Institute and Faculty of Actuaries

# C2: What a Budget! Implications for the At-Retirement Market

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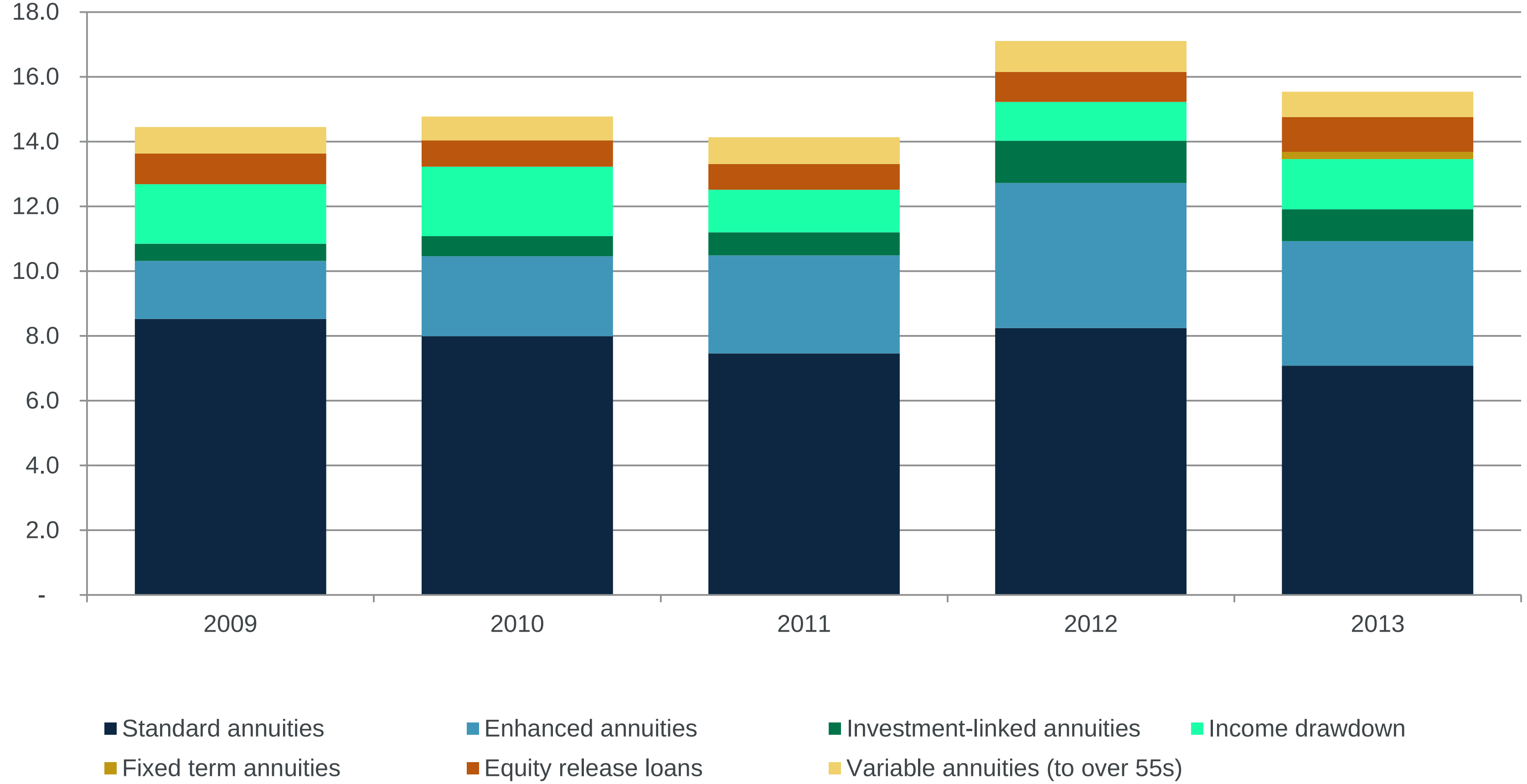
4 March 2015

