



The New Retirement Market: Challenges and Opportunities

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Summary

The flexible retirement rules introduced from April 2015 are proving to be very popular. However, while flexibility is beneficial, it adds complexity to already difficult decisions about retirement that many people may not have the knowledge, skills or motivation to tackle on their own. Two years in, while we know a lot about the new retirement market and the opportunities it offers, there are also challenges that pose significant risks to consumer outcomes if left for too long without being understood and addressed.

The ABI has dissected how people are using the pension flexibilities; how well product supply fulfils consumer needs and demands; as well as what actions Government, regulators and providers can take together to address the challenges that arise.

Consumer Demand and Behaviour

The aggregate picture emerging since April 2015 is that consumers are behaving sensibly with the new pension flexibilities. Demand for income products is also holding steady. Most pots worth over £30,000, and the majority of the money accessed, have gone into guaranteed income or flexible income products. However, there are warning signs that should not be ignored - most obviously, the existing behavioural bias to take cash when it is offered.

The reforms brought the Treasury £1.5bn in tax revenue in 2015-2016, £1.2bn higher than its original forecast. Consumers are clearly withdrawing from their pensions at a rate much faster than the Government anticipated. Most new entrants to drawdown are taking the tax-free lump sum and no income. We also know that full withdrawals tend to come from those with smaller pot sizes and from younger cohorts. This preference for cash instead of income in retirement remains a live concern: we need a study over time to better understand the drivers and the wider circumstances of the consumers making this choice to judge whether sustainability is a concern.

Retirement Market Supply

Our analysis is that the appetite for cash is driven by behavioural factors and not a lack of supply of products. The spectrum of consumer needs and preferences are being met by a wide range of products. For even the smallest pot sizes, there are accessible and affordable retirement products available, for new and existing customers. The market has seen innovation combining guaranteed and flexible income, reflecting long-standing consumer needs for both security and flexibility, and new ways to interact with providers and advisers through the development of automated advice and other digital tools.

The ABI will continue to monitor whether those with the smallest pots still have access to appropriate retirement solutions, but it is important to note that product innovation will not be the only answer to the challenges facing consumers in the new retirement market. Ultimately, people need to be saving more, and saving sooner.

Next steps

Any interventions in the retirement market need to be grounded in a long-term, stable and joined-up strategy for UK pensions policy – based on a consensus across Government, and a common view of what a good retirement should be. This strategy should promote active consumer engagement, to help people to make investment and withdrawal decisions, and to compare retirement options. It should promote use of guidance and go further to deliver affordable advice. Additionally, it should ensure that regulation is consistent, including of solutions for those who do not engage in decisions about retirement.

It is important to recognise that not everyone will reach outcomes that are unquestionably the best for them. However, addressing the challenges from the new retirement market will go a long way to encourage consumers to trust and engage with their pensions, helping to ensure that as many people as possible reach their retirement goals.



I. Purpose

The ABI is seeking to provide a holistic and transparent view of the new retirement market: to understand how customers are accessing their pensions, whether there are the products and the innovation to meet customers' needs, and how best industry and policymakers can address the challenges that have arisen since the major pension flexibility changes were introduced in April 2015.

II. Background

- The Freedom and Choice in Pensions reforms announced in March 2014 were among the most significant pension policy changes in the UK since 1921. They intended to give individuals flexibility in how they access defined contribution (DC) pensions to suit their circumstances and preferences. Before these reforms, for most people, there was little choice but to buy a guaranteed income for life, but now many more people can take their pension in one or more lump sums or as a flexible income.
- A number of factors led to these reforms. The New State Pension provided a simpler foundation for retirement income and incremental changes between 2010 and 2015 made retirement options more flexible. Additionally, there was increasing downward pressure on the rates paid by guaranteed income products, caused over time by a combination of factors, including monetary policy, changing solvency rules, increasing longevity, and the impact of the 2008 global financial crisis on overall economic conditions.
- This level of flexibility has benefits for customers and is extremely popular. But it is part of a shift in a wider set of social, economic and demographic changes, including a transfer of responsibility to the individual, most pronounced in the transition from defined benefit (DB) to DC pensions. This means that customers need to be able to make decisions about retirement which can be complex, and they may not have the knowledge, skills or motivation to do so.
- Many people accessing their pensions now are likely to own their own home and many also have access to income from DB pensions. The future will be different:
 - Studies differ on when the pensions tipping point will occur – when people will rely more on DC than on DB pensions – but it is an accepted fact that only a minority of people will have access to income from DB schemes in subsequent generations of pensioners.
 - Housing wealth is concentrated in older generations and future cohorts are more likely to be renting in retirement.
 - There is projected to be a bigger gap in pension savings between the richest and poorest.
 - More people will need to work later in life to support themselves financially, but will have unequal ability to do so. Some may not have the health required and there may not be the supply of jobs needed to meet the demand for work in older ages.
- Against this background, this publication seeks to analyse the new retirement market, and to identify and help to address its challenges, in order to help customers reach the outcomes they want and need.

