PPI / J.P Morgan Asset Management Round Table discussion: Adequacy under the new pension flexibilities

The Pensions Policy Institute (PPI) held a Round Table discussion, hosted by J.P. Morgan, on 9 July 2015 to discuss the draft of its Briefing Note *Measuring adequacy under the new flexibilities.* The event was arranged following the introduction of the new pension flexibilities and concerns around how replacement rates might interact with debt in particular. The following individuals participated in the Round Table.

Present: Chris Parrott (Heathrow Airport Holdings Limited), Christine Jackson (ITV), Magdalena Rzepecka Kennedy(RPMI), Sally West (Age UK), David Bateman (DWP), Simon Chinnery (JP Morgan Asset Management), Andy Seed (JP Morgan Asset Management), Charlotte Jackson (TPAS), David Berenbaum (TPAS), Joseph Surtees (StepChange).

Present from PPI: Chris Curry, Melissa Echalier

Simon Chinnery welcomed the invitees.

Chris Curry explained that the discussion would take place under the Chatham House Rule and Melissa Echalier explained the main findings from the PPI briefing note:

- Adequacy to date has been measured in two ways; to what extent retirement income allows individuals to fulfil their basic needs or to replicate their standard of living working life. The briefing note focuses on replacement rates.
- Replacement rates are defined as the ratio of retirement income to working life earnings. The periods over which these earnings are measured makes a difference to the ratio.
- Issues around the use of replacement rates include the definitions of 'earnings' and retirement income, how part-time or other employment patterns can be accommodated, and how debt should be accounted for.
- Questions for the round table attendees include what role replacement rates should play in the new world of pension flexibilities and what changes might need to be made to the definition of 'replacement rates'.

Questions and comments on briefing note

It was noted that replacement rates can be used in different ways; to demonstrate to an individual what they might aim for and to measure, at the population level, whether people are at risk of having insufficient retirement incomes.

It was suggested that replacement rates can be problematic because they are not meaningful to individuals. In addition, the concept of replacement rates is not aligned with other approaches to what income individuals require, such as the National Living Wage.

It was also pointed out that expenditure can be 'lumpy' while replacement rates provide for a flat rate of income and that this can represent a mismatch between the replacement rate approach and individuals' expenditure in retirement. At the same time, other group members emphasised the fact that many sources of expenditure in retirement are more regular expenses.

General discussion

What does adequacy look like

CC explained that the Pensions Commission based replacement rates on what individuals in 2003 had rather than what they aspired to.

Group members asked how the regulators defined good member outcomes, and the need to know what 'good' is was outlined. It was suggested that a baseline income measure could be useful for trustees.

The minimum income standard considers the absolute minimum rather than a minimum that will enable people to have an enjoyable retirement. There was reference to two pieces of research conducted by Barclays and NEST respectively that consider this question.

This type of research reaches a conclusion around what might be a modest but adequate income in retirement. The approach informing this type of standard asks retired individuals about their level of income in retirement, and how well they are managing on this income. The group welcomed this approach as being useful in identifying an anchor that individuals can focus on.

There was a question around whether this issue should be considered at the level of the individual or the couple.

Looking at retirement income in a more positive light
It was pointed out that individuals are positive about retirement although they may not be positive about being a pensioner. The need for a more positive approach where individuals focus on the positive things that they would like to do with their income was suggested.

Role of approaches based on behavioural economics
Pension scheme representatives pointed out that their members do not like to be lectured and this approach does not result in increased saving. They argued that, at the same time, individuals like to know what other people are doing; this could be a possible avenue to be explored as a way of encouraging pension saving.

There was discussion around auto-escalation in the US – it was pointed out that it tends to be people who are in the pension scheme in the first place who sign up and it is rare that someone signs up for auto-escalation when they start contributing to the pension.

Linking retirement income decisions to event triggers
It was suggested that dates (or reaching a particular age) are not significant to individuals and may not prompt them to make decisions around their retirement savings. It was concluded, as a result, that linking retirement savings to events might be a more effective way to prompt individuals to make decisions.

Tendency to consider pension wealth separately to other wealth
There was some critique of the tendency of the replacement rate approach as well as the more general discourse to consider pension wealth separately to other sources of wealth in retirement. There was recognition of the need for individuals to consider all of their sources of income and wealth together, particular where individuals are at risk of forgetting that they have certain assets. It was asked whether Pension Wise asks people about other sources of income and wealth, and it was confirmed that they do so.

Concerns around individuals' behaviour and understanding
Concerns around the following were raised:

- It was suggested that individuals tend to take action too late, with individuals asking what they should do when their ability to act is already compromised
- Individuals do not understand the impact of inflation, with the fact that retired people have their own separate inflation rate compounding this
- Individuals do not understand for how long they might live

- There is an issue around people not becoming sufficiently interested in pensions along with a tendency to procrastinate; e.g. 50% of people with problem debt waited for over a year before seeking help

Making talk about retirement income 'normal'
It was suggested that any talk about retirement income would be made part of normal conversation. While it was not clear how this might happen, the following points were made:

- If any savings or income benchmarks that are used are not achievable this is likely to put people off from engaging with the issue
- A straightforward question such as 'Have you got enough' might be a straightforward way to communicate with DC savers

Whether debt will become more prevalent as a result of the pension freedoms
It was pointed out that the freedoms may lead to individuals collateralising their debt against their future DC pots, with the risk that this will have a negative impact on the retirement income available to them.

There was a discussion around whether individuals should be able to access their pension pots before the age of 55. There was consideration of the US system where individuals are able to access their pension pots early and it was suggested that individuals never recover what they would have saved where they borrow against their pension pots during their working life.

At the same time, it was emphasised that some debt is due to low income or income shocks – and is not predicated on understanding around wealth or income in the future

Other issues
The tendency for some individuals to want to take money to give to their children was observed. In addition, issues of scams and financial elder were raised.