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Making the system fit for purpose:

How consumer appetite for secure retirement income could be supported by the pension reforms

January 2015

Acknowledgments

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Contents

Foreword

Foreword from Dr Ros Altmann, CBE

Pensions are not just about money, they are about people. By saving money while young, and providing extra income in retirement, pensions can support personal as well as financial wellbeing across the life-course. In the new world of pension freedoms, in order to make pension savings work best for the people who put away their hard-earned money for the future, it is vital that pensions can offer more flexibility to fit with people's more flexible lifestyles. New products are being developed, but to ensure they serve customers best, it is important to assess what people want their pension savings to achieve and how well-equipped they are to make the choices necessary to secure their goals. This major new research project offers insights into the consumer's mind-set, to better understand what types of products people might prefer and what obstacles they face in making informed choices.

The report finds that many people are ill-equipped to make financial decisions about their pension savings with striking evidence of limited understanding of important products and terms. People need help to understand the optimum timing of taking money, the tax implications of doing so and the types of products that are likely to be most suitable. Less than half of all pension savers over 50 have actually made a financial plan, and even amongst those who are just a year from retirement 40% have yet to make a plan.

Policymakers have recognised the reality that making the right decision is not straightforward. To address this shortfall in financial capability, the new system of free financial Guidance is being established. This will be crucial to the success of the pension reforms and it is essential that the Treasury promotes the new Guidance service with a major marketing campaign to establish trust among the public. Without guidance – and preferably financial advice – consumers are unlikely to be able to make the best decisions about their pensions. This research, however, reveals that a significant proportion of people do not intend to take advice. This worrying 'advice gap' appears to stem more from a lack of trust, rather than an unwillingness to pay. Therefore, the new Guidance service needs to help people realise the value of paying for expert individual financial advice to assist with retirement planning.

When developing new pension saving or income products, providers must understand the requirements of their customers. While different people have different preferences, this report indicates that many would prefer products that provide a guaranteed income in retirement, but they also want products that ensure future income is not eroded by inflation. To achieve both these aims adequately, many people may need help to consider how to plan appropriate savings levels and a starting age for income withdrawal. If their pension savings are insufficient to deliver an "adequate" and secure retirement income, the sensible approach may be to consider working longer or using other assets (such as property) to fund costs in retirement.

So this important research project offers several significant conclusions. In the short-term, policymakers must focus on ensuring take up of the free financial Guidance with a widespread marketing campaign, building within the Guidance process an effective hand-off to other forms of support including regulated financial advice. But in addition, there is an urgent need for a contingency plan to support those who choose not to go through the Guidance process as well as those who do take-up the Guidance process but are still at risk of making poor decisions. Over the longer term, financial education for all is needed, perhaps embedded from an early age into pension auto-enrolment schemes, to improve the nation's financial capability.

The people and organisations involved

Dr Ros Altmann, CBE

Ros Altmann is a leading independent expert on pensions and retirement. She managed pension funds for many years and subsequently advised the UK Government on private pensions and state pension policy. She works as an independent consultant for pension providers, consumer groups, trustee boards and industry bodies and was awarded a CBE for services to pensioners and pension provision. She is a renowned consumer champion and frequent media commentator on all aspects of pensions, as well as being the Government's Business Champion for Older Workers.

EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

ILC-UK

The International Longevity Centre-UK (ILC-UK) is the leading think tank on longevity and demographic change. It is an independent, non-partisan think tank dedicated to addressing issues of longevity, ageing and population change. We develop ideas, undertake research and create a forum for debate. Much of our work is directed at the highest levels of government and the civil service, both in London and Brussels. We have a reputation as a respected think tank which works, often with key partner organisations, to inform important decision-making processes. We are aided in this work by our Chief Executive, Baroness Sally Greengross, former director-general of Age Concern and now a cross-bench peer. Our policy remit is broad, and covers everything from pensions and financial planning, to health and social care, housing design, and age discrimination. We work primarily with central government, but also actively build relationships with local government, the private sector and relevant professional and academic associations.

Just Retirement

Just Retirement is a specialist retirement income provider. Founded in 2004 we have grown to become the largest provider of individually underwritten annuities, the second largest provider of equity release lifetime mortgages and an innovator in medically underwritten de-risking solutions for defined benefit pension schemes. We have recently entered the market to support people reduce the financial uncertainty associated with the costs of funding long term care.

Renowned for our work to bring value and innovation to people at and in-retirement Just Retirement is supporting this report to uncover fresh insights into consumers' preparations for the pension reforms. We hope the findings will help policymakers and other interested organisations build a new framework that delivers the most important objective of all – improved outcomes for people at and in-retirement.

Key Retirement

Founded in 1998 Key Retirement is a leading specialist provider of financial services to the over 55's. Key is dedicated to developing solutions to meet its customers' needs in the ever changing retirement landscape. Formerly a top 4 annuity broker, Key has recently evolved it's Retirement Options service to offer customers advice across the full range of retirement propositions, believing that no retirement income decision should be made without advice. Parent company KR Group is backed by leading private equity investor Phoenix Equity Partners which bought a majority stake in the business in 2013.

LV=

LV= is the UK's largest friendly society and a leading financial mutual, employing 6000 people and serving over 5.5 million customers and members. LV= offers a range of financial services including general insurance, investment and retirement solution products.

LV= offers customers a range of at retirement products, including annuities, income drawdown, SIPPs and equity release. LV= is focused on offering consumers choice and a blend of products to best suit their circumstances, at both the point of retirement and throughout their retirement.

We pride ourselves on not only having one of the most comprehensive ranges of retirement solutions products in the market, but also being specialists within the retirement income market. LV= is in full support of encouraging people to shop around when they retire.

We believe that the pension reforms will fundamentally change the retirement landscape for the better, giving customers more choice and control over how they manage their retirement income. With the shape of retirement changing, and people enjoying much lengthier retirements, it is even more important that they make the most of their pension fund. We are committed to working with wider industry to ensure that people make the most of their pension savings, and where appropriate, are actively encouraged to take advice.

Partnership

There is a simple belief at the heart of our business: people with lifestyle and health issues deserve a better retirement deal.

We are usually able to offer our customers – people whose health or lifestyle means their life expectancy is likely to be reduced – more money than a standard insurer can, both at and during retirement.

We can offer more because, over 19 years, we have cultivated extensive expertise and an in-house dataset that enables us to see our customers as individuals and tailor our products to meet their needs.

In addition to creating innovative and beneficial products for our customers, we make sure that we manage our risks well, and run our company efficiently and with integrity. As a result, we have gained a leading position in our market.

This means we can offer more customers a better income in retirement. We can offer our people fulfilling and challenging careers and we can offer our shareholders a meaningful, and growing, return on their investment. We can change the conversation, and we can reshape markets.

We are Partnership, and we see retirement differently.

About this report

This report outlines the findings of a major consumer research project into the preferences and characteristics of the pre-retirement group in light of the new freedoms and choice in accessing defined contribution pensions. Following an extensive literature review and focus group sessions, we undertook a nationally representative poll of 5000 people aged 55-70 who are yet to retire or draw on their private pension wealth in order to gather fresh insight. This research has been led by independent think tank the International Longevity Centre-UK (ILC-UK), and the Government's Business Champion for Older Workers, Dr Ros Altmann. It was made possible through a consortium of sponsors brought together by Key Retirement and include: EY, Just Retirement, Key Retirement, LV= and Partnership.

Summary

Secure income in retirement preferred

Our results suggest that many of those likely to be impacted by the new freedoms would prefer their pension to deliver a secure guaranteed income for life over anything else.