NOTE: Unless otherwise specified all data is from ABI 2016 Statistics, which covers information from ABI data providers. Graphs in this publication derived from ABI Statistics do not include withdrawals for trust-based schemes and drawdown providers which are not ABI data providers. The data includes firms who only offer retirement products. As a result, Full-Cash Withdrawals are not available for these companies, as there is no pre-existing pension pot.

NOTE: Please note that the graphs derived from ABI Statistics for Section IV (Retirement Market Supply) are from an ad hoc data collection and not from our regular data collection series. Where applicable, unless otherwise specified, the data is broken down into calendar year quarters.

NOTE: The number of 'drawdown sales' are different to the number of 'new entrants to drawdown'.



III. Consumer Demand and Behaviour in the Retirement Market

- **Preferences for lump sums or income differ markedly by age and pot size.** The vast majority of smaller pots are currently taken as a lump sum, with 88% of the 116,000 full withdrawals in Q2 and Q3 2016 coming from pot sizes less than £30,000. Younger cohorts are more likely to fully encash, with full withdrawals coming mainly from the 55-59 age band (Chart 3.1). Demand for income products is more evenly spread, but more common at medium to higher pot sizes. The Financial Conduct Authority's (FCA) most recent data trends on consumer behaviour align with ours, with Chart 3.2 showing how product choices differ by pot size.
- It is important to note that **most DC pots remain untouched** – while over 100,000 are accessed every quarter, over 4.7m DC pots belonging to those aged 55 and over have not been accessed.
- ABI and HMRC data suggests that the **demand for income products is steady**.
 - Following an initial surge for cash in Q2 2015, people are now taking less money in lump sums. The average size of 'flexible payments' recorded by HMRC went down 69% from £12,900 in Q2 2015 to £4,000 in Q4 2016, while the average number of payments per individual per quarter went up from 1.4 to 2.4 over the same period, suggesting a shift from lump sums towards income (Chart 3.3). However, only with longer term data can this trend be definitively confirmed.
 - **Sales of guaranteed income and flexible income products remain buoyant**, with over £5.7bn invested to buy over 82,000 income products (annuity and drawdown) in Q2 and Q3 2016. Guaranteed income sales come in at £1.2bn for each of the two quarters respectively, while flexible income sales are still higher, reaching £1.7bn in Q2 and in Q3 2016. The figure on flexible income sales for the wider market, including non-ABI members, will be higher. Comparing our statistics to the FCA's figures, ABI data providers accounted for around two-thirds of the new drawdown customers in the last two quarters.
- **People continue to take a flexible income in different ways.**
 - Most pots entering drawdown now have a tax-free lump sum taken, but no income immediately, with 40,880 drawdown contracts accessed in this way in Q2 and Q3 2016, taking out over £1bn. In total at the end of Q3, 114,000 pots in drawdown (including capped drawdown) have had a tax-free lump sum taken, but never any income.
 - **Among those taking a regular flexible income, many people are taking a sensible approach**, with 45% of pots in each of Q2 and Q3 withdrawing less than 1%.
 - Those with **larger pots** starting a flexible income take a smaller proportion of their total fund, compared to **smaller pots**, which are being withdrawn at a faster rate. For pot sizes less than £10,000, average income taken increased from 28% to 34% between Q2 and Q3. In comparison, pots valued at £50,000 and over took only 2% in both Q2 and Q3 (Chart 3.4).



- **Consumer behaviour research** shows that people appreciate pension flexibility and are spending their savings on “practical considerations”, such as savings, daily living costs, investments, or paying off debts. But, some had unexpected income effects on tax and welfare payments, which may have negative impacts on retirement outcomes. A small minority of consumers had a reduction in welfare payments or lost eligibility completely, an outcome affecting a greater proportion of those with the smallest pots than those with larger ones.¹
- Research also found that most **people who took tax-free cash** were motivated to do so simply because they could, rather than by need – a behavioural response to the way tax rules were presented to them. Many also felt that ISAs are safer than pensions and better understood, giving consumers a sense of control, while pensions were deemed too complex, have been subject to bad publicity, and can fall in value.²
- These trends show that **customer retirement preferences have not changed very much since April 2015**, reflecting a continued desire for both security and flexibility. What has changed is how customers can interact with their products, allowing them to take advantage of developments in technology. However, while advice is taken for around two-thirds of drawdown sales (covering the period from Q4 2015 to Q3 2016), this is the case for less than half of other transactions during this period, according to the underlying data for the FCA's 2017 Data Bulletin, Issue 8.

