ASSOCIATION OF
aca
CONSULTING ACTUARIES

Regis House, First Floor (126/7), 45 King William Street, London EC4R 9AN
Tel: +44(0)20 3102 6761 E-mail: acahelp@aca.org.uk
Web: www.aca.org.uk

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Sent by e-mail to retirement@abi.org.uk

Dr Yvonne Braun
Head of Savings, Retirement & Social Care
Association of British Insurers
51 Gresham Street
London EC2V 7HQ

Dear Yvonne

A NEW RETIREMENT – INSURANCE INDUSTRY REVIEW OF RETIREMENT OPTIONS

We are in receipt of your call for evidence and we are pleased to respond.

Members of the Association of Consulting Actuaries provide advice to thousands of pension schemes, including most of the country's largest schemes. Members of the Association are all qualified actuaries and all actuarial advice given is subject to the Actuaries' Code. Advice given to clients is independent and impartial. ACA members advise schemes covering the majority of members of private sector defined benefit and defined contribution schemes.

The ACA is the representative body for UK consulting actuaries, whilst the Institute and Faculty of Actuaries is the professional body.

Summary of our response

Our overall observation is that there has been a major study of the UK pensions scene undertaken by the Pensions Commission in between 2002 and 2006 and this has been supplemented by numerous Government inspired consultations on pension policy initiatives thereafter, coupled with a wide range and spread of reports from trade bodies involved in the pensions sector, as well as reports by bodies such as the Pensions Policy Institute, the Pensions Institute at Cass and numerous 'think tanks'. More recently, the DWP has published its papers on *Reinvigorating workplace pensions* (November 2012) and *Reshaping workplace pensions for future generations* (November 2013).

Whilst we appreciate that there have been trends that have developed in the more recent past, such as the growth in the number of people working beyond SPA (now over 1 million) and a widespread flatlining of incomes since 2008 which may have hindered pension savings still further, we feel this body of collective evidence is substantial and that it provides sufficient information upon which to address the three broad questions outlined in your call for evidence, namely:

- What are people's financial needs in retirement?
- How well does the current retirement income system cater for these needs?
- What changes do you think are needed?

We address each of these questions below and comment on some of the more detailed questions you pose within the call for evidence.

Peoples' financial needs in retirement

Inevitably individuals' financial 'needs' in retirement vary hugely. Those needs will be governed by very different pre and post-retirement life-styles and aspirations in retirement. Also factors such as financial commitments carried into retirement (especially any mortgage or rent costs), health and – of course – uncertain variables such as individuals' differing longevity will impact on those needs.

The Pensions Commission eventually arrived at a range of replacement incomes in retirement (*see Table below*) that it felt were appropriate targets for those with different pre-retirement incomes and this rule-of-thumb approach does have some merit in terms of simplicity. That said, latest DWP figures suggest 11 million (40%) of those aged between 22 and SPA will not meet these replacement rate targets[1].

Income bands (gross earnings) and Pensions Commission replacement rate targets		
Original 2004 income band	**Income band in 2012 terms**	**Target replacement rate**
Up to £9,500	Up to £12,000	80%
£9,500-£17,500	£12,000 - £22,100	70%
£17,500 - £25,000	£22,100 - £31,600	67%
£25,000 - £40,000	£31,600 - £50,000	60%
Over £40,000	Over £50,000	50%

(**Source**: Reinvigorating workplace pensions, November 2012, page 7)

However, others would on the one hand say that targeting these percentages actually goes beyond the real 'need' (i.e. the targeted income levels may exceed that required for a minimum socially acceptable standard of living[2], particularly for those on higher incomes), whilst others would say – given the rising costs likely to hit retirees through potentially a long period in retirement, the same targets fall short of what is necessary (particularly if that income in retirement is not indexed in retirement).