# Retirement market was already evolving

**Chart shows premiums and equity release loans per annum (£bn)**



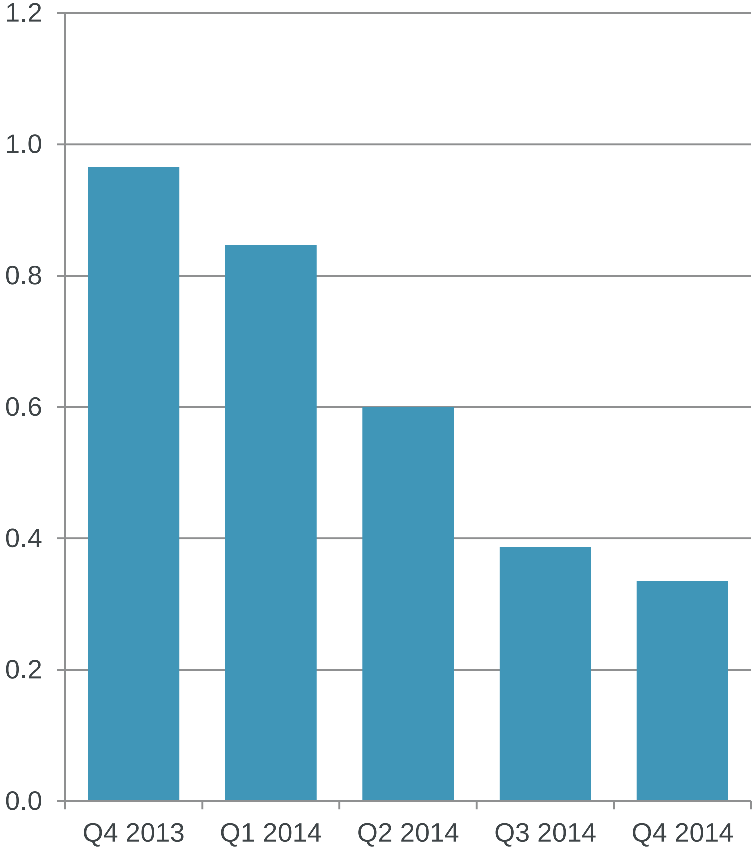

Source: Towers Watson analysis of ERC and ABI data (includes ABI members only) and Towers Watson variable annuity and enhanced annuity surveys.

# Budget announcement introduced greater flexibility

- From April 2015
  - DC pots can be withdrawn from age 55 subject to marginal rate of income tax (after lump sum)
  - DC pension holders to receive free and impartial guidance on retirement options
  - Minimum age to access pension pot will increase to 57 in 2028 and rise with the state pension afterwards
- Government consultation on changes including
  - Guidance
  - Whether (funded) DB to DC transfers should continue
- Interim measures until April 2015 - Drawdown limits relaxed and easier to take small pots as lump sums

# Recent impacts on retirement market

**Enhanced annuity premiums per quarter (£bn)**




Source: Towers Watson enhanced annuity survey, Press Release February 20, 2015

Standard Life UK annuity sales down **67%** in Q3 2014 relative to Q3 2013

*Q3 Interim Management Statement*
*29 October 2014*

The number of drawdown contracts sold by ABI members more than doubled compared to Q4 2013, with a reduced average pot size

ABI Press release
26 February 2015

# Subsequent key developments

**June:** Pension Schemes Bill introduced to Parliament

**August:** Draft Taxation of Pensions Bill

**September:** Removal of 55% tax on pension funds on death before 75

**Q1** Budget

**Q2** Initial Consultation

**Q3** Response and next steps

**Q4** Legislation progresses

**2015** Becomes law

**July:** Government responds to consultation and provides a Ministerial statement

FCA launches consultation on CP14/11: Retirement reforms and the guidance guarantee

**November:** FCA publishes PS14/17, giving near final standards for guidance providers

**December:** Taxation of Pensions Bill gets Royal Assent. FCA publishes interim report on Retirement Income market study

**January:** FCA publishes FG15/1: 'Retail Investment Advice' and "Dear CEO" letter. HMT unveils 'Pension wise'

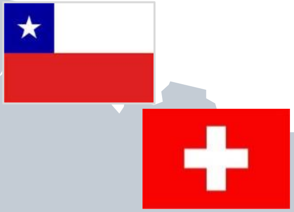
# What about guidance?

