Institute and Faculty of Actuaries

Hitting the target: delivering better retirement outcomes

IFoA response to Pensions and Lifetime Savings Association

16 January 2018

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Institute
and Faculty
of Actuaries

Hitting the Target
Pensions and Lifetime Savings Association
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16 January 2018

Dear George,

IFoA response to Hitting the Target

The Institute and Faculty of Actuaries (IFoA) welcomes the PLSA's report and the opportunity to respond to the questions your report poses. We agree with the PLSA that there is a significant risk that many DC scheme members will not save enough to meet their retirement income needs. Adequacy of saving, and in turn retirement income, is one of the IFoA's main policy concerns. As a result, we have published several reports on the issue of 'adequacy' and have further analysis underway. We hope that our analysis can contribute to your thinking and the thinking of others as we all seek to build on the success of automatic enrolment and help consumers to navigate the greater choice they have when accessing their pension post-pension freedoms.

In particular, we would like to see the Government look again at the replacement rates that are currently widely used across government, and we would be delighted to lend our voice to the PLSA and others in seeking a re-examination of retirement income targets.

Our main priorities when determining retirement income targets are:

- **Bottom-up**: What one person might consider an adequate retirement income might not be adequate for another. Taking a bottom-up approach would entail individuals thinking about all their retirement income needs to create a holistic view of what their retirement might look like. A three-tiered system, as proposed in the consultation, can help to break this down into tangible goals. This approach would also encourage a holistic view of wealth and net assets.
- **Outcome focused**: An outcomes-based approach would start with the individual thinking about the type of retirement they aspire to and the specific needs that they might want to meet. This contrasts with an individual being led by the overall amount they would need to save, which could be a large sum of money that does not hold any intrinsic value to them. If individuals are going to use these targets, it is important that they value the potential reward of their efforts to meet them.
- **Ranges, rather than a single number**: We recommend that the PLSA explores whether the expression of targets as ranges, rather than a single number, would be helpful, or not, for consumers. We consider that suggesting a likely range, rather than a single monetary target, might allow for the 'basket of goods' approach to be

updated as required without individuals seeing their targets changing, which could lead them to question the robustness of the targets. This could further support an approach which encourages the setting of a series of tangible and manageable goals for saving over the lifetime. Should the PLSA think this is worth further investigation we would be delighted to work with the PLSA to explore this further.

One further priority where we would appreciate an even greater focus is understanding life expectancy. It is important that individuals understand the potential range of ages they might live to and the impact this might have on how long their retirement income will need to last. If an individual does not understand the potential consequences of underestimating how long they might live, there is a risk that they will run out of money in retirement. Communication around longevity risk could usefully begin at the point of setting targets.

SETTING THE TARGET: HOW MUCH IS ENOUGH?

1. Do you agree that retirement income targets should be developed?

Yes, we strongly agree that retirement income targets should be developed. Individuals need to understand what level of savings they will need to meet their retirement income needs and be encouraged to save to meet them.

a. If so, do you agree that there should be three levels – broadly minimum, modest and comfortable?

We agree that there should be three broad levels, but suggest that a more positive framework may act as a greater incentive to saving. In 2016, we proposed an approach of a Bronze, Silver and Gold rating. This type of rating system could be aspirational for savers – aiming for Silver arguably seems more appealing than aiming for modest.[1] We suggest the need for a positive framing is important as earlier IFoA research found that where individuals believed their efforts to be worthwhile i.e. where the potential reward outweighs the effort, it can achieve greater engagement in financial decision making.[2]

This research also found that when people focus on outcome-based goals (i.e. the amount of retirement income needed to achieve a specific goal) they are better able to set goals and understand the impact on their quality of life of not achieving them.

Having three levels could help the individual to set goals that are tangible and more manageable, again better illustrating the potential reward. For example, being able to ascertain that you could need approximately £20,000 p.a. to achieve the goals you had set for your retirement will better enable you to understand the value of your current savings than knowing you have, say, £200,000 of savings with no clarity over what income this could provide. If an individual is aware that their current level of saving may only provide £10,000 p.a. this will let them know that they need to act.

