ASSOCIATION OF CONSULTING ACTUARIES

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23 October 2017

Work and Pensions Committee
via online submission

Dear Sir / Madam

Pensions Freedoms Inquiry

I am writing on behalf of the Association of Consulting Actuaries in response to the invitation to provide written evidence by today's date. Our headline views are as follows:

- The freedom and choice reforms are extremely popular with consumers.
- The reforms have been very beneficial for some savers, especially those with substantial pension pots.
- The benefits available from the new flexibility have not been fully captured by new products and consumers are not taking full advantage of the guidance and options available.
- There are however serious risks for members making use of the flexibility, including:
    - The danger of investing their funds inappropriately, for example in low-yielding Cash ISAs for a prolonged period.
    - The likelihood of misjudging longevity, either running out of money too soon or living in penury while keeping an overly conservative fund in case of living longer than expected.
    - The possibility of excessive tax liabilities due to the timing of withdrawals.
    - The exposure to mis-selling and particularly fraud once funds are removed from the regulated pensions environment.

Our responses to the specific questions raised are set out in the Appendix.

We hope that you find these of assistance and would be happy to discuss them further if that is helpful.

Yours faithfully

Hugh Nolan

Hugh Nolan
Chairman, DC Committee
On behalf of the Association of Consulting Actuaries Limited

APPENDIX

ACA response to the Pensions Freedom Inquiry

Q1. What are people doing with their pension pots (including defined benefit pension entitlements) and are those decisions consistent with their objectives? Is there adequate monitoring of the decisions being made?

1.1 Our experience is that most members with defined benefit (DB) entitlements continue to draw those benefits as regular income throughout retirement, having typically exchanged part of their entitlement for a tax free cash lump sum at retirement.

1.2 There is clearly a lot more interest in transfers from DB schemes to defined contribution (DC) schemes for members to access the flexibility available under those arrangements. The ACA's Survey of Pension Trends conducted over the summer of 2017 found that 47% of sponsors of DB schemes reported an incidence of transfer quotes in excess of 5% of scheme members, with a third of these reporting volumes in excess of 10%.

1.3 Much of this interest does not lead to a transfer in practice though but there has been a noticeable increase in transfers actually paid, especially for those in their mid-50s, those at or close to retirement and for those with substantial entitlements. The ACA's Survey of Pension Trends indicates that only 1 in 4 requests leads to an actual payment being completed.

1.4 This can reflect specific cash-flow requirements for the members involved (eg reshaping benefits to better suit expected outgoings, smoothing total income allowing for the State Pension, divorce settlements or providing capital for children buying property), but is often based on a perception of transfer values currently being high due to the expectation of relatively low investment returns and higher life expectancy. Higher paid members transferring their DB entitlements seem particularly interested in estate planning, as well as the personal control of their investment portfolio.

1.5 As transfers in excess of £30,000 require financial advice, the vast majority of transfers are for members who have taken such advice. Their decisions appear to be largely rational, though there remains a risk that they will not be optimal, with particular risks of members investing inappropriately, inaccurately estimating longevity or even being defrauded of their retirement savings.

1.6 Very few members with DC entitlements are purchasing an annuity at retirement these days, with most entering income drawdown and some cashing out their entitlement in full (especially for those with very modest pension pots).

1.7 The monitoring of retirement choices remains patchy and inadequate, with HMRC and FCA statistics (eg https://www.fca.org.uk/publication/data/data-bulletin-issue-10.pdf) giving some useful insight but insufficient granularity and detail to allow a full analysis. In particular, there is little evidence of what members do with their money after withdrawing it from the protected pension environment (either as a lump sum or through income drawdown).

Q2. Are people taking proportionate advice and guidance and if not, why not? Are people adjusting behaviour in response to advice and guidance?

2.1 Very few people are making use of the Pension Wise facility and pension scheme members rarely seek financial advice at retirement, except to the extent that they need to do so to access a DB transfer. In fact, FCA research suggests that only 7% of 55 year olds planning to retire in the next two years had accessed Pension Wise in the previous 12 months (https://www.fca.org.uk/publication/research/famr-quantitative-research.pdf).