- Nearly 70% of all those with Defined Contribution (DC) pots favoured this option while just 7% said paying for holidays, a new car, house repairs or other big ticket items was the most important, and 5% said paying off debts was the most important.
- And when asked what they thought was the most important aspect of a pension product, the most popular response was "I want a guarantee that I will have money to pay my bills even if I live well into my nineties" while the second most favoured response was "I want to be sure that my income in retirement will at least keep up with inflation". Only 3% agreed with the statement "I am prepared to take risks with my savings and want to have the chance to earn extra investment returns even in retirement".

While secure income in retirement is preferred, the adequacy of that income is likely to remain an issue due to levels of undersaving. According to our rough calculations, while some may be able to combine private pension wealth with the State Pension to meet their regular bills, many will not be able to, and even those that are, may need to find additional funds to meet sudden, large costs such as those related to long term care.

Older consumers are risk averse

Part of the reason why people appeared to prefer the secure income option was risk aversion. Across the entire sample there was little evidence that people would be willing to risk their hard won savings in retirement.

- 75% of the entire sample agreed with the statement; "I would prefer a secure guaranteed income in retirement over an income that might rise or fall depending on returns in financial markets" by comparison to 8% who disagreed and 3% who didn't know.
- When explicitly asked about what proportion of their pension fund they thought they could afford to lose before it seriously impacted upon their retirement plans, the most common answer was none (35%). Just 7% of those with a DC pot thought they could afford to lose 20% of their fund or more before it seriously impacted upon their retirement plans.
- Women appeared to be more risk averse than men. 43% of women with a DC pension pot said they could not afford to lose any of the fund before it seriously impacted their retirement plans by comparison to 30% of men.

While consumers want security of income they are confused about their options

With the onus now being with the individual to make an active decision about what to do with their pension pot at the point of retirement, it is vital that consumers are sufficiently financially capable to make an informed decision. Our research reveals evidence of limited knowledge about relevant products and services despite the new freedoms being less than 4 months away:

- Only half of those with a DC pension said they understood what an annuity is quite or very well.
- Only 20% of those with a DC pension pot said they understood what an enhanced annuity is quite or

very well with nearly half saying they had no understanding of this product. In addition,

- Just 33% said they understood what a joint life annuity is quite or very well.
- Just 35% said they understood what income drawdown is quite or very well.
- This compares to over 90% who said they understood what a mortgage is.

…and many have yet to make a retirement plan

- Across the entire sample (includes those with DC pensions, those with Defined Benefit pensions and those without any private pension wealth but who are still working), just 39% have made a plan. Even for those that are less than a year away from retirement, just over 40% have not yet made a plan.
- For those specifically with Defined Contribution pots, the proportion who have made a plan is only marginally higher than across the entire sample (40%). And amongst those DC pension holders who are less than a year away from retirement, 39% have still to make a plan.

There is significant risk that individuals will be overtaxed

The new pension freedoms allow individuals to take a tax free lump sum from their DC pension pot and to take the rest out at their marginal rate of tax. But evidence from our survey suggests that people do not understand the term marginal tax rate and this could result in them facing a significant tax bill.

- Only 22% of people in our survey with a DC pot said they understood the term marginal tax rate, while 43% said they had no understanding at all.
- When pressed about how to reduce their tax burden when taking money out of a pension, only half of those with DC pots gave the correct answer that you should "withdraw it in small amounts over a number of years". Worryingly, 1 in 10 actually agreed that you should "withdraw it all as one big lump sum" to limit the tax burden.

Withdrawing everything from the pension could result in retirement funding shortfalls

Analysis investigating the consequences of individuals withdrawing their pension pot and putting it into a cash ISA, highlights the possibility of them outliving their savings.

- According to our calculations, if an individual were to try to use money in an ISA to give themselves the same income as the same savings could provide via an annuity, many would run out of income by their mid-80s.
- Given that, in 2011-2013 more than a third of male deaths and more than half of female deaths occurred at ages 85 or above[1], this could be a serious problem. As the proportions living to older ages increase, many could simply run out of money.

Clear need and desire for Guidance

In response to the challenge of financial capability and consumer awareness, the Government has committed itself to ensuring the introduction of free, impartial guidance for all those with DC pension pots on the verge of retirement. We asked consumers for their views on the Guidance Guarantee:

- Over 60% of people with DC pots agreed that they would take up the offer.
- However, 2 in 10 people with DC pots still said they would not take up the offer of free guidance. This is clearly cause for concern and Government together with industry must identify ways in which these individuals are not overlooked once the Guarantee is in place to avoid poor outcomes for this group. It should be noted however, that there has not yet been any real detail or promotion of the Guidance Guarantee, and we would hope that more people would be inclined to use it once they understand what it is and how it can help.
- Face to face is overwhelmingly favoured as the method of delivering guidance. 63% of those with DC pots would like it delivered face to face. Online information is favoured second - by 20% of this group.
- Individuals realise that Guidance in itself will not be enough – just 1 in 5 people with DC pots think that guidance will be enough for them to able to make a decision about how to use their pension pot. Over 50% think that they will be more informed and know where to go for further information and advice after receiving guidance.

1 ONS, Number of survivors in the life table

Advice favoured but trust issues could lead to advice gap

Given that Guidance will not be sufficient in order for many individuals to make a decision about what to do with their pension pots, it is important to know what other sources of advice, if any, they are going to look towards. These other sources of advice are likely to be critical in determining whether or not people are able to make appropriate decisions after the reforms are in place.

- Out of all those with DC pots, a financial adviser came top, with 39% saying they would seek advice from this source. Second was the internet (33%) and third their existing pension company (27%).
- While using a financial adviser appeared to be a favoured option amongst survey respondents, this still leaves some 60% of people with DC pension pots who will not seek professional advice. This "advice gap" could result in people making ill-informed decisions unless it is filled by other forms of support.
- Amongst a list of reasons **for not** choosing advice, lack of trust was the most commonly cited. 44% of those with DC pots agreed with the statement "I do not trust the financial services sector to provide me with good advice". The second favourite option was "I don't have much money in my pension funds so it would not be worth paying" (31%) and third "I can find all the information online and get free advice that way, instead of paying for it".

High level policy implications

- There is little time left to meet all of the significant challenges associated with the new freedoms in pensions. The results of our in-depth consumer research reveal that a significant majority want to use their pension pots to deliver a secure income in retirement, but that many may be too confused to know how to go about achieving this. Low levels of financial capability could, if left unaddressed, be exacerbated by the new freedoms and result in people squandering their pension wealth, either by doing nothing in the face of complexity, by channelling money into high risk investments or by taking all of their money out and leaving it in a low interest bank account. Each option is likely to result in poor consumer outcomes by increasing the risk of a retirement funding shortfall. If people want their pension to deliver an income in retirement in a secure way, and the results of this research project strongly suggest that they do, the new framework must be built with this end in mind.
- In this regard, we think two areas in particular need to be strengthened before the new freedoms come into play.
    - First, the Guidance Guarantee is the critical policy measure that the Government has identified as a way of helping people navigate the complex arena from April 2015. Implementation is everything – it is no use having a system of guidance which is underused and untrusted. And this system must act as an effective hand-off to other forms of support and advice that can facilitate informed consumer decision making and not inertia. At a minimum, the Guidance must include relevant examples of how longevity risk could affect an individual's financial wellbeing over the duration of retirement as well as what the tax implications could be of pulling out all the money from the pension and putting it into a savings account. The Guidance must also be tailored to suit those with low levels of financial capability and very low risk appetite when providing support. And finally, the Guidance must be effectively publicised by Government and the institutions delivering it, to raise awareness of what it is and how it can help.
    - Second, there needs to be a contingency plan to support a) those who choose not to go through the Guidance process and b) those who go through the Guidance process but are still liable to making poor decisions. One measure that is urgently needed is for the Financial Conduct Authority and The Pensions Regulator to use their current powers to place responsibilities on existing pension savings providers to ask their customers a small number of mandatory questions before the customer concludes how to use their DC pension savings. These questions would in effect require the provider to actively engage with the customer to prompt them (not advise them) with the aim of helping them avoid making the most common poor choices. This report has demonstrated that older consumers have little appetite for risk but that many have very low levels of understanding about relevant products and services. We must therefore ensure sufficient safeguards are in place to reduce the risk of consumer detriment and thereby maximise the possible benefits of the new freedoms.