[1] IFoA (2016) *Assessing adequacy of retirement income: a bottom-up approach* [Available online: https://www.actuaries.org.uk/documents/assessing-adequacy-retirement-income-bottom-approach]
[2] IFoA (2014) *Outcomes and Defined Ambition* [Available online: https://www.actuaries.org.uk/system/files/documents/pdf/defined-ambition-28-april-paper.pdf]

Though overall pot size will become increasingly important as DC coverage continues to grow, we still believe that expressing the targets as income in retirement will have greater meaning for individuals.

b. How should we deal with single and dual households?

Ideally, the targets will be able to adapt to household composition. If a bottom-up approach is applied this should be feasible. The Joseph Rowntree Foundation calculator for the Minimum Income Standard can take this into account, suggesting that it would be possible. However, if this would make it overly complex, then we would suggest this is a medium-term aim as keeping to single households is likely to encourage people to set more challenging targets than smaller savings goals, which is less of a concern.

c. How should we approach housing costs to reflect rental vs ownership?

The targets should be set bearing in mind the likely circumstances of each band. For example, it is likely that those aiming for a ‘Bronze’ or ‘minimum’ income in retirement will not be homeowners. Whereas those aiming for Silver may be home owners with some mortgage debt outstanding, and finally gold may be more likely to be home owners with no mortgage debt.

d. Should the targets differ across regions, and if so how would you suggest we approach developing these?

We do not recommend that the targets differ between regions, this would add unnecessary complexity. If this were a priority, the PLSA might consider what a ‘London-weighting’ might be for each of the three levels.

2. Do you agree that the JRF Minimum Income Standard (MIS) is a suitable minimum retirement standard? If not, why not?

Like the PLSA we linked the first level to the JRF Minimum Income Standard. We chose this because:

- It has a well-established evidence base;
- it includes necessities based on what the public considers to be a minimum acceptable standard of living and not just what is needed for basic survival; and
- the JRF has already developed tools to help people ascertain their Minimum Income Standard based on their specific circumstances.

When developing the Bronze, Silver and Gold rating we aligned these to what individuals might consider to be the minimum income standard needed (Bronze), and then suggested that Silver and Gold targets should be set based on both additional aspirational lifestyle costs, as well as individuals being able to protect themselves against potential unexpected costs.

3. **Do you agree that developing a basket of goods and services for each level is the best approach? If not, why not?**

We agree that the basket of goods approach is more suitable than percentage uplifts, for the reasons that the PLSA has set out – namely, that it has a bottom-up rationale.

4. **Do you have views on alternative approaches to setting the target levels?**

We think that the approach outlined is appropriate. However, we wonder whether it could be worthwhile to investigate whether the creation of targets that are based on a range, rather than a specific number could be helpful to consumers. This could have numerous benefits:

i. The cost of the basket of goods will need to be updated, meaning that if a single figure is given, it is likely to change over time. This could lead individuals to question the robustness of the methodology.

ii. Providing a range could further enable the setting of manageable and tangible savings goals throughout the person's lifetime. For example, individuals might aim to get themselves into the range for Silver, then aim for the middle of the range, and eventually the top end of the range.

iii. Providing a range gives people a starting point that provides context for an approximate level of income they might wish to aim for in retirement, but then leaves room for them to adapt these to their personal circumstances. This aligns well to both the bottom-up and outcome-based approaches discussed in the consultation paper.

As noted above, should the PLSA believe this is worth further investigation we would be delighted to help explore this further.

5. **Who do you think should be responsible for developing and updating the target?**

The development and updating of targets should be overseen by a central function in government, but undertaken by independent bodies. The Joseph Rowntree Foundation already undertakes the necessary analysis for the Minimum Income Standard and the Office for National Statistics may be well-placed to help derive the other targets.

6. **In what ways should the retirement income targets be used to help people plan for their retirement income?**

There are many considerations for individuals when they are making decisions about their retirement savings. These include 'lifestyle' considerations such as basic living costs for the duration of their retirement, additional lifestyle costs such as hobbies or leisure activities, as well as contingencies should they be exposed to any unexpected costs. Alongside the risks that individuals must manage themselves in a DC environment such as investment risk and longevity risk.