Pension wise
Your money. Your choice.

| | | |
|---|---|---|
| Design | HM Treasury | FCA Financial Conduct Authority |
| Deliver | The PENSIONS Advisory Service | HM Treasury | citizens advice bureau |
| Engage | ABI | NAPF Securing the future of pensions | Association of Professional Financial Advisers (APFA) |

**Education** — **Guidance** — **Advice**

# Selected overseas retirement markets

| |  |  |  |  |
|---|---|---|---|---|
| **Workplace retirement savings** | **Voluntary** | **Mandatory** | **Voluntary** | **Mandatory** |
| **Implicit default** | **Withdrawal** | **Withdrawal** | **Semi-active choice** | |
| **Proportion taking annuities** | **<10%** | **<10%** | **66% medium pots** | **70%-80%** |

# What factors will affect the UK market?

Government

State benefits

Default option

Culture

“Good value„

Customer engagement

Guarantees

# Pre-retirement decisions affect post-retirement outcomes

**Base assumptions:**

- Individual saves from 25 and retires at 65
- 5% contribution rates at all years
- Starting salary £20k, salary inflation 2%
- 3% pa investment return

| Scenario | Pot size at retirement | Versus Base (%) |
|---|---|---|
| Base | £114k | |
| 1. Start 10 years later | £82k | (28)% |
| 2. As Base, increase contributions to 8% at 35 | £163k | +42% |
| 3. As 2, increase contributions to 11% at 45 | £195k | +71% |
| 4. As Base, investment returns up to 4% | £143k | +25% |