[1] DWP, 2012, *Estimates of the number of people facing inadequate retirement incomes.*

[2] The 'Minimum Income Standard (MIS)' project funded by the Joseph Rowntree Foundation aims to define an adequate income based on what members of the public think is enough to live on to maintain a socially acceptable quality of life. In April 2013, the MIS figure for a pensioner couple was £12,545pa (excluding rent) and £16,777pa (including rent). See www.jrf.org.uk/topic/mis

Because of the very varied financial needs of individuals in retirement, we do not propose to dwell on this aspect of your call for evidence as we do not feel any certain conclusions will emerge that apply across-the-board.

What we do see as having some value is a simple widely publicised table that is published annually, perhaps by GAD or some other objective body, that 'guides' the public on what level of savings they ought to be making, from different starting ages, in order to target a modest income (inclusive of the State Pension) of, say, 2x the single-tier State Pension or, perhaps, a linkage to the 'Minimum Income Standard' (see *footnote 2* on page 2). This might usefully commence in 2016 when the new State Pension comes in and, of course, the figures would need to reflect a number of provisos and broad assumptions that are made clear from the outset, updated in a timely way to reflect changes in investment climate, longevity etc.

We think there is an evident danger that the public are deterred from making adequate and indeed any pension saving by receiving illustrations from providers and by reading newspaper articles that feature capital sums (and replacement incomes) that are quite 'high' and, as a result, featuring necessary savings levels to achieve these figures that go far beyond the pockets of all but a few savers. In short, we believe the adoption of more modest retirement income targets would be helpful, recognising that some people (and their employers) will be prepared and able to save at a higher level so they can reach a higher level of financial comfort in retirement.

The current retirement system

The 'current retirement system' has been subject to a huge raft of reforms in recent years, albeit under-saving for retirement persists (and may continue to do so).

On the State Pension side, we will see from 2016 a new single-tier pension that we believe is a step in the right direction in terms of the eventual simplicity, but of course this should not disguise the fact that for those on higher incomes who hitherto have been 'contracted in', the State pension from 2016 will deliver a more modest total State pension in years to come. That said, we understand the reasoning behind the change and the need to control State pension costs given the growth in the population above SPA and longevity improvements. We also feel that over time, the simplicity of adding a private pension above a single-tier State pension is much clearer than the complexities associated with contracting-in and out.

The private pension scene is also in a state of flux, with the decline in defined benefit scheme coverage (outside the public sector) continuing and, as a result, the numbers likely to receive a 'guaranteed' earnings-related private pension diminishing as the years go by.

We are hopeful that the 'Defined Ambition' (DA) proposals presently being consulted upon by the DWP will begin to redress the trend towards more and more individuals being responsible increasingly (and often unknowingly) for the risks involved in their pensions, but we are realistic in expecting changes in provision to be modest at first. We strongly believe that the DA proposals in identifying models that cap 'guarantees', target more modest levels of retirement income and which endeavour to build income guarantees in DC arrangements are all positive steps forward in encouraging employer provision above the minimum and in meeting employees' calls for greater certainty in pension incomes.

Alongside all of this we have the ongoing auto-enrolment of eligible employees into qualifying schemes. In theory, by 2018 some 1.3 million private employers will have 'opted-in' around 6-9 million more employees into pensions, with these pensions attracting total contributions, by then, of 8% of qualifying earnings. We say 'in theory' for a number of reasons. First, it is not clear to us that either the provider market or the regulatory regime can cope with the quantum of employers with staging dates from 2015. Second, whilst employee opt-out rates are at present low at the larger employers who have hit their staging dates – with total contributions of often just 2% of qualifying earnings – it is not clear to us that this will remain the case when contributions increase to 8%, nor do we expect opt-out rates to be so low amongst small and micro employers.

That said, we fully support the auto-enrolment initiative as a valuable way to widen pension coverage and wish it well.

Inevitably, with auto-enrolment impacting on hundreds of thousands of employers who presently offer no pension arrangement, we will see a huge increase in the number of employees enrolled into DC arrangements over the next few years. Inevitably, this will highlight still further concerns that are presently 'in the news' about the charges levied by some (particularly legacy) auto-enrolment schemes and the operation of the annuity market.