We recommend that a bottom-up approach, as suggested in the PLSA's report, facilitates the:

- development of an effective communication strategy that can segment the population so that information is effectively targeted i.e. by which of the three targets is most relevant to them;
- creation and maintenance of tools that help people to assess the adequacy of their savings and take remedial action if they are not on track;
- development of default in-retirement vehicles that take into account how people may wish to access their pension in multiple ways (e.g. they may wish to secure their basic income needs, but desire flexibility to achieve their lifestyle aspirations); and
- a shift in focus to outcomes and income needs. We suggest this shift could improve engagement with financial decision makingfrom the vantage of considering what 'lifestyle' target the individual is aiming for in retirement. However some thought needs to be given to translating a DC lump sum to an income. With drawdown now used more commonly as a post-retirment vehicle, the level of sustainable income an individual can generate will be heavily influenced by both longevity and investment choice. For example, a healthy individual investing in safe, low-yielding assets will be able to generate a lower stainable income than an equivalent individual with a shorter life expectancy who has chosen higher yielding assets. We will be publishing a report in March that investigates the communication of investment and longevity risk to consumers, and what this means for their retirement planning. If it would be helpful we can share this with the PLSA upon publication.

PENSIONS

7.Do you believe that the level of pension saving that we have identified (12%) is sufficient to provide people with an adequate income in retirement?

We agree that the 8% minimum contribution level is unlikely to be adequate for a significant proportion of the population. We are also concerned that 12% would not be adequate for those who start paying into a pension at a later age, who take a career break, or who wish to access their pension at the earlier age of 55 through the pension freedoms.

Undoubtedly contribution levels have to rise, but it is the mechanism for doing so that we believe will be crucial to individuals saving adequately. The PLSA importantly sets out in this consultation that a future increase to minimum contribution levels should only be considered once the experience of raising automatic enrolment contributions from 2% to 8% is understood. Particularly for those newly entering automatic enrolment 12% may reduce their earnings by an amount that they deem too high. Once we know how people respond to the transition from 2% to 8% we would hope that the Government considers a number of options, including further increases to the minimum contribution level as you suggest, but also a system of auto-escalation, whereby individuals enter at a lower level of contribution, but the contribution increases over time.

Auto-escalation capitalises on hyperbolic discounting – this is when an individual applies a lower discount rate to decisions that have a long-term horizon. In most aspects of retirement this goes against increasing levels of saving as individuals value income today over income at a later date i.e. in retirement.

‘Save More Tomorrow’ is an auto-escalation campaign in the US designed by Professor Richard Thaler. This campaign gets prior agreement from employees to increase their pension contributions at an agreed later date. For example, when an individual joins a company they agree that should they receive a pay increase in the future, the company can at that time also automatically increase the proportion of their salary that they save into their pension. Here the individual is applying a lower discount rate to the loss of what will become immediate income in the future and so they are more prepared to commit to saving that income. This model also harnesses inertia and procrastination in the same way as automatic enrolment as if the individual wanted to reverse this prior agreement it would require action.

The success of auto-escalation in the US suggests that this model could not just be applied to a more gradual increase up to the minimum level of contribution, which may help to retain the current low opt-out rate, but also in encouraging individuals to agree to future increases that would take them above the minimum level of contribution.

One important aspect of the auto-escalation model and the pension framework more broadly, is the role of the employer. The consultation paper rightly focuses on individuals as in DC it is the individual that has to manage their investment, inflation and then longevity risk. However, as auto-enrolment has demonstrated, employers still have a crucial role in pension saving. An additional consideration in regards to the employer is monitoring whether increases in the employer contribution leads to lower wages. In addition to opt-out rates DWP should monitor, as far as it can, the impact increased contributions are having on wages.

8. In the event that automatic enrolment default contributions increase from 8% to 12%, how should they be divided between the employer and employee?