# Auto-enrolment gets more people saving

**85-90%**
enrolled to date

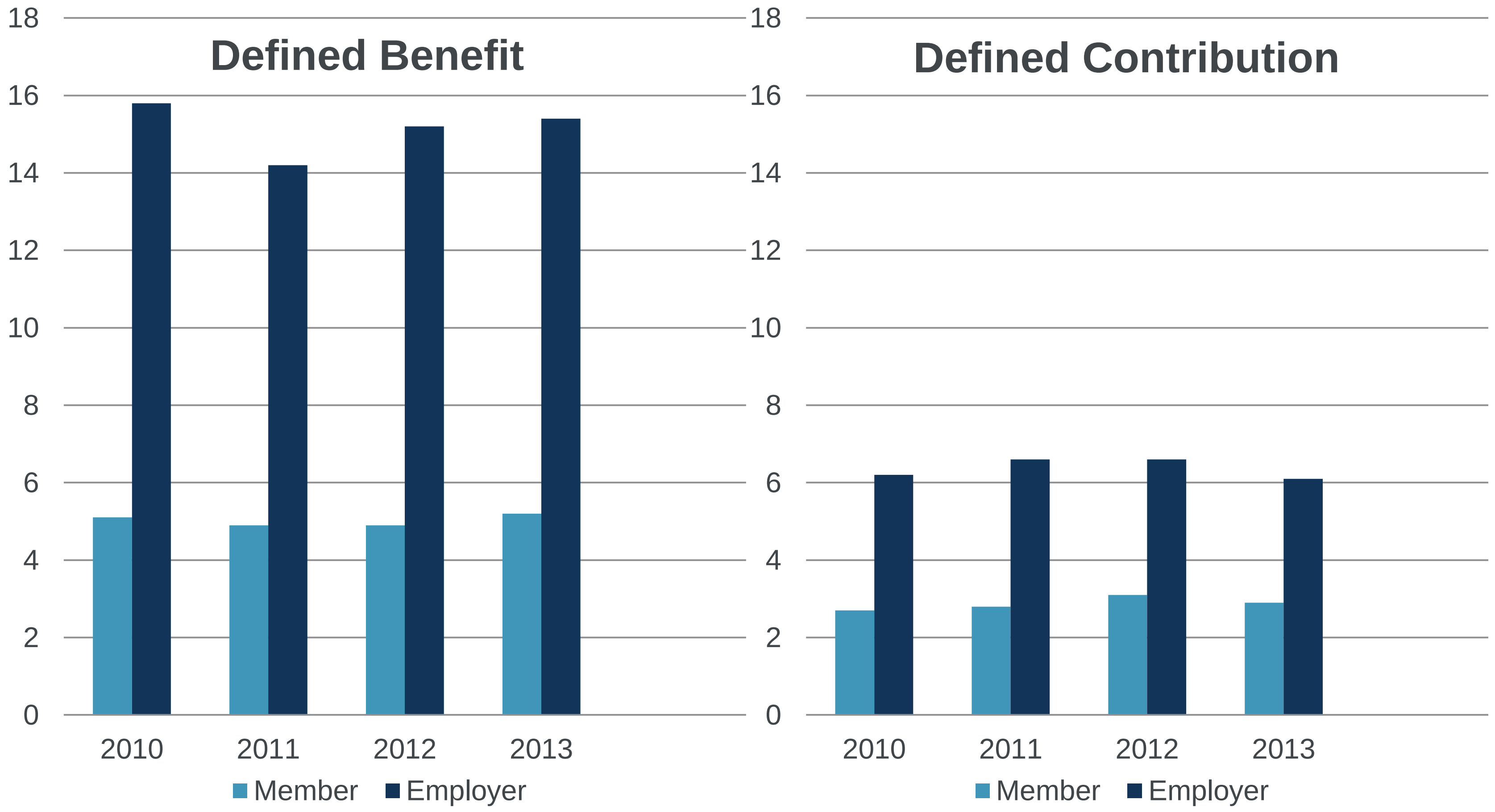
**7m in 5 yrs**
new savers

Minimum contributions increasing

| 2% | 5% | 8% |
| --- | --- | --- |
| now | 2017 | 2018 + |

*Sources: Pensions Policy Institute automatic enrolment report (July 2014);*
*DWP automatic enrolment opt out rates report (November 2014)*

# Contribution rates to private sector pension schemes (%)
## Source: 2013 Occupational Pension Scheme Survey, ONS



# Keeping customer engagement simple

**STEP 01** — **Contribute as soon as you can**

- **Start to:** Understand savings options
- **Start to:** Save for your future
- **Start to:** Save something

**STEP 02** — **Regularly check your investments**

- **Start to:** Focus on a target 'pot'
- **Continue to:** Contribute and learn about savings options
- **Focus on:** Building up your savings

**STEP 03** — **Make a plan**

- **Start to:** Check your 'pot' and make the most of guidance and tools
- **Continue to:** Make contributions and learn about options
- **Focus on:** Future options

