Think piece

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INDEPENDENTLY PROMOTING DEBATE AND FRESH THINKING IN THE FINANCIAL SERVICES INDUSTRY

A brave new retirement: funding life after work and helping to make difficult choices

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- The Association of British Insurers (ABI) has approached the Chancellor's reforms from a position of unequivocal support for the greater freedoms these changes will bring. The support stemmed not from a commercial perspective, but because those reforms were the right outcome for consumers.
- As the representative body of insurance providers, the ABI believes crucial pieces of the jigsaw being missing makes a seamless start to the reforms on 6 April unlikely.
- Given this, we believe all stakeholders should commit to a 'best endeavours beginning' whereby, from early April, we recognise the inevitable challenges of a new system going live in a spirit of openness, constructive comment and determination, to gain momentum as we all get used to how the new world is going to work.
- And critical to all this will be the message for the public that April 6 is not a deadline, it is simply the beginning of a new set of freedoms that are not going to disappear whether someone starts to engage with their choices on April 6, August 6 or in 2016 and beyond.
- After the launch, a key challenge in the second phase of the reforms is not whether new products emerge, but how we meet the potentially wide 'advice gap' between what newly empowered customers will need to discuss and what is affordable and on offer to them.

CII Introduction: after the historic announcement in Budget 2014, the Chancellor's pension freedoms reforms including the promise of free pensions guidance will come into force in just a few weeks' time. This marks the end of what to many in this sector was an eventful year of market speculation over what will happen next, debate over the effectiveness of the reforms, a series of government policy papers first sketching out the general ideas and then adding more detail, and now the advertising campaign. All across the sector and beyond are focused on the 6 April launch. But as we ourselves have said, this project's success will not hinge on what does or does not happen in those first few days after launch, but in the months and even years afterwards. Huw Evans, the new Director General of the Association of British Insurers (ABI), reflects in this Thinkpiece the widely held concerns about preparedness. He underscores the importance of working together to do our best for the launch and focus on the challenges of longer-term success.

Whatever else the Chancellor intended when he stood up on Budget day twelve months ago, he has certainly been responsible for the felling of a fair few trees as acres of print have been devoted to considering what his reforms may mean for retirement in the future. All of us in this sector and beyond have seen our fair share of finger-pointing, scare-mongering and doom-mongering as well as naïve optimism, unrealistic deadlines and yet more new ideas to add to the once-in-a-generation reforms that have already been announced. So I am going to try to avoid all of these traits in this Think piece to focus on three areas:

- How prepared are we for April - and how should we handle the inevitable challenges?
- How may the market develop and what could the inevitable second phase of the reforms look like?
- Where do the reforms leave us in the long run and how can we make the new framework a success for those in their 30s and 20s - generations Y and Z - whose financial profile is likely to be so different from those preceding them into retirement?

Let me be clear that in attempting to answer these questions, I do so from a position of unequivocal support for the greater freedoms the reforms will bring. The ABI, like many of the providers we represent, welcomed the Chancellor's Budget reforms within hours of his announcement. Not because it was good for the market cap of the industry—quite the opposite—but because it was the right outcome for consumers who were trapped between unnecessarily restrictive trivial commutation rules and annuity rates that were suffering from the sustained abnormally low interest rates caused by five years of Quantitative Easing and increasing longevity.

The ABI, like many of the providers we represent, welcomed the Chancellor's Budget reforms. Not because they were good for the market cap of the industry—quite the opposite—but because they were the right outcome for consumers.

We want the reforms to succed for customers who in many cases have been saving with our providers for 30 years to have a meaningful set of choices when it comes to decisions about their retirement income.No 'ifs', no 'buts': we want these reforms to work.

How prepared are we for April - and how should we handle the inevitable challenges?

As the representative body of insurance providers, the ABI believes crucial pieces of the jigsaw being missing makes a seamless start to the reforms on 6 April unlikely.