By the time the contribution level has reached 8%, the ratio of contribution between the employer and employee will be 3:5. Our members’ experience is that most larger occupational pension schemes do have a 50/50 split as you have proposed, with many employers offering a greater proportion of the contribution. Again, this demonstrates the important role of the employer in ensuring that individuals have a good chance of meeting their targets and saving adequately.

If higher opt-opts are experienced once the minimum contribution level increases, increasing the proportion that has to be met by the employer may help to address this. Otherwise, if the proportion stays the same an improved ratio between employer and employee contributions could be used as an incentive to encourage saving above the minimum i.e. the employer contributes a greater proportion if the individual is prepared to save more. As the report acknowledges this could mean significant additional costs for employers. We agree that a review of, and any subsequent action in relation to, the division between employer and employee contributions is a medium-term aim. We would add that it should include a review of the tax relief applied to employer contributions as this is important in rewarding employers for providing a workplace pension.

9. **Over what period do you believe an increase in contributions to 12% should be phased?**

As stated in our previous answer, any increases above those already planned to 8% should be determined based on learnings from that process and any impacts it has on opt-out rates. We recommend that this question is revisited at a later date.

10. **Do you believe there is a risk of over-saving for those on low incomes and, if so, what solutions might be worth considering? Should early access in the case of 'financial hardship' be one of them?**

Yes, there is. We recommend that the Government issues targeted communications to those on lower incomes, which alert them to the potential impact that a small amount of savings may have on any means-tested benefits, and therefore their overall financial situation. This should remind them of their right to opt-out.

Whilst there could be merit in using savings to avoid financial hardship, and in particular short-term loans, we do not think that pension savings are the most appropriate vehicle for this. Having to access funds to avoid financial hardship is likely to be indicative of underlying circumstances that a small amount of additional money is unlikely to resolve in the medium to long-term. It would likely shift the problem to a later date, rather than addressing the problem. This could have negative consequences if the individual does not approach appropriate help and advice services as soon as they might without access to the additional funding, and these services will be better able to address the underlying cause of the financial hardship.

However, if a separate financial hardship fund were created for those with lower incomes, the methods applied for getting people to save into them could benefit from the behavioural insights we have gained from automatic enrolment. Again the implications of these additional savings on means-tested benefits must be considered to ensure that the individual does not end up worse off over the medium to long-term.

11. **Can you see any impediments to our proposed approach to the inclusion of the self-employed, multiple job holders and younger workers within the automatic enrolment regime? If so, can you suggest a solution to those problems?**

We agree that automatic enrolment should be expanded to cover those identified in the report. We are pleased to see that the Automatic Enrolment Review has committed to reducing the eligible age to 18 addressing the first of your proposals. We note that the Automatic Enrolment Review has committed to calculating pension contributions from the first pound earned, rather than the current lower earnings limit and the hope that this will remove one of the barriers facing multiple job holders. The remaining barrier, not addressed in the report, is the issue of the proliferation of small pots. We do not think this barrier should hinder attempts to bring multiple job holders into the automatic enrolment framework, but instead highlights a potential short coming in the current system.

The proposed approach for the self-employed seems sensible.

12. **Do you believe that it is desirable to change the existing system of tax relief so that it would more effectively support the achievement of our proposals for a set of National Retirement Income Targets?**

In line with HM Treasury's 2015 consultation we consider the most important aspect of any changes to the pensions tax relief framework must be the incentive to save. Membership of a pension scheme requires a strong incentive to save, otherwise the requirement to lock funds away until the later stages of life will deter pension saving. Without that incentive, alternative forms of investment with no restrictions on fund access will appear more attractive and there will be a strong possibility that assets will be depleted before retirement. This could have a consequence for welfare expenditure in the form of higher payments to those who have depleted their assets.

The current tax regime has not been a barrier to participation in saving for retirement via automatic enrolment, therefore we agree that the current framework would enable changes to meet this principle, as opposed to a transition to an alternative tax system.

We recommend the proposal would be better achieved by focusing on the introduction of tools that enable individuals to set and monitor their progress towards their targets than changes to the tax framework.

