Institute and Faculty of Actuaries

AEGON Transform Tomorrow

Milliman

Pensions Freedom and Choice

What can we learn from Ireland's experience?

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Contents

Ireland - retirement options for DC

Pre 1999 Budget	1999 Budget
Tax free lump sum option – typically 25% Taxable lump sum option – taxed at marginal Options for taking trivial amounts. Annuitise the remainder.	ARF option introduced For some DC pension arrangements (“Executive pensions” & AVCs) Annuity requirement at retirement “broken”

Ireland – What is an ARF?

Approved Retirement Fund (as introduced in 1999):

- Investment fund - post retirement
- Tax free investment growth
- Flexible withdrawals – taxed as income
- Forms part of estate on death
- Some limitations on minimum income level needed / AMRF requirements
- Wider range of potential providers – insurers, stockbrokers, large distributors…

Ireland – initial expectations

Annuity market
would be decimated

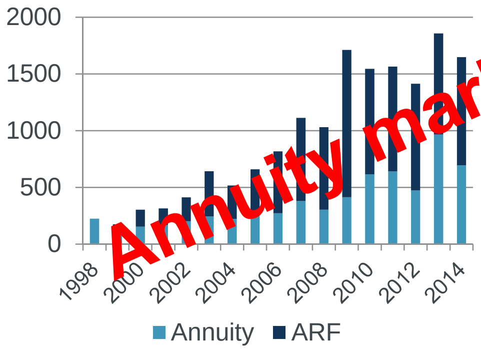
Some people with ARFs would
blow the money

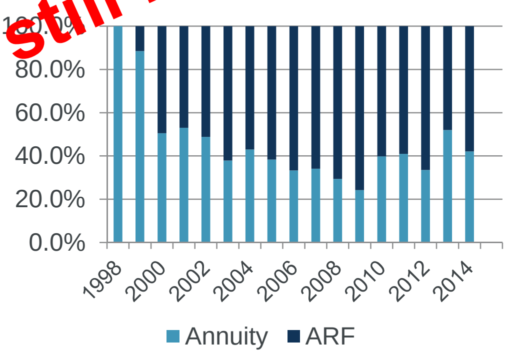
Bad news for insurers –
retirement option monopoly broken?

Ireland – Consequences for annuity market

- Traditional annuity sales instantly fell instantly to 50% of at retirement sales
  - then declined to as low as 25% of annual inflows to annuities/ARFs in 2009
  - however, total retirement income sales have grown strongly

Annuity market still relevant





Ireland – Consequences: blowing the money?

Did people blow their ARFs and run out of money?

- Quite the opposite!
- ARF became largely a wealth preservation / estate planning vehicle.
- Taxman concerned – no withdrawals = no tax revenue

Money not blown – taxman worried

Ireland – Consequences: bad for insurers?

Have insurers lost out to competitors?

- Hard to get figures for non-insurance ARFs
- Anecdotally some big individual cases, but small numbers in total
- Estimate that vast majority of the ARF market remains with insurers

Insurers doing well from ARF sales

Ireland – How have things settled down?

Small pots
Typically cash option being taken

ARFs
Now the default option for individuals at retirement

Tax man
Introduction of imputed distributions
Currently 4% to 6%
Tax paid annually even if no withdrawals are made.

Larger pots
Mostly ARF, mostly through insurers
Some annuitising still, but more limited
Some bigger ARFs through non-insurers

Annuity market
Has grown in absolute terms
c. 40% of total "post-retirement" market
But figures skewed by bulk annuities

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UK & Irish Market Similarities

	UK	Ireland
DB vc DC	Employer DB declining, DC becoming increasingly important.	Employer DB declining, DC becoming increasingly important.
Pensions tax basis	EET	EET
Income Tax relief on contributions	Full, up to Annual Allowance	Full, up to 15-40% of income based on age
Earliest retirement	Age 55	Age 60, except in special cases
Tax-free cash?	Yes, usually 25%	Yes, usually 25%, but depends on plan & TFC history. Max €200k.
Retirement income solutions	Traditional annuities, flexible annuities, UFPLS, drawdown, secure drawdown, blends	Traditional annuities, ARF, blend