We have already passed the 'six week' point when providers have to send out the 'follow-up' pack to customers contemplating retirement decisions in early April. Yet as of now:

- Pension Wise has no phone number yet so there is nowhere for pension providers to direct people to if they do not have internet access.
- We still don't know how the Pension Wise guidance sessions will work; how they will be structured and how the session will be recorded so providers and advisers know what customers have discussed and what was covered.
- We do not have any modelling shared with us on expected volumes to use the service and estimated waiting times that can be shared with customers.
- We do not know how lump sum payments by trust-based schemes will be regulated.

Since I first made these remarks in in my speech at our Retirement Conference on 25 February, the FCA have since published rules that will apply to the industry covering how providers will need to interact with customers, especially those who refuse to take up Pension Wise guidance; the Pension Schemes Bill has now become law; and the Treasury has launched a television advertising campaign.

And other significant challenges face the launch too; the unknown flows of customers who may want help, the capacity and ability of the Government's formal advice partners to be able to deal with the range of questions being asked and the capacity of providers to cope with volumes of calls are likely to be significantly higher than normal.

So how should we respond to this?

I would like all of us who are engaged in trying to deliver successful reform; providers, Government, advisers, consumer champions and regulators commit to a 'best endeavours beginning' for early April where we recognise the inevitable challenges of a new system going live in a spirit of openness, constructive comment and determination to gain momentum as we all get used to how the new world is going to work.

That is in everyone's interests given nobody can accurately predict how many potential customers are going to want to engage as the reforms go live and we will all be in unfamiliar territory - from the customer services operative in a call centre to the newly trained Pension Wise advisor dealing with their first members of the public.

Frankly, what's the alternative? Just a load of playground rhetoric and excuses that will solve nothing and undermine customers' trust in everyone concerned. Not very appealing, is it? So let's give up the blame game not just for Lent but for the immediate future and knuckle down, all of us, to the much harder challenge of getting lift off for the new system and improving it as we go along.

And critical to all this will be the message for the public that April 6 is not a deadline, it is simply the beginning of a new set of freedoms that are not going to disappear whether someone starts to engage with their choices on April 6, August 6 or in 2016 and beyond.

The danger is that the hype surrounding the new system going live subliminally encourages people to treat it as an opportunity they must take advantage of now, before it could be taken away or limited.

This is wrong and, at worst, could encourage people into rushed decisions that incur tax liabilities they could otherwise avoid or drive them into the arms of fraudsters and scammers.

So let's see some journalism, provider marketing and ministerial messaging that informs and engages, rather than excites.

How may the market develop and what could the inevitable second phase of the reforms look like?

So, enough about the launch; let's consider how the market may develop and what else may be needed to ensure the reforms can succeed in the near-term?

Innovation is vital for the long term health of the market and its providers. We support the reforms because we see the potential to help customers better with their future needs and part of the answer to this will be innovation in products.

However, we must all guard against a perception that the reforms are a switch that can turn on innovation in a long-term savings market that was previously toiling away selling old fashioned goods.

This industry has been in an almost constant state of innovation in recent years as the market moved strongly into medically-underwritten products and a greater variety of products between annuity and drawdown, such as fixed-term annuities, investment-linked annuities and drawdown with guarantees.

If you add in the wider structural move towards greater use of platform-based wealth management products and the vibrant market dynamics of traditional insurers, niche providers and asset managers all competing for business, it is impossible to characterise the market pre-Budget as stale or lacking in product innovation within the narrow parameters of the retirement options allowed by the Government.

Customer demand is largely unknowable ahead of the reforms going live. There's a likelihood that customers with modest pots will take cash; and those with large pots will get advice and remain in the drawdown space. Everything else belongs in the 'known unknown' category.