Policy background

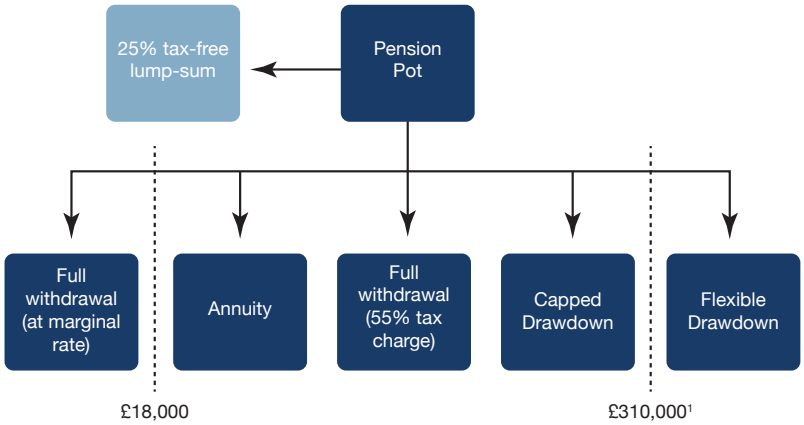
"The big thing is choice. There are a number of things that I couldn't do before that I can do now"

- Focus group participant

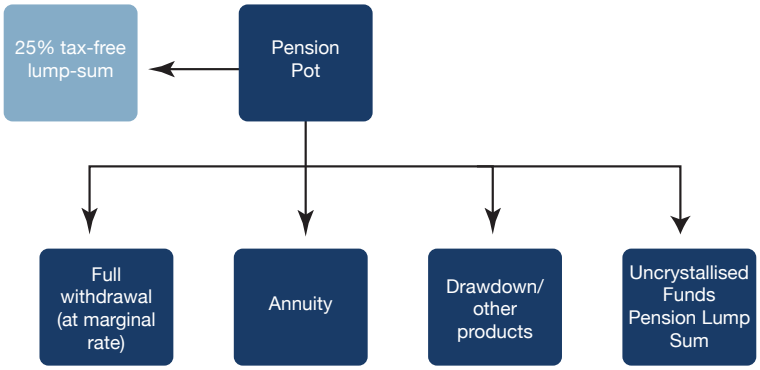
In his Budget 2014 speech to Parliament, Chancellor George Osborne announced sweeping reforms for accessing defined contribution pensions at retirement. By April 2015, the tax penalties for individuals taking all their money out in cash will be significantly reduced. Today, individuals can take 25% of their pot as a lump sum, but if they pull the rest out it will be subject to a 55% tax charge. By contrast, under the proposed reforms, while the first 25% remains tax free, the remainder can be withdrawn at the individual's marginal rate of tax. See below chart for an illustration of the changes. Many have referred to the reforms as "the new freedoms" for accessing DC pension pots, and it has led to much speculation about exactly how individuals will use their pension pot under the new tax framework.

Figure 1. Graphical illustration of changes (March 2014 vs April 2015)

Under the current system, people's choices are constrained by the size of their defined contributions pensions pot. There is some flexibility for those with small and very large pension pots, but around three-quarters of those retaining each purchase an annuity.



[1]This is a stylised assumption based on a individual with a full basic pension of £5,744 per year, who takes the maxium tax free lump sum (25%) from their defined contribution pension pot and purchases a single life, level no guarantee annuity worth £14,256 per year (an annuity rate of 6.1%) at age 65. This will enable them to meet the minimium income requirement of £20,000 per year for entering flexible drawndown.



Under the new system, regardless of the size of their defined contribution pension pot, everyone will be able to choose any of the options in the above diagram. This will mean that everyone has access to full withdrawal, an annuity or drawdown, and potentially other products created by providers.

Source: Author's adaptation of HM Treasury diagram from March 2014

Since the initial announcement, the draft legislation has also introduced a fourth facility alongside annuities, drawdown and full withdrawal called 'uncrystallised funds pension lump sum' (UFPLS). A UFPLS can be taken from uncrystallised funds with 25% of the lump being tax-free, and the remainder being taxed at the individual's marginal tax rate. This measure will therefore allow people to draw a lump sum from their pension without having to crystallise the whole pension pot.

Alongside these changes, the Government has given a guarantee that all those at the point of retirement will have access to **free and impartial guidance**. The Government has ruled that the guidance offered must be:

- impartial and be considered of good quality;
- covers the individual's range of options to help them make sound decisions to equip them to take action, whether that is seeking further advice or purchasing a product;
- free to the consumer (at point of use); and
- offered face-to-face.

Under current plans, the reforms will be implemented in April 2015[2]. By any criterion this is a very tight timeframe for relevant parties to consult, design and deliver the requirements that need to be embedded in these reforms. Indeed there remain a number of big unanswered questions – not least how people's behaviours at the point of retirement might shift in response to the planned changes and their implementation, and how a new and successful system of Guidance can reasonably operate.

Who will be affected?

According to estimates from HM Treasury, 320,000 people each year retire with a DC pension pot[3].

Analysis by the Institute for Fiscal Studies shows that this group is largely male, with women half as likely as men to be currently holding a DC pension pot[4]. It also shows that this group is primarily made up of full time workers. Full time workers are 'one and a half times as likely to have a DC pension as those working part time' and 'two and a half times as likely as those not in work'. They find that neither educational status nor numerical ability is related to the probability of holding a DC pension.

Using the Wealth and Assets Survey, the IFS found that 24% of those aged 18-64 have contributed to at least one DC pension fund and that the median value of such a fund just prior to State Pension age is £20,000. They also found that the size of individuals' DC pension pots rises as their overall wealth rises, so while the median pot in the poorest quintile is £3,807, the top quintile has a median pot size of £35,000[5].

2 For more details see the Government's consultation paper, Freedom and Choice in Pensions (2014). https://www.gov.uk/government/consultations/freedom-and-choice-in-pensions

3 HM Treasury Budget 2014: greater choice in pensions explained

4 Crawford R and Tetlow G (2012) *Expectations and experience of retirement in Defined Contribution pensions: a study of older people in England*, Institute for Fiscal Studies, London

5 Crawford R and Tetlow G (2012), *Fund holdings in defined contribution pensions,* Institute for Fiscal Studies Wealth and Assets Survey figures relate to the 2008/10 wave.

How people might respond to the reforms: evidence from past literature

"Now there's the government change, what I'm going to do next April is I'm going to take the full capital sum and spend it."

- Focus group participant

In the face the proposed reforms, a number of commentators have looked to other international markets and the behavioural economics literature to understand the possible reactions of UK consumers to the new freedoms.

Outliving your savings

When an individual retires they face a longevity risk, the risk that they will live longer than their savings last. There is also the risk that an individual is so afraid of outliving their savings, that they under consume and end up dying without making full use of their pension pot. An annuity insures against both these risks, protecting against under and over consumption during retirement by providing a stable income for the duration of retirement.

Until the recent pension reforms, individuals in the UK were incentivised to purchase an annuity or income drawdown plan that capped the amount of withdrawals that could be taken from the pension fund. Prior to announcement of the reforms it has been estimated that approximately 75% of individuals with DC pensions annuitised[6]. As of April 2015 however, individuals will have much greater freedom with regards to how they choose to use their pot. In some countries where similar freedoms are already in place, the level of annuitisation is much lower. For example, the USA has a voluntary annuitisation rate of just 2% and Australia's is between 2% and 10%[7].