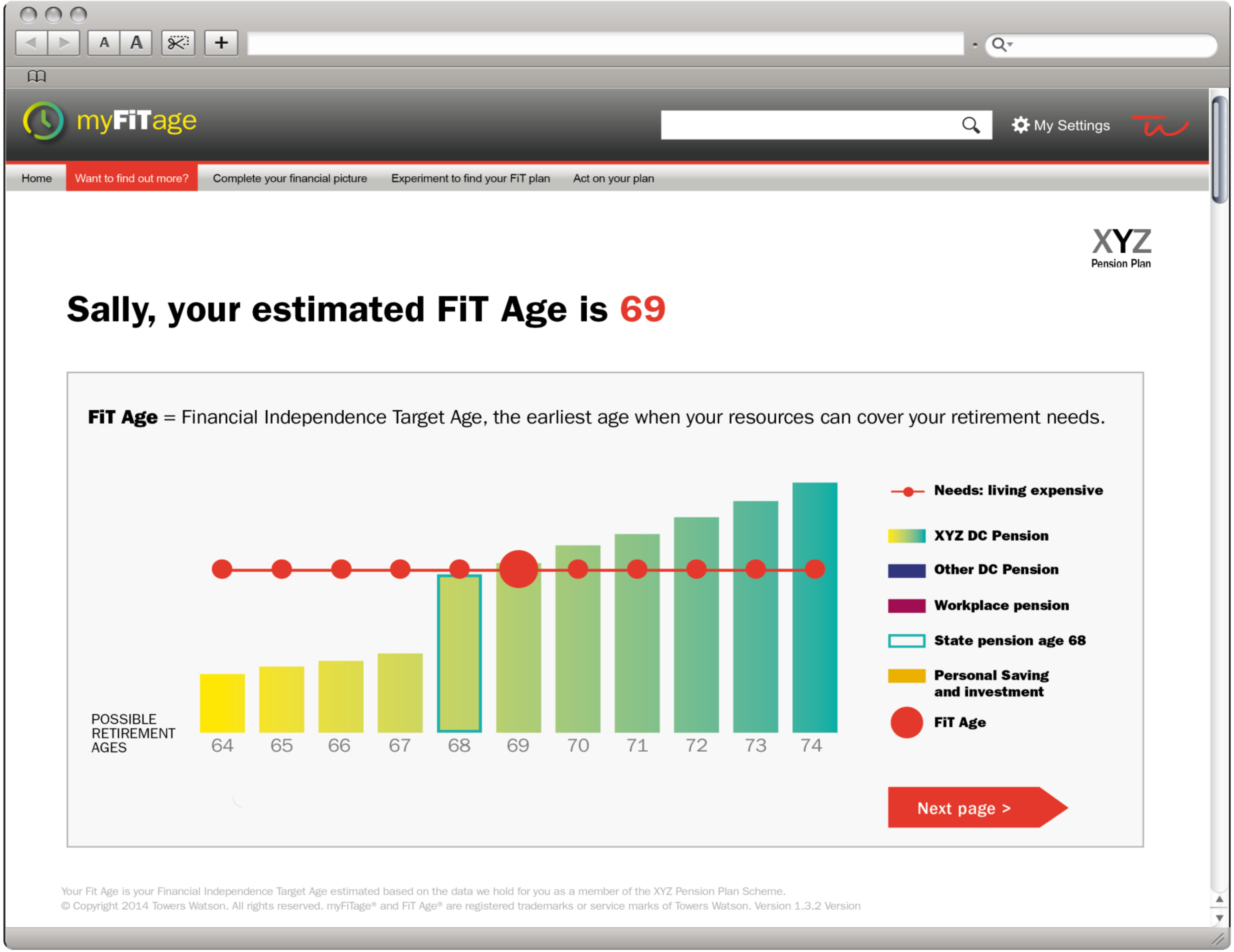
# Effective communication

**FiT Age = Financial Independence Target Age**

**the age at which an employee's total saving resources are expected to meet retirement needs.**

**An approach to addressing benefit adequacy issues**



myFiTage
My Settings
Home
Want to find out more?
Complete your financial picture
Experiment to find your FiT plan
Act on your plan
XYZ
Pension Plan
Sally, your estimated FiT Age is 69
FiT Age = Financial Independence Target Age, the earliest age when your resources can cover your retirement needs.
POSSIBLE RETIREMENT AGES
64
65
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68
69
70
71
72
73
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Needs: living expensive
XYZ DC Pension
Other DC Pension
Workplace pension
State pension age 68
Personal Saving and investment
FiT Age
Next page >
Your Fit Age is your Financial Independence Target Age estimated based on the data we hold for you as a member of the XYZ Pension Plan Scheme.
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# We have the building blocks for a successful future …

Pre-retirement | Near retirement | Retirement | Post-Retirement

- Encourage saving
- Education
- Annual statements
- Apps / ads
- ATR / Investments

- Set out options available
    - “Bank account”
    - Drawdown
    - Annuity
    - Insurance
- Customer specific lifestyling

- Regular review of decisions and options available

… but communication and engagement critical

# What I'll cover

The new world allows good outcomes for customers, but they'll need help and support to make some very tough decisions.

In supporting these decisions, providers will inevitably acquire risks of their own.

- Recent market environment
- Emerging complexities and risks in the new world
- Illustrated using real customer feedback

# Retirement market subject to many pressures

Perception of poor value

*Historically low yields*

*Increasing life expectancy*

Press and media focus

*“Rip off annuities” and “misinformation”*

*“Lack of shopping around”*

Focus on conduct and conduct risks

*ABI Code*

*Thematic Review*

Budget 2014

Retirement Income Market Study

It’s been really tough, and it’s getting tougher: how do we get good customer outcomes in the new world?

