How might the UK pensions landscape evolve to support more flexible retirements?

Pensions Policy Institute

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The event kindly hosted by J.P.Morgan Asset Management

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Purpose and approach

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- To explore how the UK pension system might evolve under the new Budget freedoms
- Approach:
  - Evidence from liberalised, mature or maturing DC markets
  - Input from:
    - Pension specialists
    - Interviews with asset managers with a presence in US and Australia

Overview of four countries' pension systems

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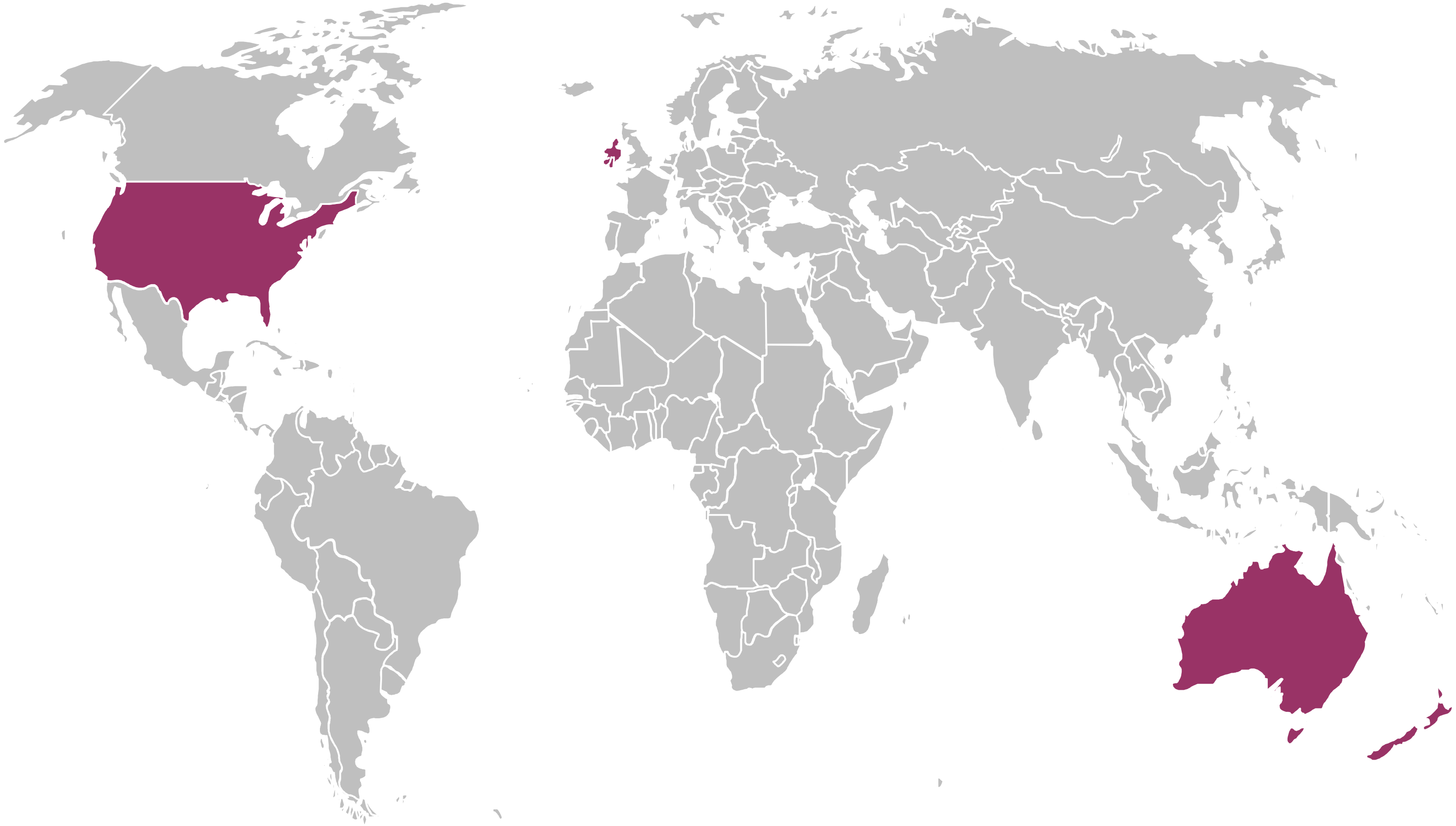