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UK: Pre-6/4/2015 predictions on likely behaviours

Those with:

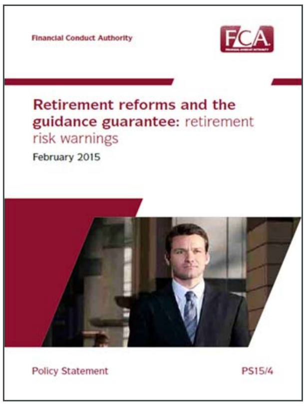
- small pots (<£15k): **cash in**
- larger pots but low wealth: **quick drawdown, minimising tax**
- larger pots and medium wealth: **combination of annuity, drawdown and other retirement income products**
- large pots and high wealth: **slow drawdown, other retirement income products including some annuities**

Pent-up demand suggesting a likely surge of activity at the earliest opportunity.

- those seeking out options vs those already decided

Retirement Risk Warnings (2nd Line of defence)

Introduced as additional consumer protection without consultation and within 6 weeks of pension freedoms coming into force


Financial Conduct Authority

FCA

Retirement reforms and the guidance guarantee: retirement risk warnings

February 2015

Policy Statement PS15/4

- Have you taken guidance from Pension Wise?
- Have you taken regulated advice from a financial adviser?
- Relevant questions asked to identify presence of risk factors, and risk warnings given, unless adviser is transacting claim

UK: What happened?

Association of British Insurers (April-June 2015)

£2.5bn
payments made to customers
(£1.3bn in cash lump sums with average pot size c.£15k)

72% reduction in annuity sales Q1 15 vs Q1 14 (20,600 vs 74,100 contracts)

£2.3bn used to buy income generating contracts

£1.3bn
in 19,600 drawdown contracts.
Av fund size: **£68k**
Changed provider: **55%**

£990m
in 17,800 annuity contracts.
Av fund size: **£55.6k**
Changed provider: **45%**

What happened?

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3,000
more calls than usual on first day of new tax year (+100%)

42% more calls in Apr 2015 vs Apr 2014 (+26% over yr to mid-Aug)

50% calls directly from policyholders (now 40%, normal level 30%)

175
new customer service recruits to support increased demand

Retirement settlements
up 400%
Proportions <£10k <£20k
56% 77%

43%
settled for cash
45%
triviality/small pots

What happened?

Types of callers:

Guidance and clarification

Desperate / insistent	Informed
Tempted / curious	Misinformed

How are savers exercising new freedoms?

69%
had taken entire pension pot as a cash lump sum
(average pot size £14,100)

26%
will hold the cash payout in a bank or building society account

Other uses:
- 18% on home improvements
- 16% to clear mortgage/debt
- 10% for holidays
- 9% for stocks & shares
- 7% for replacement cars

Risks:
- Pay too much tax
- Run out of money
- Poor rates of return

Source: Research by Harris Interactive for Royal London. 800 customers accessing freedoms May-Jul 2015

How are savers exercising new freedoms?

- On the whole, pretty rationally:
  - those with pots that can reasonably provide a lifetime income are still seeking ways to achieve that
  - those with smaller pots are seeking to improve their circumstances in the short term
- Concerns about people cashing in to buy high-end sports cars are wide of the mark
  - "*If people do buy a Lamborghini but know that they'll end up just living on the state pension, that becomes their choice*" **Steve Webb, Pensions Minister,** March 2014
  - At that end, the tax hit would be substantial
  - For the smaller pots being cashed in, replacement cars would be much more modest

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Options for retirement income…