# Customer risks : the theory

The FCA have provided a helpful “quant” model for thinking about customer risks

“Consumers do not always make choices in a rational way based on all the available information” FCA – RI MS 14/3.2

- Present Bias
- Overconfidence
- Loss Aversion
- Framing effects

# Customer risks : the reality

The ABI have "humanised" it

"Freedom and Choice in Pensions, A behavioural Perspective"

- Defer consideration / action due to complexity
- Overconfidence
- Faulty heuristics
- Influenced by perception of others

overwhelmed by options

find it hard to compare

have a preference for defaults

# Our customers …

What do they need, want and expect?

My thoughts on what our customers actually told us

# Customers told us …

They need help and support; they recognise this and are actively looking for it.

**Reassurance**

- Engagement is often emotional – smaller pot sizes in particular
- Confusing, outside their control and source of anxiety

**Sacred**

- Recognition of need to provide for retirement and income
- Fear of social censure

"Frivolous" spending is unlikely.

# Customers told us …

They are…

- Not comfortable making decisions by themselves, especially on investment
  - ➢ They are looking for help
- Likely to defer decisions / planning until close to retirement
  - ➢ Initial engagement will remain difficult
- Seeking personalised information
  - ➢ Everyone is different
- Seek independent help via other sources : online articles, personal research

They are actively looking for support from their providers across all of this and more.

# Income remains an important consideration

Customers who want an income cared most about three key things:

1. Left over money goes to spouse/estate
2. Income paid out for the rest of life
3. Paid a fixed amount each month

When push came to shove, they chose flexibility over guarantees

Customers have no idea when they're going to die, and no idea how long they'll be active.

# Customer behaviours are changing

**Full lump sum** – smaller pots, more meaningful as capital

**TFC pre-retirement**

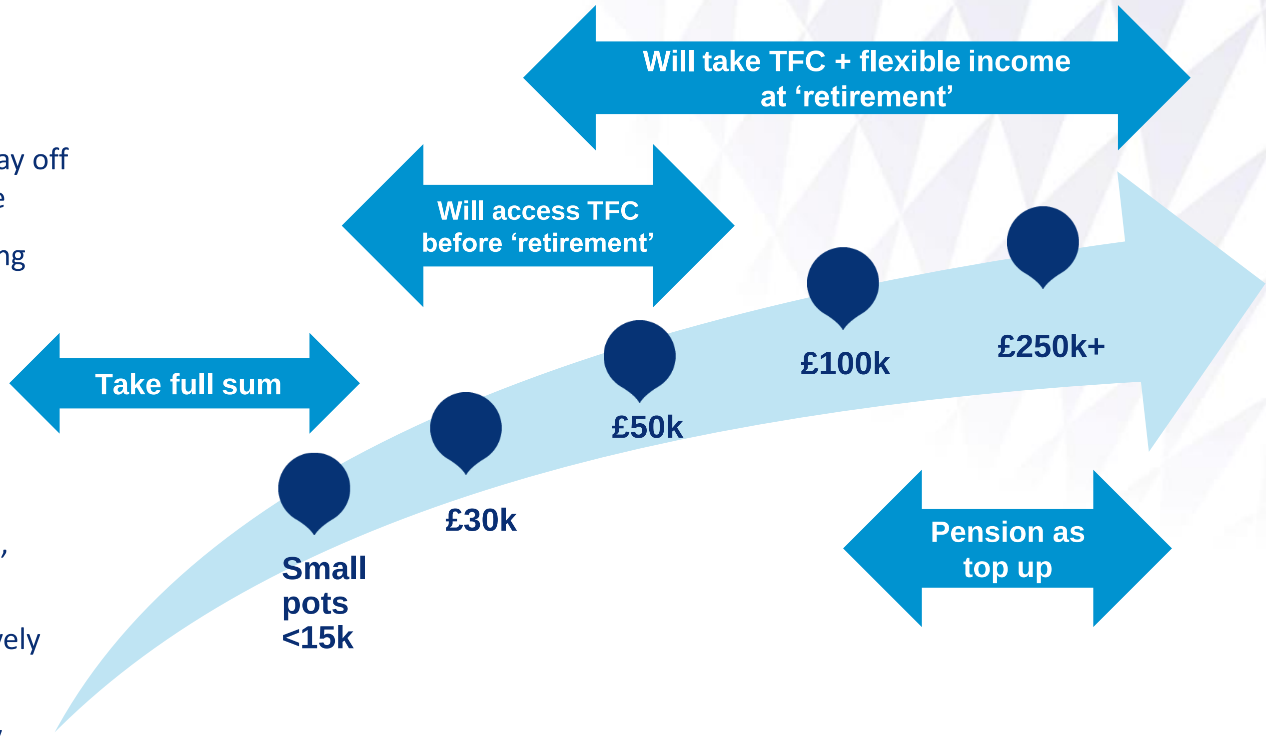
Only for specific needs only e.g. pay off mortgage, gap year/career change