While an annuity may not suit everyone, there is evidence of under-annuitisation in countries such as Australia and the USA, where individuals are exposing themselves to running out of money before they die. The Pensions Policy Institute reported that in the USA, 'half of those in or close to retirement in 2010 were in danger of exhausting their private pension savings before their death'[8].

By providing a stable retirement income, annuitisation has clear benefits, so the very low levels of voluntary annuitisation in certain countries has become known as the "Annuity Puzzle". Much of the discussion since the UK's new pension freedoms were first proposed has focussed on this issue and its potential ramifications for UK consumers. So why do some people choose not to annuitise and what might be the implications?

Behavioural biases

There is a wide body of research which attributes low voluntary annuitisation rates to behavioural biases as well as a lack of understanding, among retirees.

People may not annuitise their pension pots because they gain a feeling of security from having liquid savings in the bank. The Strategic Society Centre has described this as a 'psychological dividend'[9] and argues that savings could boost people's confidence and expectations. Annuitising a pension pot would result in the loss of this dividend, even if it would provide security in other ways, and so people may choose not to.

Hu and Scott (2007) argue 'mental accounting and loss aversion can explain the unpopularity of annuities by framing them as risky gambles where potential losses loom larger than potential gains.'[10] Individuals face a potential loss as there is a probability they will die before they get as much out of an annuity as they initially put in. They are loss averse and this makes them overstate the likelihood of this, therefore they choose not

6 Pensions Policy Institute (2014) *Freedom and Choice in Pensions: comparing international retirement systems and the role of annuitisation.* PPI Briefing Note Number 66.

7 Ibid.

8 Ibid.

9 Lloyd (2014), *New Annuity Era – Understanding retirement choices and the annuity puzzle,* Report for the Strategic Society Centre

10 Hu W and Scott J (2007) "Behavioural Obstacles in the Annuity Market" in *Financial Analysts Journal*, Vol. 63, No. 6

to purchase an annuity. Framing an annuity as a risky investment, rather than as guaranteed consumption, can therefore have a big effect on the take up of the product[11].

Brown et al (2013) suggest that complexity may act as a barrier to the annuitisation of pension pots. Using experimental evidence they show that 'individuals have difficulty valuing annuities, and this difficulty – rather than a preference for lump sums – can help explain observed low levels of annuity purchases'[12]. When people retire and face the annuitisation decision, they are making a choice they have no prior experience of. Brown et al use their research to argue that in the face of this, individuals resort to 'rule-of-thumb behaviors'. In an experiment where they presented individuals with hypothetical choices, they found 'a large divergence between the price at which individuals are willing to buy an annuity and the price at which they are willing to sell an annuity'. This implies people were using 'a simple "buy low, sell high" heuristic' rather than fully understanding the decisions they were making.

In a similar vein, the Strategic Society Centre suggest that when people choose not to annuitise they are 'simply displaying inertia in the face of a complex decision'[13]. Instead of trying to understand the complexities of various annuity options, individuals may choose to put their money in to 'easy access liquid savings accounts which do not commit individuals to any course of action'.

An alternative explanation for low annuitisation may be that people do not accurately predict how long they are going to live for. If people think they are only going to live for a short period after retirement they may not think that an annuity is the best option. Research by the IFS found that 'over half (58.5%) of individuals aged 50–64 (who are not yet retired) have never thought how many years of retirement they will have to fund' and that 'this figure is higher among members of DC pension schemes than among members of DB schemes'[14]. People who have considered their life expectancy in retirement do not expect to live as long as they might, 'only 9% of men and 10% of women expect to live until at least age 90, when in fact the official estimates are that 18% of men and 29% of women will do so.' The IFS go on to argue '…to the extent that DC scheme members underestimate their true life expectancy, they will see annuity rates as offering poor value for money'.

Who is most at risk due to the reforms?

In the OECD latest Pensions Outlook, it is argued that while the new freedoms in accessing DC pensions may increase pensioners control over their accumulated funds, it could be "detrimental to retirement income adequacy as well as incentives to work, due to individual's myopic behaviour and insufficient financial literacy". They argue that "the overall outcome depends on how successful individuals are in assessing their needs over their remaining life expectancy. In any case, such withdrawals bear risk that retirees outlive their savings, especially those with low wealth"[15].

Research from the Pensions Policy Institute has explored which groups are likely to be most at risk from poor decisions under the new policy framework. According to their analysis, the highest risk group was those with between £19,400 to £51,300 of DC savings and no DB entitlement. They estimate that this group constitutes a significant number of people - 694,000 or 12% of people aged 50 to SPA in 2014. The group scores low on financial capability, while financial advice is largely unused making them susceptible to poor decisions. In addition, the group does not have many other potential sources of income to fall back on other than the state and housing wealth, if they make poor decisions regarding their DC pension[16]. For this reason not only are they at high risk of making a poor decision, but the consequences of making a poor choice are potentially much worse.

The catastrophic costs of taking money out of the pension and putting it into a savings account

Taking the entire pension pot and putting it into a savings account could result in significant retirement funding shortfalls. To illustrate this, below we calculate the value of a cash ISA versus a single life level annuity for an individual in three different scenarios. In the first the individual retires with a pension pot of £25,000, in the second he has £50,000 and in the third he has £100,000.

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11 Lloyd (2014), *New Annuity Era – Understanding retirement choices and the annuity puzzle,* Report for the Strategic Society Centre

12 Brown J et al. (2013) Complexity as a Barrier to Annuitization: Do Consumers Know How to Value Annuities? Pension Research Council Working Paper, University of Pennsylvania

13 Lloyd (2014), *New Annuity Era – Understanding retirement choices and the annuity puzzle,* Report for the Strategic Society Centre

14 Crawford R and Tetlow G (2012) *Expectations and experience of retirement in Defined Contribution pensions: a study of older people in England*, Institute for Fiscal Studies, London

15 OECD (2014) OCED Pensions Outlook 2014

16 Pensions Policy Institute (2014) Transitions to Retirement - 'How complex are the decisions that pension savers need to make at retirement?

In these scenarios we base our analysis on the following simplifying assumptions:

- The individual in question is a man who retires at age 65.
- He takes 25% of his pension pot as a tax free lump sum, with the rest he either buys a single life level annuity, or he puts it in to an ISA. From the ISA he withdraws the equivalent of the annuity each year as his retirement income.
- All annuity calculations were obtained using MoneyFacts in November 2014. Calculations are based on a non-smoking man, age 65, with no existing health conditions[17].
- We assume that interest rates on ISAs remain at their current rates. The best rate available in November 2014 was 1.6% p.a.[18]. It should be noted that neither ISA rates nor annuity rates will stay the same over the next 30 years so these assumptions are used for illustrative purposes only and will not reflect the "true" value of each option over the time period in question.
- ONS figures estimate cohort life expectancy for a 65 year old man to be another 21.2 years[19]. This means our retiree can reasonably expect to live until he is 86 or more.

The table below is an illustration of how much money is left in an individuals' pot after they have taken 25% of it as a tax free lump sum. It then details the annual annuity an individual could buy with this money, and the total value of this annuity to the individual, both at age 86 and over 30 years. It also shows how long the individual would be able to live off the savings in their ISA account if they were to withdraw the same amount each year as the annuity would offer.

Table 1. Example of the value of an annuity versus putting money into a cash ISA at current interest rates (for illustrative purposes only)

Scenario	Pot value after taking 25% tax free	Annuity (p.a.)	Age at which savings run out	Cumulative value of annuity at age 86	Cumulative value of annuity over 30 years
£25,000 pot	£18,750	£1023	86	£22,506	£30,690
£50,000 pot	£37,500	£2112	86	£46,464	£63,360
£100,000 pot	£75,000	£4291	85	£94,402	£128,730

According to the above illustrative scenario, if individuals were to try to use their ISA to give them a comparable retirement income to an annuity, many would run out of money long before the end of their lives. In 2011-2013, more than a third of male deaths and more than half of female deaths occurred at ages 85 or above indicating that many are already living beyond the point at which their savings would run out had they had put all their money into a cash ISA at current interest rates.