13. **From a practical perspective, what would be the best way to alter the current regime so that savers are helped to achieve our proposals for a set of National Retirement Income Targets?**

One possible change is the positioning of tax relief – many people do not understand the tax benefits of saving into a pension. Repositioning tax relief as either a bonus or as a deferral of taxation could lead to a greater understanding of the tax benefit of saving into a pension and how the taxation of pensions works more broadly.

PROPERTY

14. **How can equity release products be used to support retirement income be improved?**

Drawdown equity release products already exist and they allow borrowers to draw funds against the value of their home. However, due to the cost of processing requests there are minimum amount restrictions on the sum that can be withdrawn. These products could be better used to support an individual's retirement income if the minimum amount requirements and the costs of processing requests are reduced, so they can be used more like bank accounts. Mechanisms like this already exist within the mortgage market and so there may be an opportunity to learn from other markets relating to property.

Furthermore, equity release products can be used to repay existing debt, but there are few products that specifically allow servicing of the interest. If interest serviced products became more widely available it could help retirees with interest only mortgages that are maturing, but who do not have sufficient savings available, to repay the debt.

15. What is needed to help pension funds increase investment in housing?

The Government's 2017 Industrial Strategy and National Productivity Investment Fund commit to support the creation of new housing and importantly for pension funds this includes spending by housing associations.

One area we believe that the Government could create an appealing investment option is in affordable housing. Affordable homes are an important component of the overall housing market, representing around a third of all current construction. Housing associations build the great majority of affordable homes (although there is some evidence of interest from other players including insurance companies like Prudential). According to think tank Policy Exchange, housing associations have the capacity to double the level of building, which would help to clear long local authority waiting lists for social housing. Policy Exchange argues that the reason housing associations are not doing this is that they face restrictions in the way they can invest capital, and lack access to cheap debt finance.[3]

There are international examples of this type of investment being structured in a way that offers institutional investors a regular income stream over many years. In 2015, Legal & General formed a partnership with Dutch asset manager PGGM to construct affordable accommodation for the rental market. The rental income is available to institutional investors as an asset class, aiming to offer high income security and diversification.[4]

The IFoA would urge the Government to focus on making the regulatory environment supportive to housing associations given that they build the great majority of affordable homes and this can be structured in a way that appeals to institutional investors such as pension funds. One example of how this might be achieved is in relaxing liquidity requirements on DC schemes. We will be publishing a paper on illiquidity in DC before the end of Q1 and we would be happy to share this with the PLSA.

WORKING LONGER

16. In your experience, what are the most effective ways that pension schemes or pension providers can help members understand and take advantage of the options for drawing their pension while still working?

Drawdown may provide the best route for people to draw some of their pension while still working, yet many DC schemes do not currently offer the full range of drawdown options. This means that members may only have the choice of a cash lump sum or an annuity unless they transfer to an alternative provider. Unless a provider offers products that are suitable for their members to access the freedoms while still working, it is unlikely that they will promote how the freedoms might be used in this way.

[3] Policy Exchange (2014) *Freeing Housing Associations: Better financing, more homes, November 2014*

[4] Press release: Legal and General's Build to Rent housing pipeline hits 800 new homes in Salford [Available online: https://www.legalandgeneralgroup.com/media-centre/press-releases/archive?id=50288]

17. What principles should underpin employers' and pension providers' approach to helping people work for longer?

This is one of the strengths of the freedom and choice reforms, helping individuals to work part-time and supplement their income from their pension. Though the Money Purchase Annual Allowance has been lowered and this may have implications for those who are paying into a pension to benefit from the employer contributions, whilst withdrawing the savings that they have made to date.

We would also lend our voice to those calling for a 'Mid-life MOT' that encompasses career and financial planning for those age 50. This would need to be run independently from the employer. However, this could have benefits for the employer too. If people take a proactive approach to up-skilling or re-training with a view to continuing work past State Pension age, this will better enable employers to undertake workforce planning to ensure that their employees are able to transition between roles dependent on their circumstances e.g. to a less physically demanding role, or to a role that has greater flexibility in case they have care responsibilities. It could also help employers to identify which employees are likely to need to continue working passed Spate Pension age, and those who are likely to want to remain in the workforce, again this would aid workforce planning.