1 Citizens Advice (2016) Life after pension choices: Consumer reflections on pension freedoms and thoughts on the future.

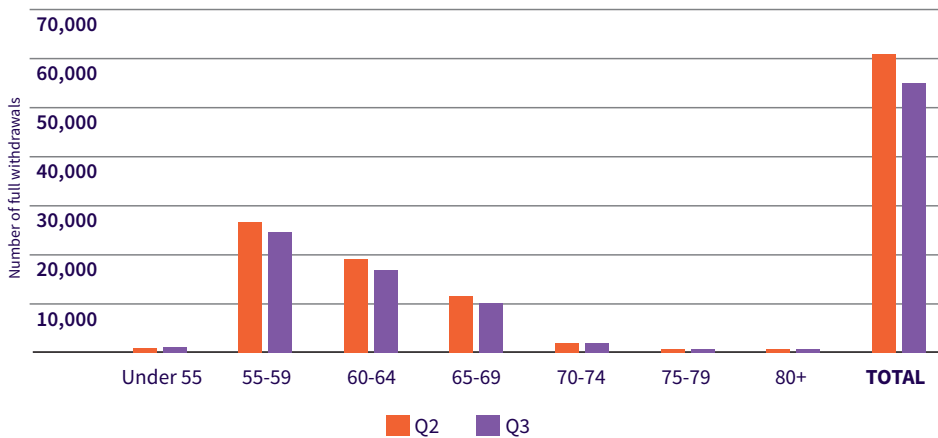
Retrieved from: <https://www.citizensadvice.org.uk/Global/CitizensAdvice/Families%20Publications/LiferafterpensionchoicesPDF.pdf>

2 Ignition House (2016) New Choices, Big Decisions: Exploring Consumer Decision Making and Behaviours Under Pension Freedom and Choice. Sponsored by: The People's Pension and State Street Global Advisors.

Retrieved from: <https://bandce.co.uk/wp-content/uploads/2016/03/ssga-tpp-report-new-choices-big-decisions.pdf>



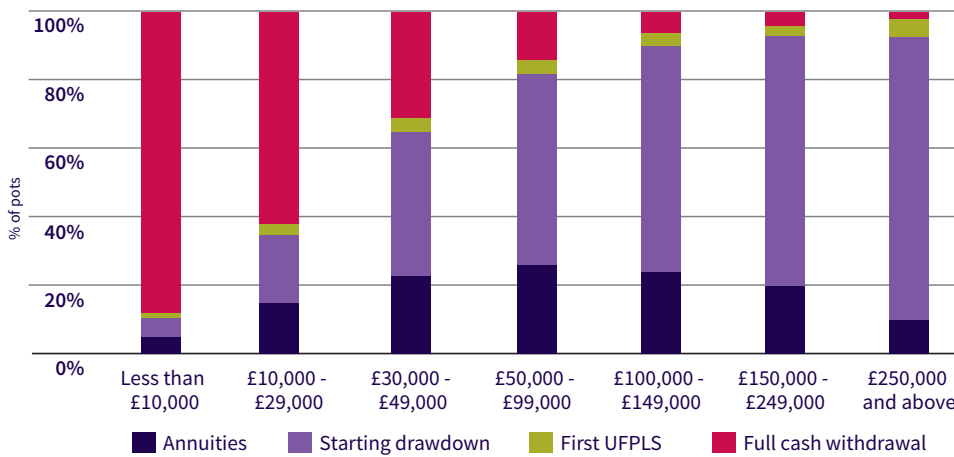
Chart 3.1 – Number of full withdrawals by age



Key message: Younger cohorts are more likely to fully encash, with the highest number of full withdrawals coming from the 55-59 age band.

Chart 3.2 – Options taken at different pot sizes, Q2 2016

(Source: Underlying data for the FCA's 2017 Data Bulletin, Issue 8.)

