging scams.

Against this backdrop, products offering certainty, such as annuities, still have an important role to play. The challenge now, as the market develops post-reform, must be to ensure that innovation works in the consumer's interests, with a focus on good value. This has not always been the case in the past, and regulators will need to be proactive in forestalling problems.

These challenges also highlight the need for information and advice. The Pension wise service is a vital part of the landscape, but it will need to be broad enough to encompass related issues such as debt, carrying on working, tax and planning ahead for the cost of care. For example, people may need to consider whether to use pension savings to pay off debt – given that the Financial Conduct Authority has estimated that around 40,000 people a year may soon be retiring with unpaid interest-only mortgages.

It will also be vital that guidance is available when needed – which is unlikely to be just at retirement. Age UK would like to see a joined-up advice journey, with people offered advice mid-career, at retirement and then later on when they may be facing decisions about funding care.

However, guidance can only go so far – people will not be obliged to take it up. Our main test for the pension reforms as a whole is that they must be capable of delivering a reasonable outcome for disengaged pension savers. The final piece in the retirement jigsaw must be to look at how we can frame people's choices and use defaults to prevent significantly adverse financial outcomes.

Tom Wright CBE, Group Chief Executive, Age UK

Paul Cox
New options, new appetite for risk?

As pension providers position themselves to serve a new market, now is a good time to consider what consumers close to or at retirement say their appetite is for taking investment risk, and what this might mean for the way solutions are designed and communicated.

Recent ABI data shows that sales of lifetime annuities by savers in DC schemes are some 40 per cent lower than the year before. This suggests that consumers are already thinking about alternatives beyond the traditional 25 per cent of their pot as tax-free cash and three-quarters used to buy a lifetime annuity.

The market is now in a period of considerable flux. Yet according to the evidence, if you ask savers in DC schemes age 55 and over to mentally trade-off investment return potential with investment risk taken, more than half say they want to take no investment risk. This would seem to suggest at least some savers needs are being met by the features of traditional arrangements.

Fewer than a third say they are willing to take some risk, and for those savers who said yes to taking some risk, it seems that what they have in mind when they hear the terms 'some', 'medium', and 'middle' risk, is a modest chance of loss with some chance of modest gain.

In other words, when the average saver hears the term 'medium risk', they may actually mean low investment risk. Overall, we can say that in research offering a simple trade-off of investment risk for potential investment outcome, there is most demand for a no investment risk product and some demand for a low investment risk product.

Research on attitudes is one dimension, but what about behaviour? Quantitative analysis of member record data from a sample of DC schemes during the financial crisis found that almost half of low and middle income savers who were continuously employed and contributing took some form of action, from switching funds to ceasing contributions. This seems to indicate that periods of high investment volatility and significant drops in market value can change consumer behaviour. This could well have implications for at-retirement product design.

Of course, when consumers actually choose a product, they are likely to weigh several product features – price, cost, potential investment return, and level of investment protection, among others. Recent research examines these more practical everyday decision-making situations by looking at how different product features interact and the correlations among them.

When consumers are asked to weigh several product features, there's still significant consumer demand for a retirement product with very high investment protection of capital. In this more real setting there's also significant demand for taking some risk. It seems that many savers are attracted to better potential investment outcomes and for this some uncertainty of outcome is willing to be tolerated, within a product that offers good value for money.

Overall then, the research suggests that the retirement products savers would like to see are those with no investment risk and one with a modest amount of investment risk, where the level of investment certainty is high but less than 100 per cent. These type of features and how they are communicated are just some factors that those responsible for designing products post-April may need to bear in mind.

Paul Cox, Senior Lecturer in finance, University of Birmingham
Investment Adviser, NEST

The retirement challenge: UK and international comparisons*

Analysis by the Pensions Policy Institute

	United Kingdom	Australia	United States	New Zealand
Life expectancy at 65 years old (years)	19.3	20.8	19.2	19.9
Average DC pension at retirement (£s)	£20,000	£21,875	£99,721	£5,000-£7,500
Proportion of population over 65 years old as a percentage of working population	29%	23%	23%	23%
Value of basic state pension / social security for adult male (without age or disability additions) (2014)	£113.10	£202.26	£407.65	£207.76
Median gross replacement rate from public (state) and private pensions (2013) (male/female)[3]	37.9% / 37.9%	60.2% / 55.8%	41% / 41%	50.1% / 50.1%
Average time spent in retirement (male/female)	21/21	21/23	19/19	18/19

Fig. 1: UK life expectancy at age 65 for men and women 1911 - 2010

(Source: ONS)