- Employees continue contributing
- Pensions sacred – won't take income whilst still working

**TFC + income at retirement**

- TFC reward for working x years (accessible cash for family, hols, home improvements)
- Income expected even if relatively small
- Drawdown preferred (flexibility, avoids annuity)

**Pension as top-up** – only for wealthy when not essential for income e.g. use earlier (when it can be enjoyed)



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mortgage,

- Employ
- Pensior income

**TFC + inco**

- TFC rev (access home ir
- Income small
- Drawdc avoids annuity)

**Pension as top-up** – only for wealthy when not essential for income e.g. use earlier (when it can be enjoyed)

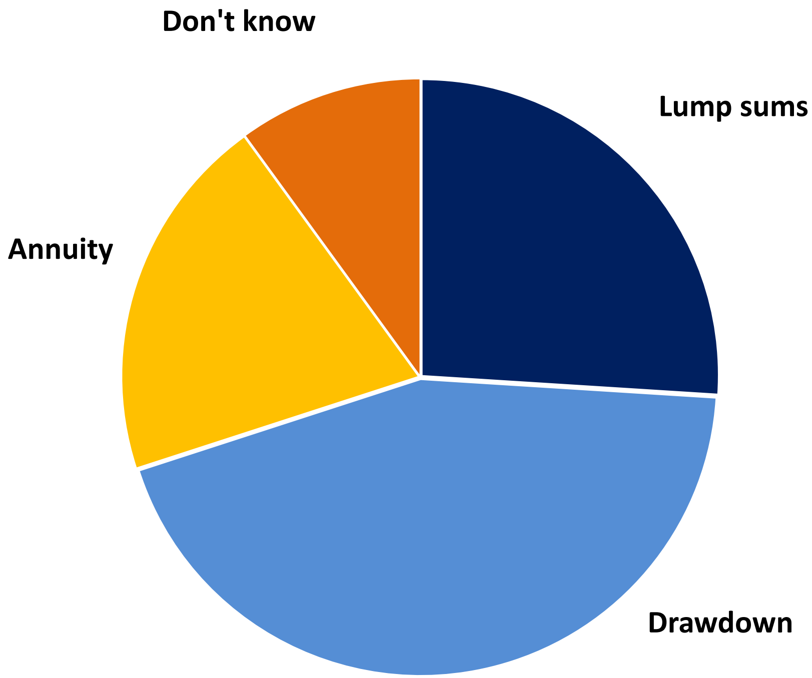
Will take TFC + flexible income at 'retirement'

Many different likely behaviours and many different needs:

- Will they do what they say?
- Should they do what they say?

Will actual behaviours be well aligned with the needs of those customers?