After April 2015, the UK will have less rules around the decumulation phase

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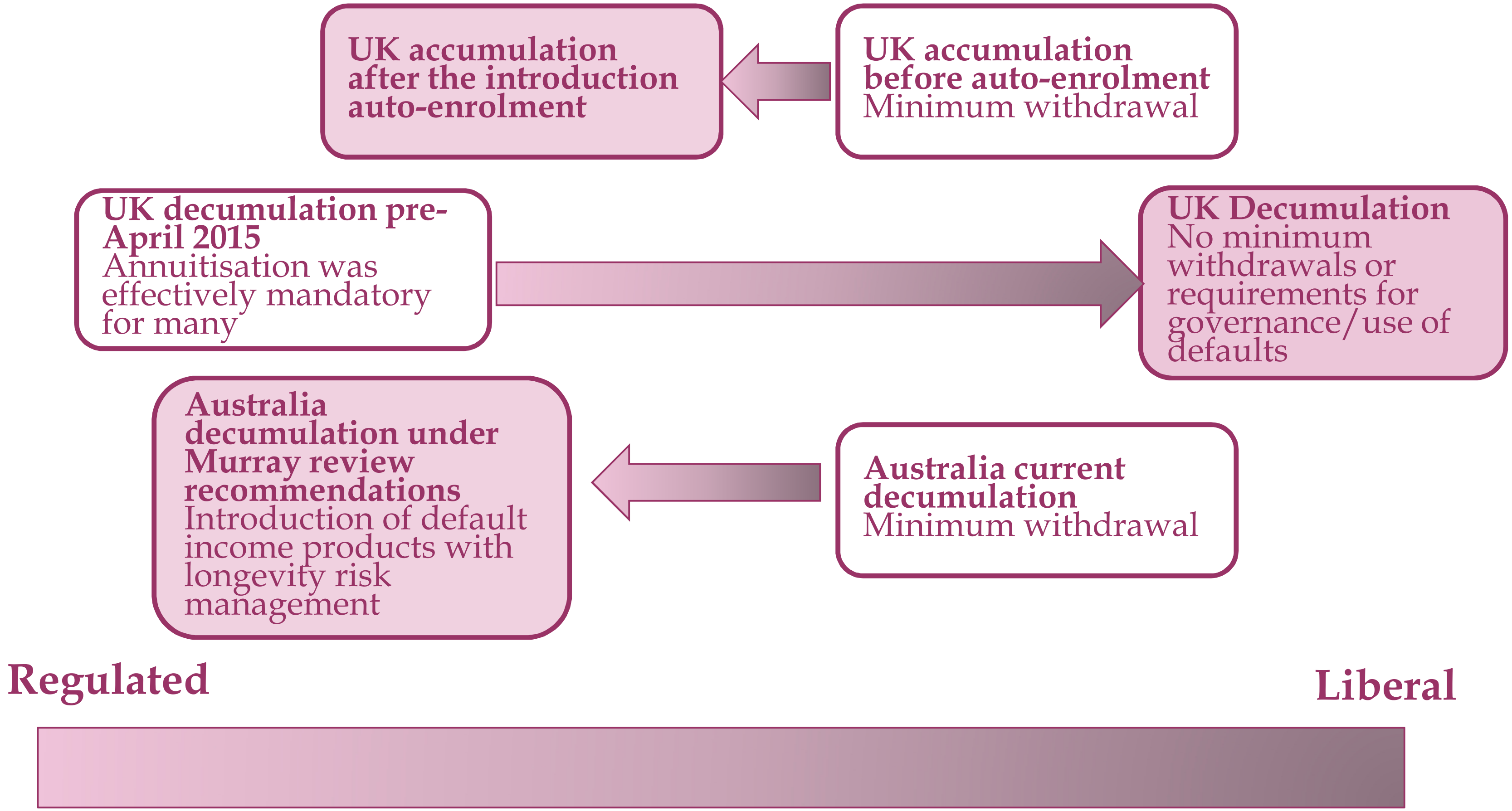
Direction of travel for regulation of decumulation in the UK and Australia and accumulation in the UK



Overview of pension systems

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	Type of state pension	Median DC pension pot	Ways in which funds are accessed
Australia	Means-tested	A$150,321 (£77,565)	54% lump sums, 46% - drawdown
Ireland	Flat-rate contribution based	No figures available	Individuals opt for drawdown where possible
New Zealand	Flat-rate residency based	NZ$10,500 – 15,000 (£5,352 - £7,645)	Lump sum or gradually withdrawn
United Kingdom	Flat-rate contribution based	£19,400	Lump sum and annuitisation until April 2014
US	Earnings-related	IRA balance $49,899 (£33,915)	Frequently retained in scheme and drawndown