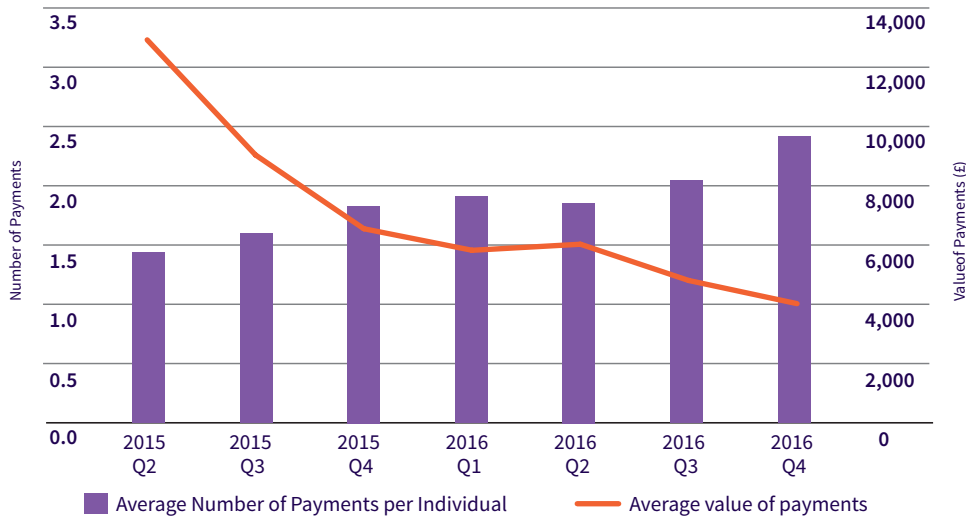


Key message: Demand for income products, as seen in the different purple-coloured bars, is more evenly spread across different pot sizes, but is more common at medium to higher pot sizes. Those with the smallest pots tend to fully encash.

Note: UFPLS stands for Uncrystallised Fund Pension Lump Sum. The publication refers to UFPLS as "Lump Sum" for most of the document.

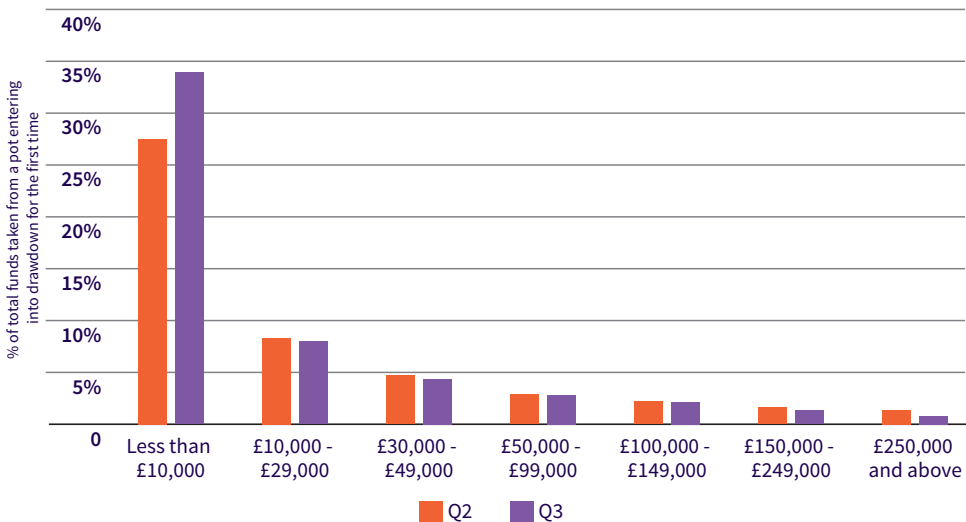
Chart 3.3 – Number and value of payments per individual since pension freedoms

(Source: HMRC 'Flexible payments from pensions', ABI analysis)



Key message: The average value of payments (red line) went down 69% between Q2 2015 and Q4 2016 from £12,900 to £4,000, while the average number of payments per individual (blue bars) went up from 1.4 to 2.4 over this same period. This potentially shows that following an initial surge for cash, more people are now taking an income. Only more detailed analysis and longer-term data can confirm this trend.

Chart 3.4 - Differences in quarterly income paid between larger and smaller pots



Note: The amounts paid are for new entrants into drawdown

Key message: Where a flexible income is started, larger pots have a smaller proportion of their total fund taken, compared to smaller pots, which are being withdrawn at a faster rate. For pot sizes less than £10,000, average income taken increased from 28% to 34% for new entrants into drawdown between Q2 and Q3. In comparison, pots valued at £50,000 and over took only 2% in both Q2 and Q3.