VALUE FOR MONEY THROUGH GOOD GOVERNANCE

18. Do you agree TPR should rebalance its priorities to focus more on trustee effectiveness? How do you think that TPR can be more effective in promoting the appointment of high-quality trustees?

We agree that the quality of trustees in some pension schemes could be improved. The quality of trustees varies from scheme to scheme and so we welcome tPR's 21st Century Trusteeship campaign to develop trustees' effectiveness. This should be considered on both an individual basis and on a collective basis as it is important that within a board of trustees there is sufficient breadth of knowledge and competence to cover all aspects of scheme governance.

19. Do you believe that the powers of IGCs should be enhanced in order to deliver better outcomes for savers and, if so, how?

The protections in place for scheme members should be equivalent for those in trust-based and contract-based arrangements.

20. Do you agree that the pensions industry should develop metrics to measure value for money? If so, which metrics would be most useful to aid comparison of the value for money offered by pension schemes or providers?

Yes, as value for money is much more complex than simply the lowest charges, though this would be an important part of offering value for money. In addition to charges we would recommend the inclusion of good governance and scheme member communications. Good governance and effective communication would facilitate other aspects of value for money such as transparency, effective administration, appropriate defaults, investment returns and appropriate member engagement.

RETIREMENT DECISIONS: MAKING THE MOST OF THE NEW FREEDOMS

21. Do you believe that the proposed decumulation process provides an effective means of guiding savers to decumulation products or solutions that are appropriate to their needs? If not, what alternative approach do you suggest?

We are concerned that the decumulation process does not guide savers to appropriate solutions and in some cases is guiding them to solutions that could result in a poor outcome. The path of least resistance in the new framework is to withdraw savings as a lump sum. This is problematic in a number of ways. The individual needs to be aware of the tax implications of doing this and they will then need to manage those savings to meet their income needs for the duration of their retirement.

- No amount of financial education will enable individuals to work out their actual lifespan, therefore advice, guidance and defaults should focus on the role of guarantees which pool longevity risk. Whilst feedback on the guidance provision is high, the uptake is low. Auto-enrolling individuals into the free guidance session, so that it must be taken before funds can be accessed, could be a relatively simple way of increasing take-up.
- A decision tree could be used as part of the guidance to enable individuals to assess their preference between drawdown, annuitisation and the various options available for combining the two. The principles for this decision tree should be consistent across the market so that consumers are not led towards different product options by different providers.
- For those who do not access the guidance, defaults which offer an element of guarantee could help to protect people from running out of money in retirement.

22. Are there any legal or operational impediments to the proposed method of achieving good outcomes for savers at the point of decumulation?

There are three considerations we are not sure have been adequately addressed:

i. the ability to get members to make active decisions
ii. whether an ‘independent body’ will necessarily encourage shopping around across providers for the most suitable product / solution
iii. the distinction between guidance and advice that results in a personal recommendation are likely to have to be reconsidered, which would impact the role of financial advisors and guidance services

23. Do you agree that the product / solution principles we propose should be mandated by government? Are there any other principles you consider to be appropriate?

An important additional principle is that the consumer must not be defaulted into an arrangement that they will be tied into as it could potentially be unsuitable for them circumstances.

ENGAGEMENT: BUILDING CONFIDENCE

24. What impediments, if any, are there to the wide-scale uptake of fin-tech solutions across the pensions sector?

We agree that there should be at least one high-profile pensions dashboard hosted by a public body. The results of two focus groups that we held with Ipsos MORI demonstrated that consumers prefer to receive information on their pension from independent bodies.[5] In addition to the dashboard(s) the evolution of the Single Financial Guidance Body creates an opportunity to develop a 'one-stop-shop' for online tools and communication that help people to set retirement income goals and assess their progress towards them.

We agree the dashboard and accompanying tools should not be restricted as current low levels of access of the services offered by Pension Wise suggest that there is a significant role for pension providers and other consumer bodies in helping individuals to assess the adequacy of their savings.

25. In the context of workplace pensions specifically, which heuristics and 'teachable moments' have proved most effective?