17 https://www.onlineannuityplanner.com/MoneyFacts/v1/planner?cid=MF106

18 This is Money, Best Savings Rates table, 11 November 2014.

19 ONS, Historic and Projected Mortality Data from the Period and Cohort Life Tables

Tapping into UK consumer preferences

While there is a wide behavioural economics and marketing literature on the preferences of those saving for retirement and on the "annuity puzzle", its findings have often been based on *revealed preferences*. Revealed preference is an economic method of examining individual behaviour which uses the choices consumers make in practice to infer their underlying preferences. There is much less research based on directly asking consumers to state their views and preferences. Moreover, much of the recent speculation into how consumers will react to the UK reforms, has been based on revealed preferences of individuals from other countries – not directly from UK consumers. Since financial preferences surrounding risk, savings and income are likely to be underpinned by social and cultural norms, which may in turn, be region or country specific, this could be a significant oversight. In addition, while a number of commentators have speculated about what sorts of retirement income products individuals might be attracted to in the new world, there is a dearth of hard evidence in terms of tapping into the views of UK consumers in this regard. This report attempts to fill this significant hole in the evidence base by conducting a large-scale survey of people in the UK who are close to retirement but have not yet drawn on their private pension wealth.

Methodology

We took a two-stage approach to assessing the views of consumers. First we undertook two focus groups to assess some of the underlying, qualitative issues facing this age group in order to help us construct a questionnaire for some large-scale polling. Second, we commissioned the polling agency YouGov to conduct a nationally representative survey of over 5000 UK adults aged 55-70. The figures were weighted and filters used to ensure that the final results were nationally representative of the 55-70 age group who are yet to tap into any private pension wealth and are not yet retired. Fieldwork was undertaken between 17/09/2014 - 23/09/2014. The survey was conducted online using a subset of the 280,000+ individuals who have agreed to take part in surveys through the YouGov panel.

Based on our assessment of previous related literature, we focussed our questions for the consumer research around six core areas:

1. Consumer awareness and financial literacy
2. Prevalence of retirement planning
3. Attitudes to risk
4. Preferences for using pension wealth in retirement
5. Consumer understanding of the new freedoms and preferences views on the Guidance Guarantee
6. Sources of advice

Consumer awareness and financial literacy

"I'm very innocent in financial matters. I just can't bear to think about it. I don't even know about how much of your pension you can draw as a lump sum. Is that to do with the State Pension?...I find it extremely confusing that there are all these sources of money and I've always been like this".

- Focus group participant

With the onus now being with the individual to make an active decision about what to do with their pension pot at the point of retirement, it is vital that consumers are sufficiently financially capable to make an informed decision. Our research reveals evidence of limited knowledge about relevant products and services despite the new freedoms being less than 6 months away:

- Only half of those with a DC pension said they understood what an annuity is quite or very well.
- Only 20% of those with a DC pension pot said they understood what an enhanced annuity is quite or very well with nearly half saying they had no understanding of this product.
- Just 33% said they understood what a joint life annuity is quite or very well.

- Just 35% said they understood income drawdown quite or very well.
- This compares to over 90% who said they understood what a mortgage is.

There is also evidence to suggest that women and people of lower social grade are particularly susceptible to low levels of financial capability. Our survey results show:

- While 62% of men with a DC pension said they understood what an annuity is quite or very well, this fell to 41% of women with a DC pot.
- Similarly, while 61% of people with a DC pot amongst social grade ABC1 said they understood the term annuity quite or very well, this fell to 40% amongst those of social grade C2DE.

The low level of understanding about retirement income products is clearly a concern. Many individuals will be retiring with limited understanding of what options are available and what their possible benefits and costs might be which could lead to poor decisions or apathy in the face of complexity. And our survey results suggest that this is likely to be particularly true for women and those of lower social grade.

Consumer understanding of tax implications

Low levels of awareness about tax issues also threaten to erode pension income. The new pension freedoms allow individuals to take a tax free lump sum from their DC pension pot and to take the rest out at their marginal rate of tax. But evidence from our survey suggests that people do not understand the term marginal tax rate and this could result in them facing a significant tax bill.

- Only 22% of people in our survey with a DC pot said they understood the term marginal tax rate, while 43% said they had no understanding at all. This rose to 55% of women with DC pots and 56% of those in social grade C2DE (working class).
- When pressed about how to reduce their tax burden when taking money out of a pension, only half of those with DC pots gave the correct answer that you should "withdraw it in small amounts over a number of years". Worryingly, 1 in 10 actually agreed that you should "withdraw it all as one big lump sum" to limit the tax burden.

Misunderstanding the tax implications of the reforms could result in consumers facing avoidable tax bills and therefore generating less income for their retirement leaving them with shortfalls. This might boost Government tax revenues in the short term, but may result in reduced revenue overall because it will leave individuals with less to live off for the duration of their retirement and therefore require more State support later on.

Planning for retirement

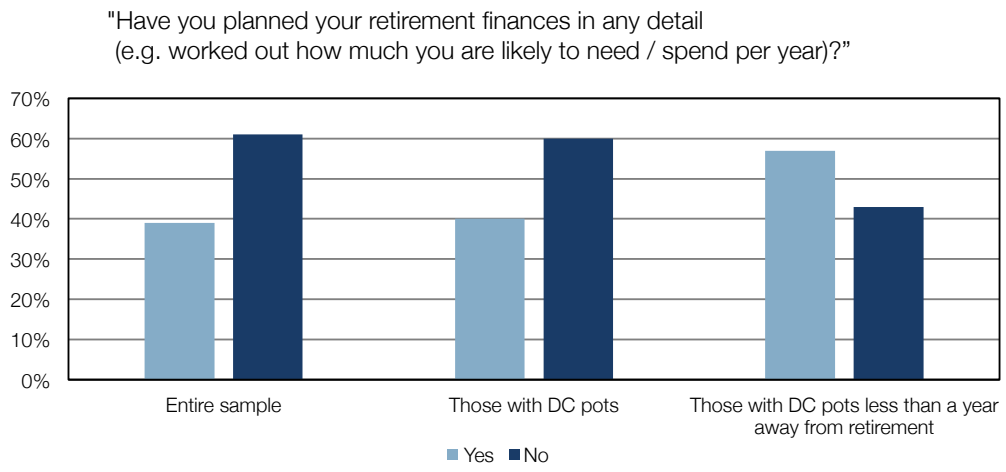
"I really don't understand what the options are. I have absolutely no idea. Almost head in my arms, I'm relying very much on the professionals within the company that I worked for to start me on the path of what's happening".

- Focus group participant

In order for consumers to understand what types of retirement income products they might need, it is helpful to make a plan about how their private pension(s) plus State Pension along with any other sources of income will meet their spending needs over the duration of retirement. This plan can help guide the decision making process in a more informed way. Unfortunately, our survey highlights that a significant proportion of pre-retirees have yet to plan their retirement finances in any detail.

- Across the entire sample which includes those with DC pensions, those with Defined Benefit pensions and those without any private pension wealth but who are still working, just 39% have made a plan. Even for those that are less than a year away from retirement, just over 40% have not yet made a plan.
- For those specifically with DC pots, the proportion who have made a plan is only marginally higher than across the entire sample (40%). And amongst those DC pension holders who are less than a year away from retirement, 39% have still to make a plan.

Figure 2. Planning for retirement



Why the lack of planning?