The UK state pension is low relative to the others under consideration

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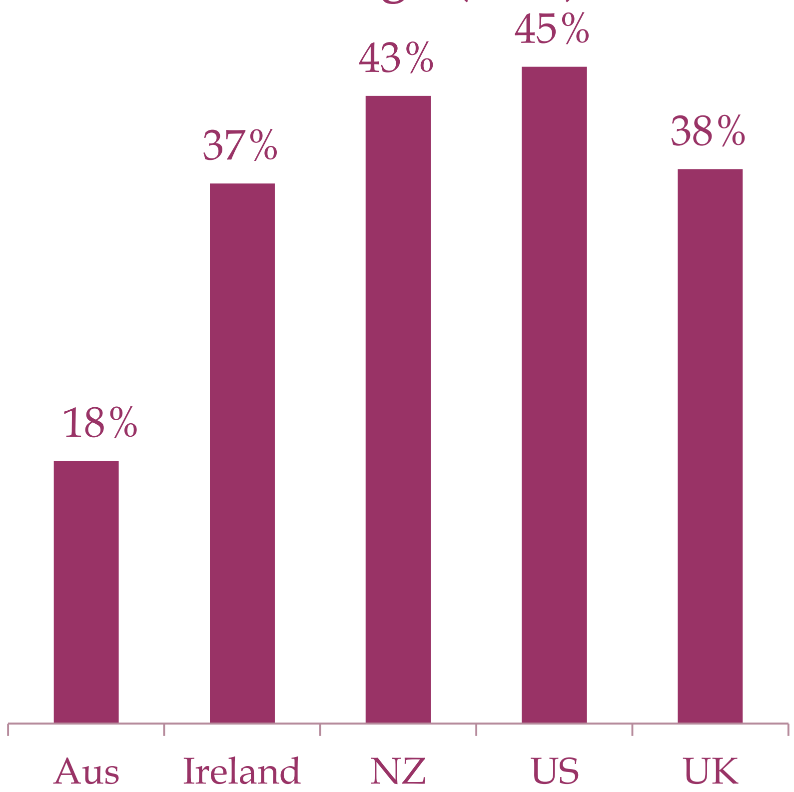
State underpin as percentage of average worker earnings (2013)

Average net pension replacement rate as percentage of average worker earnings (2013)



Source: OECD

Comparisons with other countries suggest some possibilities for the UK

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- The low level of the UK State Pension suggests that, relative to other countries, individuals will typically require another source of regular income
- The absence of healthcare costs in later life in the UK may remove one of the barriers to conversion of pensions savings to a regular income during retirement
- Tiered tax rates in the UK mean that it is likely to be advantageous to withdraw pensions gradually over a number of years to avoid paying higher levels of tax, unlike Australia and New Zealand

The actual behaviour of DC savers overseas provides some insight around the UK direction of travel

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- Annuities are available in the US and Australia, but are not popular, however, drawdown is
- The use of drawdown products without longevity insurance can lead to some individuals accessing their resources too quickly, or too slowly
- The use of pension pots to repay debt has been observed in other countries. The relatively high rates of personal debt in the UK suggest that using DC savings to pay off personal debt may be popular
- 'Rules of thumb' provide insight and some guidance, although are not generally played out in reality

The UK has a good framework for managing risk when approaching retirement

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- The US has generally made less use of de-risking strategies; target date funds (TDF) tend to be used more by younger cohorts and workplace schemes
- Evidence indicates that in Australia there is little or no change to an investment strategy as an individual transitions from the accumulation to decummulation phase
- The UK has a strong history of de-risking towards retirement especially using lifestyle and TDFs. Some asset allocation changes have occurred as a result of the pension freedoms but significant challenges remain

The UK is more annuity friendly

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- UK Individuals and organisations are used to framing retirement decisions in terms of the purchasing power of a regular income rather than the possibility of losing the whole pension pot on death or as investment returns
- Annuities are already widely available in the UK, including a sophisticated market for underwritten annuities which take into account lifestyle and health conditions
- The UK tax and regulatory framework does not discourage annuitisation

Some barriers, however, are present in the UK; including loss aversion and the bequest motive

Conclusions

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- Strong reason to expect that there will be more use of a guaranteed income product in the UK than in other markets
- UK changes to regulations have focused on standards for guidance providers; other countries' experience suggests further regulations may be considered, especially as issues arise
- While some UK asset managers and pension providers have made alterations to asset mixes there is currently no single approach or default
- In the absence of defaults in the UK, there is a question around the emergence and use of suitable 'rules of thumb'

Question for the panel

What are the implications of the research findings for the evolution of the UK pension landscape?

Jonathan Lipkin

Director, Public Policy

The Investment Association

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The People's Pension

the people's pension

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Question and discussion

What are the implications of the research findings for the evolution of the UK pension landscape?

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Question for the panel

What other policy or regulatory changes should be introduced?

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Question and discussion

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Questions and discussion