2.2 Some pension providers report that savers calling to make withdrawals are unaware of the practicalities, such as taxation, and change their minds after the implications are explained to them. It is entirely feasible that members will not identify large differences in the tax outcome for relatively minor changes in withdrawal timing (eg those retiring in the final quarter of a tax year may pay substantially more tax on an immediate withdrawal compared to waiting until the following tax year when they will have no other earnings).

2.3 Members with small pots seem to take single lump sum withdrawals, which is perfectly reasonable even if it may not be optimal in all cases. We are not overly concerned about the lack of advice taken in these circumstances.

2.4 We are concerned that members in drawdown appear to be withdrawing unsustainable amounts. This may be a deliberate strategy to enjoy the fruits of their labour in the early years of retirement but it is likely that many savers are underestimating their likely longevity, both in terms of average life expectancy and the fact that most retirees will live longer than this average.

2.5 The cost of advice can inhibit members from transferring from DB to DC pension arrangements, with anecdotal evidence of initial charges of up to 3% of the transfer value plus ongoing charges of 0.5% pa. As the FCA's recent report on Financial Lives has disclosed, there is no guarantee that the advice received for these high charges will be of a correspondingly high quality.

2.6 In any event, there is a limited capacity of financial advisers who are competent and willing to advise on pension transfers. Our Pension Trends Survey found that over 60% of employers with DB schemes say members have difficulty in finding advisers prepared to advise on pension transfers. This difficulty with limited capacity is exacerbated in geographical locations where major employers are undertaking a significant pensions restructuring exercise.

Q3. To what extent will pensions dashboards enable consumers to make more informed decisions about their retirement savings? What are the remaining obstacles to their creation and success and how should those obstacles be overcome?

3.1 More information will help consumers make more informed decisions, especially if it is presented simply and clearly (rather than just confusing people with an overload of information). For example, illustrating the amount of guaranteed income people can expect will allow them to plan better for the flexible part of their retirement savings to generate the best overall outcome.

3.2 It is however important to recognise that a lack of information is only one part of the difficulties members face when making good decisions about their pension pot at retirement.

3.3 We have no specific comments to make on the obstacles facing such dashboards.

Q4. Is Pension Wise working? If not, how should it be reformed? Are there any implications for the proposed creation of a new single public financial guidance body?

4.1 Pension Wise provides invaluable guidance to consumers who use the facility, though we are aware of some criticisms at times.

4.2 A new single public body providing financial guidance might potentially be accessed more regularly by consumers and build greater awareness of the valuable service.

Q5. Are there persistent gaps in the advice and guidance market and what might fill them? Is automated advice and guidance filling gaps as expected?

5.1 There is a very limited amount of advice available at a proportionate cost for pension savers with modest pots, though those with substantial benefits are generally well served by advisers.

5.2 Automated advice would seem to be a natural solution for consumers with smaller pots, as long as it is accessible and understandable. We believe that illustrating a wider range of potential strategies for consumers would be helpful, with strawman examples of how people might sensibly make use of the flexibility available.

5.3 For example, someone in a demanding manual occupation who is struggling to continue working a few years ahead of State Pension Age could benefit hugely by drawing a modest DC pot of say £15,000 over a three-year period at £5,000 pa to bridge the gap between employment and the State Pension. The alternative of an annuity of £10 per week for life gives little help for the short-term problem faced here.

Q6. Is there evidence of product market competition resulting in cheaper, clearer or wider products for consumers? Are people switching from their pension provider in accessing their pots? Is an adequate annuity market being sustained?

6.1 Providers are extending the range of products and services available, but only to a limited degree. Income drawdown facilities are now available at lower levels, albeit not across the full spectrum and with relatively higher charges where pots are lower.

6.2 We are slightly surprised by the limited range of products available to date but understand that this reflects demand to a large extent.

6.3 The complexity of drawdown products inhibits switching to a new provider.

6.4 We firmly believe that an annuity would still be highly beneficial to many people in retirement. Member feedback continually shows that consumers want a reliable, guaranteed income for life but the annuity market has been tarnished by largely unfair criticism, with savers imagining that the provider benefits inappropriately from early deaths.

6.5 It may well be appropriate for pensioners to purchase an annuity later in life, when the disadvantages of locking in to a low yield are more than offset by the benefits of a secured income for life. It would seem sensible for consumers to plan for this by purchasing a deferred annuity but this option is extremely unusual in the current market.