Understanding the reasons why individuals have not yet planned their retirement finances is important because it can help to reveal the types of measures needed to address this issue and improve peoples' readiness for retirement. We would argue that the importance of making a plan has been exacerbated by the new pension freedoms because it will be up to the individual to decide how they use their DC pension wealth as well as any other assets to fund their retirement income needs. In this regard, our research found that:

- 37% of those with a DC pension who had not made a plan had failed to do so because they had "no spare money at the moment". This suggests that some individuals believe they are too financially constrained to make a plan – perhaps because they think there is little added value in making a plan as their current level of wealth affords them with few options. This is cause for concern. People across the income spectrum can gain from planning their future finances – it can help individuals assess how they might be able to meet their day to day spending needs while avoiding future debt problems.
- 18% of those who had not made a plan, said they "didn't know how to go about doing this". Even amongst those with DC pots who were less than a year from retirement, more than 1 in 10 said they didn't know how to go about making a plan. For these individuals, basic information about how to make a plan and where to go for help and advice is likely to be critical.
- 10% of those with DC pots who had yet to make a plan, said it was because they had not had the time. This rose to 16% of those who had not made a plan and were less than a year way from retiring. Raising awareness about the sources of support that are already available to make the planning process easier – including access to generic as well as regulated financial advice – is likely to be important in addressing the needs of this group.

Underestimation of life expectancy

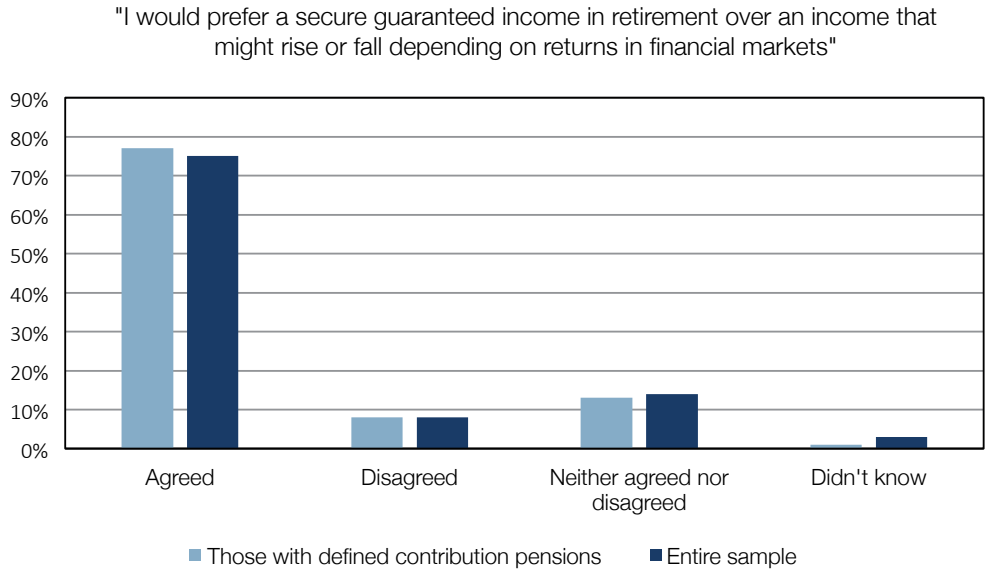
Not only is there evidence of limited understanding of financial products, which is partly driven by a lack of retirement planning, but there is also evidence that the pre-retirement group significantly underestimate their life expectancy. According to our calculations, men in our survey underestimated their life expectancy by between 4.2 and 5.5 years, while women underestimated their life expectancy by between 5.6 and 6.3 years. These calculations are based on how long, on average, our survey respondents thought they would live compared to ONS cohort life expectancy data for the same age and gender cohorts. Underestimating life expectancy by such a large margin may result in individuals deciding to overspend in the early years of their retirement resulting in a funding shortfall in later years. The combination of low levels of financial capability, little future planning and underestimating life expectancy could act as the perfect storm for inducing poor decisions at the point of retirement.

Attitudes to risk

Along with other behavioural characteristics outlined above, risk appetite is likely to be a key driving force behind consumers' decision making processes. In the context of this report, we refer to risk appetite as the extent to which individuals are willing to embark on an investment which might put at risk the savings that they have at their disposal. The responses to our survey, suggest that most people who are yet to retire are risk averse and would therefore favour security over volatility even if extra volatility offered the potential for higher returns:

- 75% of the entire sample agreed with the statement; "I would prefer a secure guaranteed income in retirement over an income that might rise or fall depending on returns in financial markets" by comparison to 8% who disagreed and 3% who didn't know.
- Out of all those with DC pots, the proportion of people who agreed was even higher than across the entire sample (77% versus 8% who disagreed and 1% who didn't know).
- There was a significant difference in the results between men and women with DC pots, with women more likely to agree that they would prefer secure income in retirement (84%) versus 73% of men.

Figure 3. Preference for security of income in retirement



These results do not necessarily mean that individuals are completely risk averse. It may, for example, be the case that some might consider risking a small proportion of their underlying savings so long as the rest is used to generate a secure income to meet day to day living expenditures. The survey allowed us to test this point:

- Up to 39% of those with DC pots agreed that they would be prepared to risk ***some*** of their own money when making a saving or investment. But the important word here was "some". When actively prompted on what percentage of their pension fund they thought they could afford to lose before it seriously impacted upon their retirement plans, the most common answer was none (35%). Just 7% of those with a DC pot thought they could afford to lose 20% of their fund or more before it seriously impacted upon their retirement plans.
- Women appear to be more risk averse than men. 43% of women with a DC pension pot said they could not afford to lose any of the fund before it seriously impacted their retirement plans by comparison to 30% of men.

Taking all the responses into consideration, it appears as though the overwhelming majority of individuals amongst this pre-retirement 55-70 age group are indeed risk averse and would prefer options that do not put their money at risk and that deliver a stable and secure income in retirement.

Pension as income: consumer preferences for retirement income products

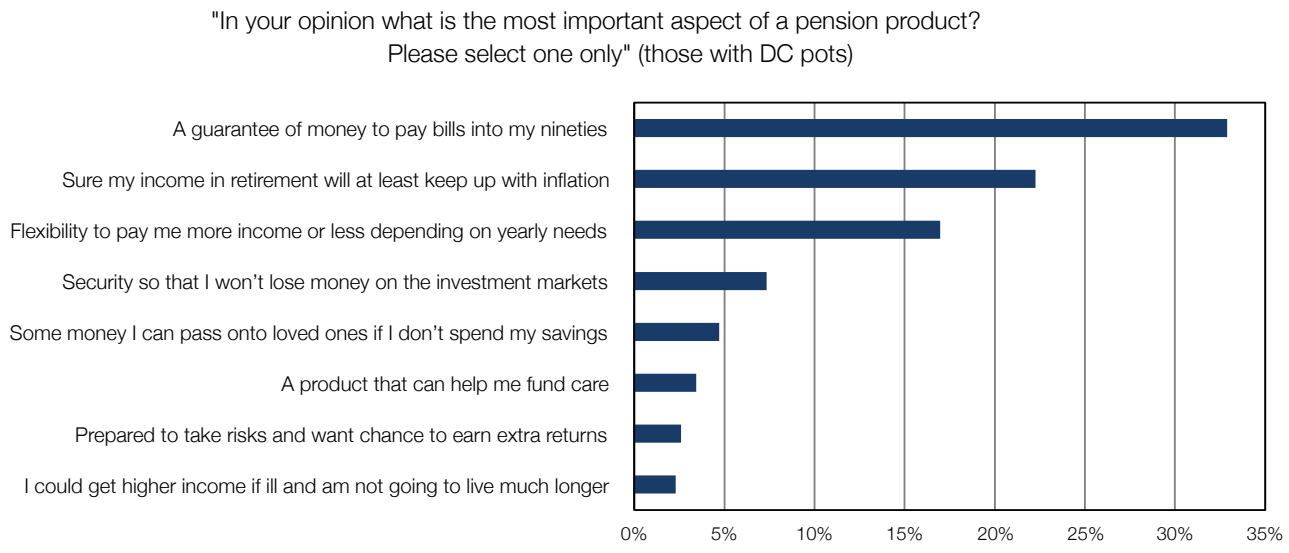
Some of the post-Budget speculation has focused on the risks of consumers withdrawing everything and wasting their hard earned savings on big ticket items. To test this proposition we asked our survey respondents what was the most important thing they wanted their private pension to achieve during retirement.

