PPI Transitions to Retirement Series policy seminar: How might the UK pensions landscape evolve to support more flexible retirements?

The Pensions Policy Institute (PPI) held a policy seminar on 23 April 2015 to launch its most recent report in the Transitions to Retirement series. *How might the UK pensions landscape evolve to support more flexible retirements?* was sponsored by The Investment Association and The People's Pension.

The Transitions to Retirement Research is a series of reports exploring the complexity of decision making for savers in Defined Contribution (DC) pension schemes at retirement, the scope for innovation in developing flexible retirement income solutions in the UK, and the implications of the new Budget freedoms for providing defaults and improving member engagement and communications. The PPI's Transitions to Retirement research series is being sponsored by Age UK, Fidelity, The Investment Association, Partnership, The Pensions Advisory Service, The People's Pension, The Pensions Regulator and State Street Global Advisors.

This report used international evidence as a basis for exploring how the UK pensions and retirement income system might evolve; considered in the context of changes in the retirement landscape, particularly the new flexibilities announced in the 2014 Budget.

Chris Curry, PPI Director, chaired the seminar, welcomed attendees and made introductions.

Melissa Echalier, PPI Senior Policy Researcher, and **Sarah Luheshi, PPI, Deputy Director,** presented the findings of the Research.

Chris Curry posed the following two questions to the panellists:

1. What are the implications of the research findings for the evolution of the UK pension landscape?
2. What other policy or regulatory changes should be introduced?

Jonathan Lipkin, Director of Public Policy, The Investment Association, made the following points:

- A key point that needs to be kept in mind is that individuals do not behave in ways that economic theory would imply they will or ought to. This is good news for automatic enrolment and indicates that as inertia is playing a major role, policies such as auto-escalation, automatic investments and other defaults designed in the best interest of consumers are likely to be accepted by consumers operating under this principle. But the challenges for the industry are: what should defaults look like, particularly for retirement income? And what is the provider's role and responsibility in responding to the new freedoms? Academic research has suggested that a strategy involving drawdown and phased annuitisation could be a possible default for meeting people's needs for growth and risk-protection.

- Jonathan noted that one factor behind both the US and Australian preference for drawdown over annuities may have been a backdrop of strong equity market performance. Given market conditions seen from the UK, it was perhaps a positive that the current debate is taking place in both realistic and sober tones about risks as much is at stake.

- Jonathan made the point that there needs to be clarity around advice and guidance as well as a focus on robust design of products and strategies, with transparency of charging structures. He said that data quality in DC markets needs to improve if we are to have evidence-based policy. He urged that we accelerate the process of bringing together a platform for people to view all of their pension entitlements in once place.

Darren Philp, Head of Policy, The People's Pension, made the following points:

- It's always difficult to compare across borders because each country provides such different contexts. Darren highlighted some of the differences which were affecting the way private pensions policy impacted individual decisions:
  - In Australia, the state pension is means-tested, and therefore designed to be a safeguard. However, as a result of this, people are motivated to spend down their savings, in order to qualify for the pension in later retirement.
  - New Zealand's state pension is universal and very generous. This encourages people to make personalised decisions about what to do with their private pension savings.
  - The US system of state provision is minimal and encourages people to ensure that they are providing for themselves.

  He pointed out that the NHS and provision of free health care makes a substantial difference to the decisions people make about how to use their private pension savings in the UK and how these decisions differ from those that people make in other countries. He concluded that while we could learn a lot from experiences in other countries, it was problematic to apply these to the UK. He also made the point that defaults would be very important going forward and that the DC market already had the tools to ensure these were appropriately designed and delivered.

- Darren commented that policy making in Freedom & Choice had been far from ideal and was lacking in analysis and evidence. He stressed that pensions policy-making required more use of analysis and evidence and less tinkering. He predicted that the pendulum would in all likelihood swing back at some point towards more restriction on how people can use their pension savings, once politicians react to trends that have developed. He expressed a desire that this reaction should involve considered, joined-up policy which included the regulator. He asked what the Government's "pensions narrative" was.

Steve Groves, Chief Executive Officer, Partnership, made the following points:

- It is important not to forget the purpose of pensions which is to provide a secure income in retirement. Looking at other countries highlights that people are not investing securely overseas, and as a result they are running out of money in retirement. In particular, people are using private pension savings to pay off debts; might that be what will happen in the UK? Will pensions in fact become a new type of credit, providing a tax-incentivised way to pay off debts accumulated during working life? Other countries provide a useful context for exploring the UK. Ireland appears to have the closest policy profile to the UK while the US and Australia appear to be moving in the opposite direction and restricting freedoms. It is critical that UK politicians observe developing trends in other countries and make policy amendments where necessary. He expressed concern that we are losing sight of the purpose of pensions.