Earlier this year we co-sponsored a Pensions Policy Institute series on consumer engagement throughout the life course.[6] This research investigated when and what types of behavioural interventions are most and least likely to be effective. The 'teachable moments' it identifies include:

- Moving away from parental home
- Starting employment
- Buying a house
- Moving in with a partner
- Getting married
- Starting a family
- Divorce
- Bereavement

[5] IFoA (2017) *How can we help individuals make better retirement choices?* [Available online: https://www.actuaries.org.uk/system/files/field/document/Retirement_Game_190417%20presentation.pdf]

[6] PPI (2017) *Consumer engagement: the role of policy through the life course* [Available online: file://actuaries.org.uk/dfs/XA65Redir/rebeccad/Downloads/201707%20Consumer%20engagement%20-%20the%20role%20of%20policy%20through%20the%20lifecourse.pdf]

26. Do you agree that the language and layout of key customer communications and assumptions should be standardised? If so, which elements should be standardised?

In order to support individuals in making increasingly complex decisions about their retirement income, clear and consistent communication with the public is important. We were supportive on the content in the ABI's 'Making retirement choices clearer'. In addition to the definitions in their work we suggest three further areas that might usefully be addressed:

- Longevity risk
- An explicit distinction between guidance and advice
- Transfers from a Defined Benefit (DB) arrangement to a Defined Contribution (DC) arrangement to access the Government's pension freedoms

Longevity risk
An explanation of longevity risk could be useful in communicating the importance to an individual of their savings lasting for the duration of their lifetime. Understanding life expectancy and estimating how long one individual will live is complex. It is important that individuals understand the potential range of ages they might live to and the impact this might have on how long their retirement income will need to last. If an individual does not understand the potential consequences of underestimating how long they are going to live, there is a risk that they will run out of money in retirement. It is important to acknowledge that whilst we can help consumers to understand this issue, no amount of financial education will enable individuals to work out their actual lifespan, therefore advice, guidance and defaults should focus on the role of guarantees which pool this risk.

We suggest that a possible standardised explanation of longevity risk could be, *'The risk that you live longer than expected which means that your savings have to last for longer. To protect against running out of money should you live longer than expected there are products available that will pool this risk and guarantee you an income for life'.*

The difference between guidance and advice
An IFoA survey on public attitudes to the pensions freedoms found that many over 55s are confused about the distinction between guidance and advice, with 45% of respondents admitting they do not understand or are not sure of the difference between guidance and advice.[7] Making clear that advice and guidance are distinct could be crucial for managing customers' expectations of what information they will receive. It is important for customers to understand how the guidance they receive from Pension Wise should be treated, compared to regulated financial advice, when making important financial decisions about their pension.

We therefore suggested an amendment to the ABI's Guide by including an additional sentence to help individuals understand that even if they have received guidance, they may wish to pay for regulated financial advice before making a decision regarding their pension. At the end of the definition of guidance it may be useful to add '*If after receiving guidance you are not sure what to do with your money, then you may consider paying for an independent financial adviser to recommend suitable products (please see the section on*

[7] IFoA (2016) *Freedom and Choice: Public attitudes one year on, Survey Report* [Available online: https://www.actuaries.org.uk/documents/freedom-and-choice-public-attitudes-1-year-survey-report]

advice for more information).' Sign-posting between the two definitions acts as an additional alert to individuals that there is a clear distinction between the two.

DB to DC transfers

The decision and related terminology around Defined Benefit to Defined Contribution transfers can be complex, some attempt to tackle this could be a helpful way to explain this complicated procedure to customers.

We would suggest wording such as *'You may have a DB pension, but wish to change to an alternative type of pension. When you approach your pension provider about this option, you can expect to receive a quote for the transfer value for your existing pension benefits. You can use this amount to transfer to a different pension plan, but you will give up the rights associated with your DB pension. If your transfer value is over £30,000 you may have to pay for financial advice before your pension provider can allow you to transfer your pension.'*

Should you wish to discuss our response any further please contact Rebecca Deegan, Head of Policy, on rebecca.deegan@actuaries.org.uk.

Yours sincerely,

Marjorie Ngwenya
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