- Amongst all those with DC pots, top of the list was for the pension to be used to generate a guaranteed income to pay regular bills in retirement. Nearly 70% said that they wanted their pension pot to deliver this. Just 7% said paying for holidays, new car, house repairs or other big ticket items was the most important, while 5% said paying off debts was the most important.

These results suggest that in the new world, consumers with DC pension-pots will continue to view their pensions as a way of generating a stable income to meet regular expenditures rather than predominantly as a means to "live for today". The preference for using private pension wealth in this way feeds through into the types of retirement income product features that are most popular amongst this group:

- When asked what they thought was the most important aspect of a pension product, the most popular response was "I want a guarantee that I will have money to pay my bills even if I live well into my nineties and beyond" while the second most favoured response was "I want to be sure that my income in retirement will at least keep up with inflation". Only 3% agreed with the statement "I am prepared to take risks with my savings and want to have the chance to earn extra investment returns even in retirement".
- While the preference for a secure income was clear, there was also some support for product features where income could rise or fall over the duration of retirement in line with how their spending needs change over time. 17% of those with a DC pot said they wanted "a retirement income that will be flexible enough to pay me more income or less income depending on my needs each year".

Figure 4. What do individuals want their pensions to deliver



Making decisions at the point of retirement

While there is a clear preference for using pensions to generate an income to meet living costs in retirement, evidence from our survey suggests that a high proportion of individuals approaching retirement are unsure about what action to take.

- Out of all of those people with a private pension (DC as well as Defined Benefit) in the sample, under half (40%) said they were confident in terms of making a decision on their own regarding their pension savings while 30% said they were unconfident.
- Proximity to retirement appears to make some difference about level of confidence amongst consumers. For those who are less than a year away from retiring, the proportion who are confident rises to just over half while the proportion who are unconfident falls to 27%. But this still leaves 3 in 10

people who are unsure about what to do or where to go next. And it is important to remember that this question only tests self-rated confidence and not the actual ability to make an appropriate decision.

Lacking confidence in the face of the new pension freedoms

- Proximity to retirement has less of an effect for those with DC pension pots. In fact, those who are less than a year away from retiring are more unconfident than those who have longer to go before retiring (37% of people with less than a year to go are unconfident compared with 30% of people who plan to retire in 1-2 years).
- We think that the uncertainty about what to do for those on the verge of retirement with DC pots is likely to stem from the sweeping reforms being introduced in 2015. While many of those with DC pots have heard about the new pension freedoms, the majority remain confused about what it means for them. According to the results of our survey, while over 80% of people with DC pots said they were aware of the new freedoms, only 34% said they had quite or very good understanding of what the freedoms meant for them.

Consumer views on the Guidance Guarantee

"I wouldn't necessarily do what they say but I'd be interested to hear what they say"

"I'm a bit concerned about the advice they'll be giving, about the quality of the advice, will you be able to sue them if they give you bad advice"

- Focus group participants

In response to the challenge of financial capability and consumer awareness, the Government has committed itself to ensuring the introduction of free, impartial guidance for all those with DC pension pots on the verge of retirement. We asked consumers for their views on the Guidance Guarantee and found:

- There is evidence of strong demand for the Guidance Guarantee with over 60% of people with DC pots agreeing that they would take up the offer.
- However, 2 in 10 people with DC pots still said they will not take up the offer of free guidance. This is cause for concern and Government together with industry must identify ways in which these individuals are not overlooked once the Guarantee is in place. Publicising the benefits of the Guidance more widely is likely to help in this regard. The survey results with regard to Guidance should be read with caution given that respondents were surveyed before Guidance had been promoted. It nevertheless demonstrates the importance of raising awareness about Guidance and we would hope that all those eligible would take up Guidance once it is operational.
- Face to face is overwhelmingly favoured as the method of delivering Guidance. 63% of those with DC pots would like it delivered face to face. Online information is favoured second - by 20% of this group.
- Individuals realise that Guidance in itself will not be enough – just 1 in 5 people with DC pots think that Guidance will be enough for them to able to make a decision about how to use their pension pot. Over 50% think that they will be more informed and know where to go for further information and advice after receiving Guidance.

What about Defined Benefit pensioners?

As part of the reforms and subject to financial advice, members of private sector DB schemes (or public sector funded schemes such as local authorities, but not the unfunded ones such as NHS, civil service or teachers) will be allowed to transfer from DB to DC and therefore access their pension pot under the new freedoms. While shifting savings out of DB and into DC schemes may be sensible for a small minority of cases (perhaps those who are single, in very poor health, have very small deferred entitlements with other pensions elsewhere, or those who need to pay down debts and have no other means of doing so), for the vast majority, such a move is likely to significantly reduce their income in retirement. It could therefore, depending on motivations of consumers and suitability of advice, increase harm to the consumer. In order

to crudely test consumer preferences for moving from DB to DC we asked all those with DB how likely they were to consider it as an option.

- While the majority of people with DB pots said they were unlikely or very unlikely to consider transferring (59%), 7% said they were likely or very likely to consider transferring and 34% said they needed more information before they could make a judgement.

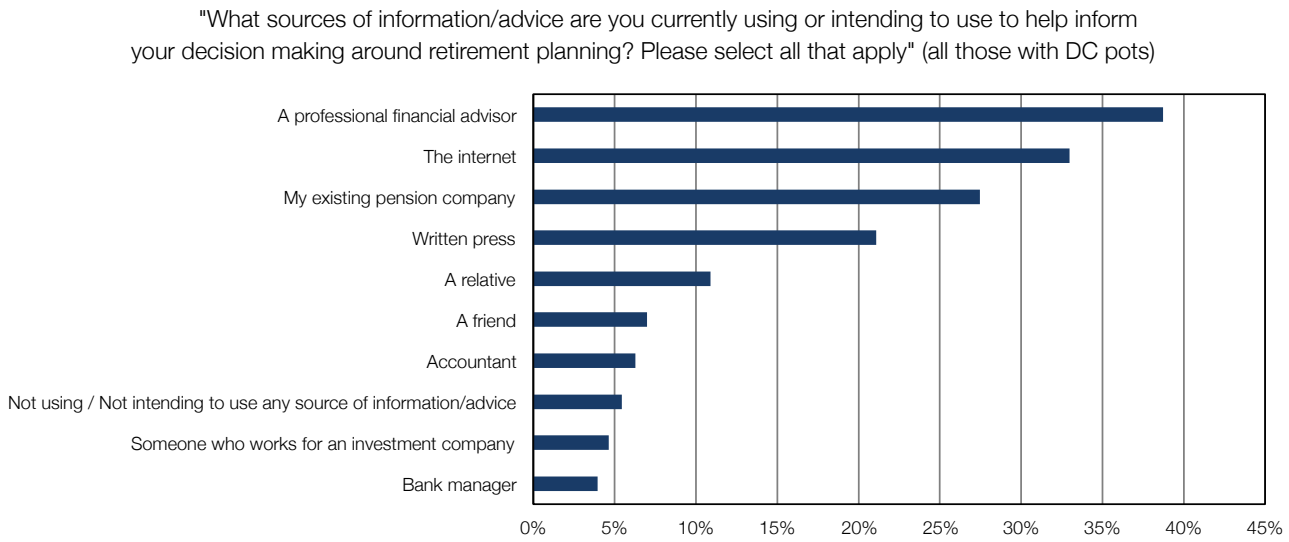
It is critical that private DB pension holders understand the opportunity cost of transferring and that they get sound professional advice before they do so. Government and regulators must watch this space very carefully.