6.6 An annuity purchase would also be helpful to mitigate the potential impact of cognitive decline at older ages, when some consumers will be less capable of actively managing a drawdown policy.

6.7 Members with modest pots at retirement might decide to withdraw all their funds in a single lump sum, despite having to pay tax at a higher rate during that tax year. Temporary annuities for say 2 or 3 years could optimise the saver's tax position (as could multiple withdrawals in successive tax years) but again these annuities seem to be largely ignored in practice.

Q7. Are the Government and Financial Conduct Authority taking adequate steps to prevent scamming and mis-selling?

7.1 The Government and FCA have clearly made an effort to prevent scamming and mis-selling and we have welcomed the various measures taken to date. However, we are disappointed that the legislation to implement the proposals contained in the recent consultation on pension scams has not yet been laid before Parliament.

7.2 There is however no doubt that allowing consumers to remove their accumulated retirement savings outside of the regulated pensions environment introduces substantial risks.

7.3 Fraudsters can now encourage savers to withdraw substantial assets with false promises of high yielding investments. The protections available within the regulated environment can thus be bypassed easily.

7.4 Uncertainty over future investment returns, a lack of understanding about longevity (including the difficulty in predicting lifespan for an individual) and practical issues about ongoing monitoring of a decumulation strategy make it inevitable that some consumers will make poor decisions, even if well advised. There is also a distinct possibility that financial advisers may provide inappropriate or inadequate guidance despite their best efforts and intentions.

7.5 Given the speed with which the reforms were introduced and the lack of prior consultation with the industry, it is hardly surprising that were some initial gaps in the regulatory framework.

7.6 It is however disappointing that these gaps have not been addressed sooner, with the FCA taking three years to adjust their regulatory materials in relation to DB to DC transfers, with a substantial amount of money having been transferred and withdrawn without an appropriate process in place.

7.7 FCA materials may still lack real teeth, with a focus on regulation through Guidance rather than Rules.

7.8 We do not believe there is a silver bullet to prevent scams and mis-selling. We would encourage continued and strenuous efforts to inform and educate consumers about the potential risks.

7.9 With this in mind, we welcome the continued focus in this area and believe the proposals raised in the latest FCA consultation will be helpful.

Q8. Are the freedom and choice reforms part of a coherent retirement saving strategy? To what extent is it complimentary to or undermined by other policies?

8.1 Freedom and choice reforms do not appear to be part of a completely coherent retirement saving strategy for Government.

8.2 Tax relief and auto-enrolment encourage consumers to save for retirement, providing a higher quality of life for pensioners and limiting the strain on the State pension system. However freedom and choice does bring the risk that accumulated funds will be withdrawn and depleted prematurely, either deliberately, recklessly or in ignorance of the relevant factors and potential consequences.

8.3 That said, the added flexibility available can be hugely beneficial for consumers if used well. The ability to withdraw money to meet specific needs such as a new car or house repairs is very valuable and it is also clear that the expenditure pattern of pensioners after retirement is not well matched by a traditional annuity. As illustrated in paragraph 5.3 above, consumers may have particular short-term needs that can be met by using the flexibility to prevent serious financial hardship.

8.4 It is disappointing that many consumers do not appear to be making the best use of the flexibility available, with limited product innovation from providers and very few members accessing the helpful guidance available from Pension Wise and TPAS. The rushed implementation of the reforms has led to unfortunate and unintended consequences, with inadequate initial protection for consumers facing a new environment.

8.5 In practice, the principal beneficiary of the reforms is the Treasury, with an acceleration of the tax receipts from pension payments. The reforms have also been very positive for the most well-off consumers who can access good advice at a proportionate cost and can use the new flexibility for estate planning as well as retirement income.

8.6 It is extremely likely that some consumers will exhaust their private retirement savings prematurely and they may then be increasingly reliant on the State for benefits. The benefit of the accelerated tax receipts may well be outweighed by an increased burden on the State finances in years to come.

8.7 In fairness, the reforms do support other initiatives to boost retirement saving by making pension saving appear more attractive to consumers. The improvement in the public perception of pensions is extremely welcome and will be very helpful in encouraging pension saving.

About the Association of Consulting Actuaries (ACA)

Members of the ACA 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 include the scheme actuaries to schemes covering the majority of members of private sector defined benefit pension schemes.

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

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