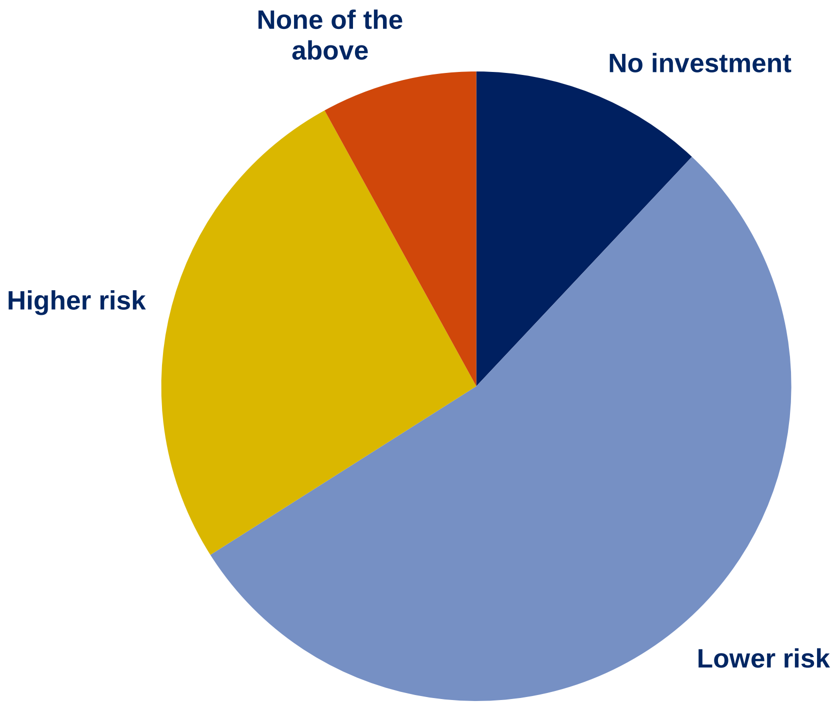
# Drawdown will be a much bigger consideration




- How much income do I need?
  - How long for?
  - What if I get ill?
- How to plan for life expectancy?
- Should I ever annuitise?
- What about inflation?
  state benefits?
  defined benefit?
- Tax management?
  - Regular – easy!
  - Lump sums …

**Managing a drawdown retirement strategy is fundamentally complex**

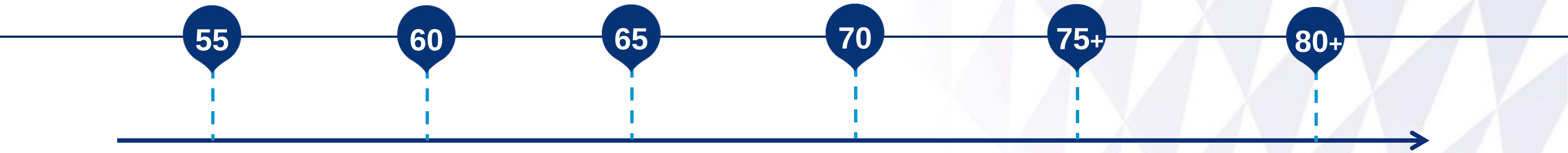
# Investment matters




- Will this match the customers' objectives?
- Will the right people buy the right assets?
- In the event of a market fall:
  - What do I think I will do?
  - What will I actually do?
  - What should I have done?
- Sometimes the right answer can give a poor outcome

How to invest to get a good outcome whilst understanding and accepting the risks of doing so?

# Retirement choice drives complexity




**55+**
- Still working
- Taking cash
  - Tax-free cash
  - Tax impact on taking more (still earning)
- Future planning
  - ISAs into pensions
  - Investment life styling
  - Consolidation

**At retirement**
- Retirement decision
  - Income shape
  - Flexible (drawdown) v fixed (annuity)
  - Essential v lifestyle income
  - Allowing for existing benefits (e.g. with profits, GAO etc.)
- Implementation decisions
  - Investment selection
  - Income sustainability
  - Longevity uncertainty
- Planning for the unexpected

**Monitoring**
- Reviewing investments and income
- Inflation risk
- Composure risk
- Behavioural risk

**Later retirement**
- De-risking income (conversion to annuity)
- Planning for long term care
- Leaving a legacy

## Key factors driving member outcomes:

| | |
|---|---|
| Income | Investments |
| Tax | Review |

# Risks across the whole customer engagement

The “quant” view …

- **Initial Engagement**
- **Decision support**
- **Products & investments**
- **Ongoing support**

# Risks across the whole customer engagement

The “human” view …

- Getting ready
- Support and help
- Making it safe and good
- Managing change

# Risks across the whole customer engagement

**Getting ready**

**Support and help**

**Making it safe and good**

**Managing change**

- The new world supports better outcomes for individuals
- But customers have tough decisions to make and face major risks
- They expect support and reassurance from their provider

**As providers we will inevitably face our own risks in providing this support.**

# Questions

# Comments

Expressions of individual views by members of the Institute and Faculty of Actuaries and its staff are encouraged.

The views expressed in this presentation are those of the presenter.