Sources of financial advice

Given that guidance will not be sufficient in order for many individuals to make a decision about what to do with their pension pots, it is important to know what other sources of advice, if any, they are going to look towards. These other sources of advice are likely to be critical in determining whether or not people are able to make appropriate decisions after the new reforms are in place. Of particular relevance here is the role that professional financial advisers might play. Professional advice can give individuals confidence that they will get a product that meets their needs and is suitable for their particular circumstances. There is also more protection for individuals who purchase a product through advised sales than those who choose to go it alone[20].

- Out of all those with DC pots, a financial adviser came top with 39% saying they would seek advice from this source. Second was the internet (33%) and third their existing pension company (27%).
- Across the whole sample, financial adviser was also top of this list, suggesting that there is significant appetite for professional advice to navigate through the various choices people will face at the point of retirement.

Figure 5. Sources of information and advice



While using a financial adviser appeared to be a favoured option amongst survey respondents, this still leaves some 60% of people with DC pension pots who will not seek professional advice. This "advice gap" could result in people making ill-informed decisions unless it is filled by other forms of support. Using various sources of information from the internet or talking to family members may be sufficient for some people but could result in poor decision-making from others. We asked the respondents who said they would not seek financial advice, why this was the case. The findings suggest that a lack of trust in financial advice is a key driving factor.

- Amongst a list of reasons for not choosing advice including statements about its cost effectiveness (often perceived to be the key reason why those with moderate wealth may not choose advisers), lack of trust was the most commonly cited reason. 44% of those with DC pots agreed with the statement "I do not trust the financial services sector to provide me with good advice".

20 The Money Advice Service: https://www.moneyadviceservice.org.uk/en/articles/do-you-need-a-financial-adviser

- The second favourite option was "I don't have much money in my pension funds so it would not be worth paying" (31%) and third "I can find all the information online and get free advice that way, instead of paying for it".

The results suggest that trust, not money is the key reason why people have decided that they will not see a financial adviser when looking to draw on their pension funds. This is a really important finding because it suggests that there may well be appetite for using professional advice so long as levels of trust can be raised. While this is no easy task, there are a number of sources of good regulated advice that could be highlighted through the Guidance Guarantee in order to help alleviate some of the concerns of consumers on the verge of retirement and reduce the potential size of the advice gap[21]. It is therefore important that the Guidance process is perceived to be a trustworthy hand-off linking up to other forms of support and advice. Effective promotion will be key in this regard.

The value of making an active decision, based on an overview of the products and services that are available cannot be overstated. A clear example of this is annuity sales and the issue of shopping around. According to the Financial Conduct Authority's thematic review of annuity sales, 80% of consumers who purchased their annuity from their existing provider could have got a better deal on the open market. Despite this finding, the review noted that in 2012, 60% of annuities were purchased through the customer's existing pension provider or a third party with which their provider had an arrangement. The review highlighted that those who would be eligible for an enhanced annuity stood to gain the most from shopping around, but often failed to explore this option[22]. Individuals need to be aware of and understand the potential costs and benefits of different products and we would argue that access to professional financial advice can be helpful in this regard.

New freedoms will not address issues of undersaving

"The concern, I think, is what happens if something I haven't prepared for, which is illness, occurs because the standard of care here…is so poor."

- Focus group participant

While the focus in light of the new freedoms has been predominantly on what people will do with their DC pension pots at the point of retirement, there has been less focus on arguably the bigger issue about how people are going to use all their assets as well as the State Pension to fund retirement. This is important because, as our survey shows, for many, private pension wealth will not be sufficient to deliver an adequate level of income in retirement. Our survey asked people to estimate what they thought their private pension pots could deliver in terms of annual income in retirement versus what they thought they would need to pay their regular bills. While this is by no means an exact science, it gives us a rough indication of the extent to which those retiring today are likely to face a retirement funding shortfall tomorrow.

- Across the entire sample of people, respondents expected to need on average £20,000 a year to pay their regular bills but estimated that their total private pension income would be worth 15,800 a year (£4,200 shortfall).
- For those with DC pots (they may have DB as well as DC), respondents expected to need on average £19,500 a year to pay their regular bills but estimated that their total private pension income would be worth just 14,600 per annum (£4,100 shortfall).

Based on these crude figures, the average person is likely be able to meet their regular bills if they combine their private pension with their State Pension but not much more. Most will therefore struggle to meet additional costs such as those related to funding care or spending on big ticket items such as holidays or cars without tapping into other assets. Not only, therefore, does this demonstrate the importance of using pension wealth to generate income throughout the duration of retirement, but also planning in advance about what individuals should do in case of additional costs – i.e. those related to long-term care. The Guidance Guarantee and any future retirement planning must take this bigger issue into account in order to support the financial resilience of individuals over the duration of their retirement. More information and support about working longer and delaying retirement may well be appropriate for some, allowing extra pension accrual and higher lifetime income.

21 See for example financialadvisor.org which provides links to fully qualified financial advisers through the professional body the Chartered Insurance Institute.

22 FCA (2014) Thematic review of annuities: http://www.fca.org.uk/static/documents/thematic-reviews/tr14-02.pdf

Conclusions and high-level policy recommendations

"I think it's temporarily a more confusing situation"

- Focus group participant

There is little time left to meet all of the significant challenges associated with the new freedoms in pensions. The results of our in-depth consumer research reveal that a significant majority want to use their pension pots to deliver a secure income in retirement, but that many may be too confused to know how to go about achieving this. Low levels of financial capability could, if left unaddressed, be exacerbated by the new freedoms and result in people squandering their pension wealth, either by doing nothing in the face of complexity, by channelling money into high risk investments or by taking all of their money out and leaving it in a low interest bank account. Each option is likely to result in poor consumer outcomes by increasing the risk of a retirement funding shortfall. If people want their pension to deliver an income in retirement in a secure way, and the results of this research project strongly suggests that they do, the new framework must be built with this end in mind.

In this regard, we think two areas in particular need to be strengthened before the new freedoms come into play.

First, the Guidance Guarantee is the critical policy measure that the Government has identified as a way of helping people navigate the complex arena from April 2015. Implementation is everything – it is no use having a system of guidance which is underused and untrusted. And this system must act as an effective hand-off to other forms of support and advice that can facilitate informed consumer decision making and not inertia. At a minimum, the Guidance must include relevant examples of how longevity risk could affect an individual's financial wellbeing over the duration of retirement as well as what the tax implications could be of pulling out all the money from the pension and putting it into a savings account. The Guidance must also be tailored to suit those with low levels of financial capability and very low risk appetite when providing support. And finally, the Guidance must be effectively publicised by Government and the institutions delivering it, to raise awareness of what it is and how it can help.

Second, there needs to be a contingency plan to support a) those who choose not to go through the Guidance process and b) those who go through the guidance process but are still liable to making poor decisions. One measure that is urgently needed is for the Financial Conduct Authority and The Pensions Regulator to use their current powers to place responsibilities on existing pension savings providers to ask their customers a small number of mandatory questions before the customer concludes how to use their DC pension savings. These questions would in effect require the provider to actively engage with the customer to prompt them (not advise them) with the aim of helping them avoid making the most common poor choices. This report has demonstrated that older consumers have little appetite for risk but that many have very low levels of understanding about relevant products and services. We must therefore ensure sufficient safeguards are in place to reduce the risk of consumer detriment and thereby maximise the possible benefits of the new freedoms.

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