Secondly, product development does not happen in a vacuum, it has to be determined by customer demand and the availability of provider capital. Customer demand is largely unknowable ahead of the reforms going live, other than the strong likelihood that customers with modest pots will take cash and those with large pots will still be advised and remain in the drawdown space. Everything else belongs in the 'known unknown' category. At the same time, insurers are seeking PRA approval for their capital requirements under Solvency II which goes live in January with internal models being submitted for approval five days before the Government's pension freedoms go live. Until insurers know the outcome of their PRA application and get final approval for their capital models, there is a very obvious limiting influence on the ability of the market to back untested new products with large amounts of capital when consumer needs and behaviours are unknowable.

However, these are short term factors. Over time - the next 5 years, not just the next 5 months - the freedoms granted by the reforms will undoubtedly prompt innovation and new options for customers, not least because of the significant investment in digitally enabled channels by leading providers. Just as examples, we could see:

- further development of the shorter term retirement products currently being offered
- annuity products that are geared towards being taken later in life when lower risk investments and more manageable longevity risk make for a better deal,
- greater use of products offering income with potential for growth, with guarantees either on the income or capital.
- greater flexibility, allowing greater scope to pass money on or switching
- more focus on long term care costs integrated into a retirement income product rather than as a stand-alone purchase.

There is so much exciting potential here with a very competitive UK market place able to serve its consumers well. But we must remember that healthy markets evolve and change, just as their customers do, they do not arrive in a puff of smoke on a date set by Parliament.

For me the key challenge in the second phase of the reforms is not whether new products emerge, but how we meet the potentially wide 'advice gap' between what newly empowered customers will need to discuss and what is affordable and on offer to them. At least this debate has kicked off; it is a regular source of discussion on industry forums such as 'Pensions Play Pen' and is the subject of an excellent recent Reform pamphlet by Mark Hoban exploring the possibilities of a 'RetirementSaver Service.'

Here, the main challenge will be to have an in-depth understanding of customers' behavioural impulses as well effective data from providers and the Pensions Wise delivery partners from the initial period 'go live' period. The ABI has recently published a report commissioned from ideas42 looking in more depth at what behavioural science can tell us about how the reforms may need to be developed.

We all need to go beyond the somewhat superficial references to 'present' and 'optimism' biases to a more sophisticated understanding of how we are conditioned to respond to the level of freedoms retirees will now face. Biases around representativeness and social norms can be just as influential in guiding our behaviour as better-recognised impulses and we will need a way of meeting consumer needs that takes account of this analysis.

So, what could this involve?

Firstly, the FCA has to continue more urgently down the road of defining what is permissible in the grey area between an advised and execution-only sale.

It has started this thinking which is welcome but if customers are going to get answers to some of the questions they will be answering, providers will need greater certainty about what they can say and help explain, especially through digitally enabled solutions.

Secondly, some form of greater aggregation of pension and savings assets is likely to be needed, whether through individual providers, a state-backed dashboard or other alternatives. The essence of providing useful guidance and information to a customer is knowing accurate information about their situation and it is hard to see how a more effective system could develop without significant movement in this direction.

Thirdly, we need think further about how to make it easier for customers to compare options in a way they can understand and navigate. Without this, the complexity which is the flip-side of the new freedoms, could all too easily prevail with negative results.

Where do the reforms leave us in the long run and how can we make the new framework?

2050 is an impossibly long time away to think about for the politicians and regulators of today but it is very much part of the mindset of the long-term savings industry that is currently serving customers who are relying on it to be serving their needs in 2050 with products they are saving into today.

Our 35-year-old colleagues will be 70 in 2050 which provides some perspective as does casting our minds back to some of the events of 1980 (Coe-Ovett at the Moscow Olympics/John Lennon's murder) which are so easily memorable to those of us alive at the time and that are only the same distance time-wise looking back as the period to which we are looking forward.

We know for sure that our Generation Y and Z colleagues, relatives and friends will have a fundamentally different asset profile from the baby-boomer and Generation X that have preceded them with house purchases later in life, student debt to pay off and a greater reliance on inherited wealth. They will have been digital natives all their adult lives by the time they come to their retirement choices and will have only accumulated through digitally-enabled savings models.