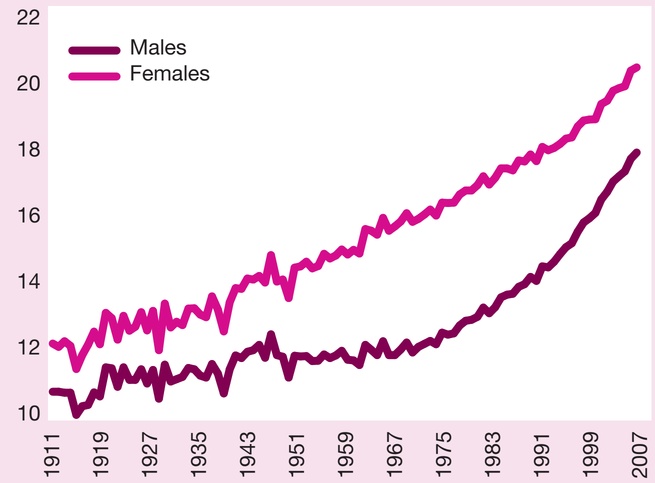


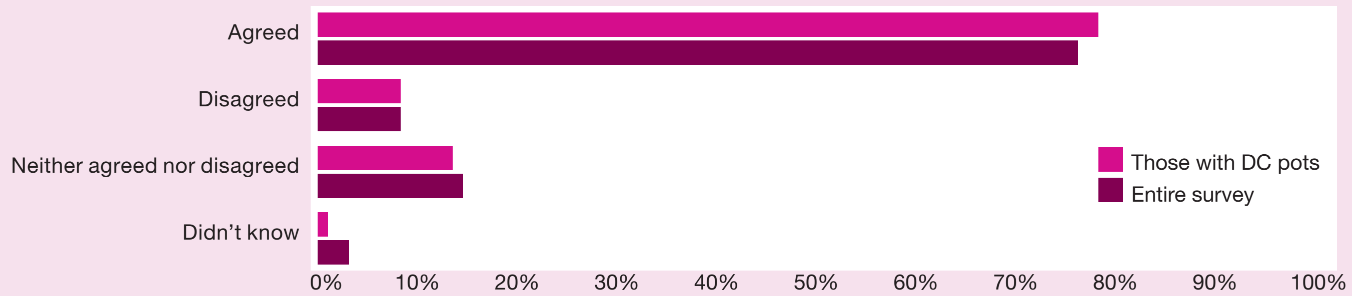
Fig. 2: How much money per month do you need to have the lifestyle you want in retirement?

(Source: Based on quantitative survey of 1,000 people aged 55+, May 2014. Quotas set on size of private pension pot, age, gender and geography)

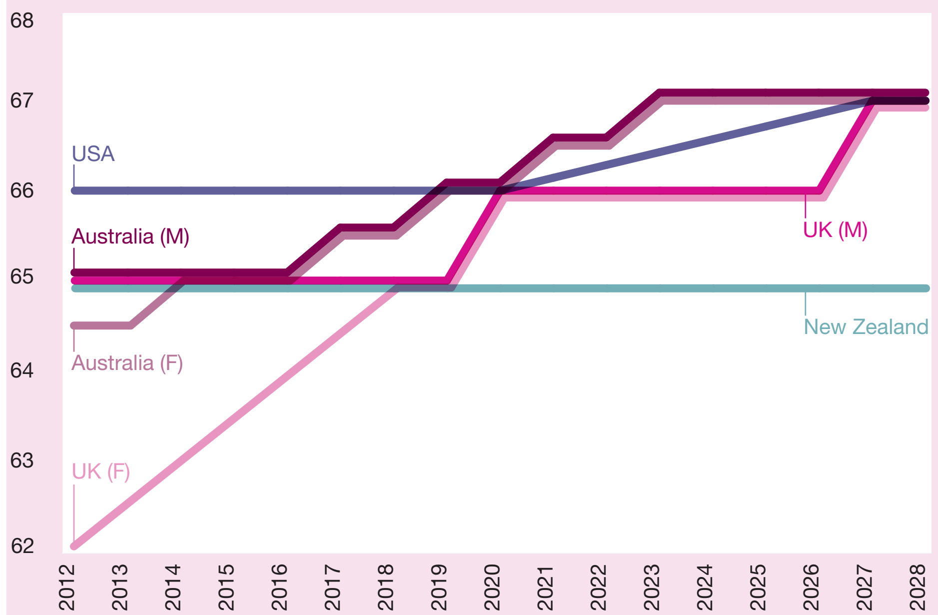
Pension pot size	Required[1]	Years lasted[2]	Actual[3]	Difference
Sub £20k	£1,964	20	£834	-£1,130
(Don't know)	38.70%	60.50%	52.80%	
£21k - £50k	£1,771	30.87	£1,178	-£593
(Don't know)	25.00%	59.60%	49.00%	
£51 - £100k	£1,614	27.86	£1,852	£238
(Don't know)	10%	50%	45.60%	
£100k +	£2,257	32.1	£2,641	£384
(Don't know)	17.40%	21.20%	2.80%	
Whole sample	£1,875	23.3	£1,467	£408
(Don't know)	27.10%	53%	46%	

Fig. 3: Preference for security of income in retirement

"I would prefer a secure guaranteed income in retirement over an income that might rise or fall depending on returns in financial markets. (Source: ILC-UK, Making the system fit for purpose (2015). Based on representative survey of 5,000 people aged 55-70 yet to retire or draw on their private pension wealth)



Projected state pension ages



1 Respondent's designated value'
2 Respondent estimate for years pension funds will last at nominated withdrawal rate.
3 Respondent's estimate of likely achievable income

*
Life expectancy at 65 years old: OECD (2013), Pensions at a Glance 2013
Average DC pension at retirement: ABI (2013) The UK Annuity Market: facts and figures; ASFA (2014) An update on the level and distribution of retirement savings; PPI source from EBRI, data from savers with 401(k) or IRAs; New Zealand Inland Revenue (2013) KiwiSaver Evaluation: Annual Report July 2012 to June 2013
Proportion of population over 65 years old as a percentage of working population: OECD (2013), Pensions at a Glance 2013
Value of basic state pension / social security for adult male (without age or disability additions) (2014): www.gov.uk; www.humanservices.gov.au; faq.ssa.gov; www.workandincome.govt.nz
Median gross replacement rate from public (state) and private pensions (2013) (male/female): OECD (2013), Pensions at a Glance 2013
Average time spent in retirement (male/female): OECD (2013), Pensions at a Glance 2013. Calculation based on assumption that people don't die before age 65. Life expectancies are average for men and women, though ages of leaving the labour market are separated by gender.

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ISBN number: 978-1-909505-53-7