On charges, we believe that competition (and some scale solutions) will continue to drive down costs, but we do believe that providers will have to provide greater transparency and adjust charges on legacy arrangements or face continued criticism from the public and political world. If actions are not taken to reduce charges at the extreme end of the market, then we can expect the charging caps that will be applied by government to tighten. Certainly, the provider market needs to do a much better job than hitherto in explaining/justifying how charges above the lowest market levels can allow a more active investment strategy to be adopted with, as a result, the likelihood of higher investment returns over the longer-term.

The profusion of new small 'pots' over the next few decades may also heighten calls for reforms to the drawdown rules – reforms that we have sympathy with and which we refer to later in the next section (and in **Appendix A**).

On annuity reform we think it inevitable that providers will be expected to provide greater transparency over how annuity rates are determined and we expect to see a narrowing in the range of rates between providers for similar products and terms as a result.

We do not believe that annuity providers should be subject to caps on charges, but we would expect greater transparency and competition in the market to reduce profits on annuity business over time (coupled with the competitive effect of initiatives to extend drawdown and more DA schemes, some of which will self-annuitise). However, we do feel that charges on the sale of non advised annuities will need to be addressed and regulation of the market tightened up.

We remain pessimistic that the reforms to the advisory market will lead to more individuals seeking advice ahead of making important pension and savings decisions. Indeed, the evidence to date is that the move to a largely fee-based market has had the opposite effect. Whilst, over time this may change, it seems likely to us that engagement by a wider public in these matters will remain elusive and that initiatives such as auto-enrolment, auto-escalation (of pension contributions) and wider access to more DA-type employer sponsored schemes are more likely to be successful in achieving better levels of pension saving than other means, such as more fee-based advice or, for that matter, more access to financial education in schools (which may be too remote from the time when pension decisions are taken).

Options for change

In the previous section, we have covered a number of the options for change that we endorse. We summarise these and others below:

- We see as having some value **a simple widely publicised table that is published annually, perhaps by GAD or some other objective body, that 'guides' the public on what level of savings they ought to be making, from a start date of different ages, in order to target a modest income (inclusive of the State Pension) of, say, 2x the State Pension (c£15,600 in 2016) or, perhaps, a linkage to the 'Minimum Income Standard'.**

- Employers and employees will both benefit from the ability to offer **Defined Ambition** schemes as proposed in the DWP paper *Reshaping workplace pensions for future generations*.

- We endorse (voluntary) measures to **encourage greater 'scale' in UK pension provision** as a means of holding down charges and offering the potential of improved investment returns via pooling.

- The auto-enrolment 'revolution' places employer sponsored provision at the heart of the system to extend pension coverage amongst employees. We believe that beyond 2018, the Government should look towards building on auto-enrolment by **encouraging the greater use of auto-escalation** (see **Appendix B**) by schemes and/or **consider the gradual phasing in of higher minimum levels of pension contributions**, including the use of financial incentives in support of such initiatives.

- Annuity providers should voluntarily provide greater transparency over how annuity rates are calculated. **The non advised annuity market needs to be better regulated and maximum charges considered**.

- We support the **wider use of drawdown**, particularly in respect of using small pension pots so these can be drawn over a short period, say 5 years when first retired or working part-time beyond SPA, with this giving the individual the flexibility to defer and then draw a higher State pension (see **Appendix A**)..

Finally, a comment on simplicity. We have no doubt that for the wider public, the complexity surrounding pensions remains one of the greatest problems in stimulating any engagement with pension savings at all.

Some of the changes we propose above we would hope would extend simplicity, but we would argue that much remains to be done to explain pensions to the wider public in terms that the public understand. A key problem here are regulatory requirements or interpretations of regulatory requirements that mean many people simply give up all hope when reading or listening to material supplied to them which, it is said, is necessary to protect their interests.

In short, we believe any 'New Retirement' initiative needs to encompass a thorough review of the regulatory restrictions and the language used in pensions so this does not discourage the take up of pensions.

Yours sincerely

Andrew Vaughan
Chairman
Association of Consulting Actuaries

About the Association of Consulting Actuaries (ACA)

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