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So what will they need? Most importantly of all, they will need to have saved more. That is why it is so important that on completion of auto-enrolment roll-out in 2017, we have a full commitment to building on it with auto-escalation, successful reform of tax incentivisation and policies to help the self-employed benefit fully from pension savings.

More broadly, we will need to have a social and public policy infrastructure that is adapted to our ageing society. This could be through an independent Retirement Commissioner that both we and the NAPF see merit in, as well as through a fully-joined up government approach to saving, tax and social care rather than the piecemeal departmental siloisation that we get at the moment. We will also have to have resolved what the 'new defaults' are for people looking for greater certainty in their decumulation products.

Conclusion

Taken together, it is easy to find this an over-powering set of challenges, not least because there are so many I haven't mentioned.

But let us return to the excitement of new possibilities; the opportunities to serve customers better, create healthier, more innovative markets and to genuinely meet the needs of our changing world.

Two years ago, pensions and long term savings discussons were dominated by sterile and circular debates about how to get people to save and recriminations about annuity purchases.

Now, we have a starting point for a new landscape with as many possibilities as problems that could offer real solutions for the ever-more complex retirement needs of our fellow citizens.

Whatever the possible trials and tribulations of the coming months, the frustrations and the finger-pointing, let's hold onto that and all do our bit to achieve change we can be proud of.

If you have any questions or comments about this Thinkpiece, please contact us: thinkpiece@cii.co.uk; +44 (0)20 7417 4783.

This Thinkpiece was derived from a presentation delivered by Huw Evans to the ABI Retirement Conference, 25 February 2015. For more information, see: https://www.abi.org.uk/News/News-updates/2015/02/ABI-Retirement-Conference-2015-latest-updates

Huw Evans is Director General of the Association of British Insurers, having taken up the position on 1 February 2015. He was previously Deputy Director General and Policy Director, having joined the ABI as Operations Director in 2008. In addition to being at the heart of the industry's preparations for the pension reforms, he led the ABI's work on the negotiations with the Government on the future of flood insurance. Previously he was a senior manager in the Group Strategy team of the Royal Bank of Scotland Group. He served as a special adviser to the Prime Minister, Tony Blair from 2005-6 and to the Home Secretary, David Blunkett from 2001-4. Prior to that he worked in politics and journalism, having read Modern History at Lady Margaret Hall, Oxford.

The **Association of British Insurers (ABI)** speaks on behalf of 300 member insurers, accounting for 90% of the UK insurance market. It promotes best practice, transparency and high standards within the industry; and also provides consumers with general information on insurance and savings products and services. It was formed in 1985, funded by member subscriptions, and all members agree to its compulsory codes of conduct. www.abi.org.uk

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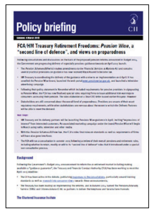
Other CII work related to the Government pension reforms:



CII Policy Briefing: The Government's retirement freedoms, Pension Wise, and views on preparedness (updated 6 Mar 2015) – an updated briefing reflecting the Treasury's announcement on the public-facing identity of what is called "Pension Wise". This note covers the Government's update on Pension Wise delivery, including Treasury and FCA actions in the last few months. http://bit.ly/18upAVL

CII Report: Guaranteed guidance for retirement: What consumers want (Oct 2014) – to contribute evidence-based thought leadership to the public debate on the development and implementation of the Government's guaranteed guidance proposals, the Chartered Insurance Institute commissioned primary research into consumer views towards this service. The research was with over 1,000 consumers who are the target users of the service, surveyed at the end of July and beginning of August 2014. http://bit.ly/1A815Vc

CII Consultation Response: FCA consultation: retirement reforms and guaranteed guidance (Sep 2014) – the CII concured with the Financial Conduct Authority's (FCA) proposed standards, which were in line with what the CII proposed in its response to the original HM Treasury consultation, and so we agree with the approach taken. http://bit.ly/1tYNFvG