Annuity	Cash	Drawdown	Secure drawdown
✓ Certainty of income	✓ Certainty of lump sum	✓ Flexible	✓ Certainty of income
✓ For life	✓ Spend how you like	✓ Real asset growth	✓ For life
✓ No investment risk	✓ No investment constraints	✓ Buy annuity later	✓ Income reviews
✓ Joint life / death benefits		✓ Death benefit	✓ Deferral bonus
			✓ Access
			✓ Death benefit

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and risks…

Annuity
- Irreversible?
- Inflexible
- Later life health issues
- Inflation erosion
- Early death

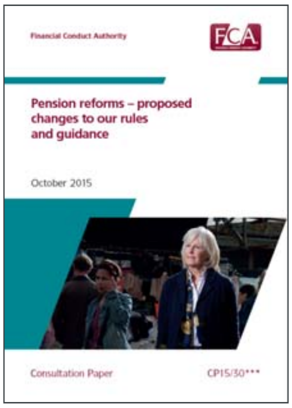
Cash
- Tax
- Unregulated investments
- Outliving investment

Drawdown
- Market risk
- Sequence of returns
- Outliving investment

Secure drawdown
- Additional cost
- Restricted fund choice

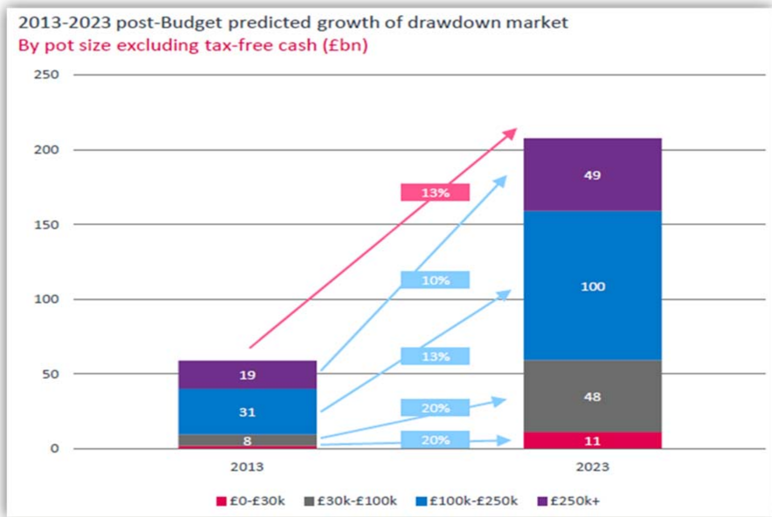
Further consultation (CP15/30)

FCA consults on further proposed changes to its rules around pension reform in light of experience over last 6 months



- Proposal to removing requirement to ask client questions to identify if risk factors are present:
  - if pot less than £10,000, and
  - no safeguarded benefits
- Still have to deliver relevant consumer risk warnings

Market predictions



Source: Spence Johnson Market Intelligence Report 2014

Market predictions

- Smaller pots will continue to be taken in cash
  - may be some issues with unexpected tax bills
- Drawdown market likely to grow strongly
  - for medium sized pots, drawdown may be for fairly rapid drawdown over a small number of years
- Annuities will grow slowly from their reduced base as the number and size of money purchase pots grow in future
- The secure/guaranteed drawdown market will grow steadily
- Blends of drawdown and guaranteed income solutions (annuities or secure drawdown) will be popular for larger pot sizes
- New solutions for cheaper, simplified advice for those with modest pots
- Growth in digital solutions (advised and non-advised options)

Conclusions

- Greater freedoms have been popular and are here to stay
- Actual experience has been largely in line with predictions
- Pension providers have been stretched but have generally coped well (retirement risk warnings incorporated successfully at short notice)
- Some unanswered questions remain over:
  - scope and take-up of guidance
  - degree to which unexpected tax liabilities may have been triggered
  - development of cost-effective personalised advice solutions for those with modest pots
  - regulation in relation to consumer protection (from themselves and from others)
- The market will continue to develop to provide advised and non-advised solutions, including simpler drawdown.