- Steve felt that there should be two changes to regulation. Firstly, we could take a closer look at the debate around whether or not there should be an independent Commission to take pensions out of the political system, or whether we simply need a long-term consistent narrative, to ensure stability in the pensions system. This would also address the risk that politicians seek to favour the motivated "grey vote" at the expense of the "dis-engaged young" who will ironically have to meet the debts of the old Secondly, it is essential that a simple online advice service is on offer. The current regulatory system does not provide an option which enables the many to get good outcomes at low cost. Those who pay for regulated financial advice tend to get the best outcomes. A simple online advice service would provide an affordable third way and prevent the vast majority from getting poor retirement outcomes.

The following points were raised during the questions and discussion section. They do not necessarily reflect the views of the PPI or the PPI seminar speakers.

- There are three main motivations for the of use private pension savings: need to repay debt; need to top up state pension income; or desire to leave an inheritance. The strength and nature of these motivations are likely to differ between people on the basis of wealth. The question was put as to whether it is fair that wealthier people are in effect benefiting from subsidies which aid them to leave an inheritance while less well-off people do not have this option? It was suggested that that people with less wealth may also wish to leave bequests and that appropriate products must be made available to help them to do this.

- There is still no consensus on what good outcomes look like as it is still not decided how best to strike the balance between allowing people freedom and helping them to do what is in their best interest. However, the definition of good outcomes hasn't changed from what it was before Freedom & Choice was announced.

- People do not "have a clue" what to do with their pension savings because they do not understand investments, taxes, benefits and the implications of all of these. Who will be blamed when the system goes awry? Several attendees responded by saying that industry would no doubt get blamed. The point was made that blame in fact lay with the politicians who had introduced the new freedoms, a radical policy, with very little planning or consultation (in contrast to automatic enrolment which took 10 years from conception to implementation.) Much of the problem arises from the complexity of the UK system and guidance and advice will play a key role in helping people. International examples of guidance and advice systems might be very helpful.

- Development must take place which allows for people to access the right product for their needs at the right time. Old defaults, such as annuitisation at a certain age, are no longer sustainable. It was pointed out that purchasing an annuity and then living for 20 years could yield negative results if interest rates are poor. A discussion needs to take place exploring these issues; gradual drawdown coupled with an annuity would probably make sense for many people. There is still a market for annuitisation but that perhaps it must be called by a different name now. Appetite is certainly low for annuitising in early retirement, people are reluctant to pay over a lump sum, but annuitising later to ensure against ill-health or long life is still attractive. We need to focus on strategies, rather than products.

- Guarantees are very expensive and perhaps it may make more sense to focus the discussion around a steady income in retirement. Is a steady income needed above the level required for "heating and eating" or would some steady income to meet basic needs plus a level of flexible income be more desirable? Guarantees are difficult to provide along with all of the other characteristics that consumers want such as liquidity, growth and protection.

- There is evidence that people are already cashing in small private pension saving pots in order to pay off debts. Allowing free access sends the message that building up debt is fine and could provide a round-about way of accessing pensions early. Debt for the current generation is on the increase as a result of the difficulty young people are experiencing purchasing a home at younger ages (which could lead to people being less able to pay off their mortgages before they retire.) In Australia, three times more retirees are approaching retirement with mortgage debt than there were before similar freedoms were introduced there. A burden may be shifted on to younger generations who might have to take financial care of their parents after the parents have spent all their pension savings.

- The was some discussion around the merits of setting up a new pensions commission, it was suggested that the industry write to the Government requesting one be set up before any further policy is made. A pensions commission might be a good idea but you can't "take the politics out of pensions". On pensions decisions, cross-party consensus is important as well as evidence-based policy. Are there any decisions left for a pensions commission to take? There may be scope for a commission to help provide trustees with a safe harbour (as in the US) which would allow them to take a more interventionist stance with advising employees.

- The FCA should be responsible for monitoring withdrawals under freedom and choice, rather than HMRC. What role will the regulator play in monitoring any new defaults that arise? The regulator is likely to take a more interventionist role in future.