IV. Retirement Market Supply

- Providers successfully implemented the Government's 2015 reforms to a very short timetable, helping to ensure that customers had access to flexible options, developing new products and embedding support throughout the retirement journey to provide access to the necessary guidance.
- As a result, there is a **wide range of retirement products** – offered by both ABI and non-ABI members – to ensure that customer needs are being met. Some new products and features have also been introduced in the period since April 2015 (Chart 4.1). It is also important to note that while flexible options are widely available, not all trust-based schemes offer flexible options to its members.
- For even those with the smallest pot sizes, there are currently **accessible and affordable retirement products** available, for new and existing customers. Flexible income products are already available on the open market without advice, with no minimum pot size, and at prices below the auto-enrolment charge cap (Charts 4.2, 4.3a, 4.3b). The ABI will however continue to monitor whether those with the smallest pots have access to appropriate retirement solutions.
- **Competition** in the retirement market is evident from almost half of guaranteed income sales, and over half of flexible income sales, being to new, rather than existing customers. However, switching providers should not be used as a definitive benchmark to measure competition or outcomes. Around half of customers that buy from their current provider have a guaranteed annuity rate; customers do not only transfer at the point of taking their pension, as 89,000 customers aged 55 or over transferred to another provider in Q2 and Q3 combined; and customers can transfer once in drawdown.
- **Choosing a flexible income product** is very different from shopping around for a guaranteed income, which is driven primarily by finding the best income possible for the customer's needs. **Flexible income providers compete on several factors:** guarantees, customer service, investment choice and performance, and flexibility in access to funds. Value for money is important in all of these. These multiple aspects of products make it more difficult to compare them.
- **Product innovation** since 2015 has been driven by long-standing consumer preferences for both security and flexibility, with additional hybrid products combining guaranteed and flexible income being added to the market, as well as new features to help people pass their pension on to beneficiaries (Charts 4.4). There has also been innovation in how providers and advisers interact with customers, such as in the development of automated advice and other digital tools.
- However, **product innovation had already happened before 2015**, including guaranteed income based on health and lifestyle, hybrid products bringing together flexible and guaranteed income, blended solutions which combine products from different providers, development of simpler flexible income products, as well as a risk warning system to flag sustainability concerns to financial advisers.

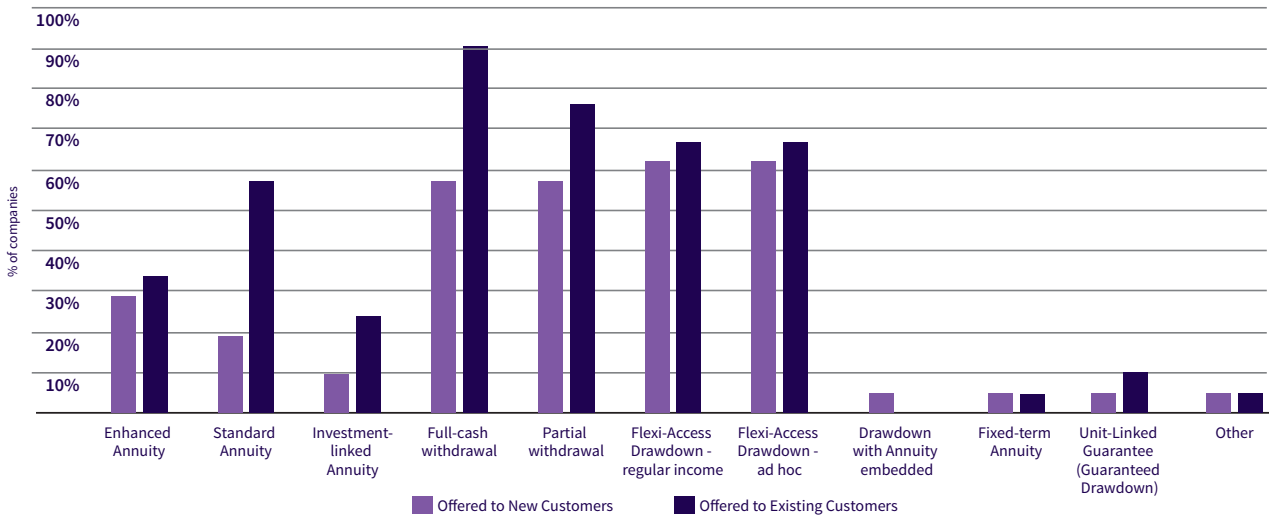


- While the ABI will continue to help monitor whether consumer needs are being met, **there are also limits to future product innovation**. For one, innovation will need to be within the constraints of legislation: products can at this time only be a guaranteed income, flexible income and lump sums or a combination of these. Other barriers to innovation include the need to hold capital under prudential regulation and lack of customer demand for particular product features. Additionally, future innovation should not happen just for the sake of it; it should only ever be done to meet consumer needs and demand.
- There are also limits to what future product innovation will be able to achieve. Alongside market developments, there must also be a simultaneous push by all stakeholders to help ensure that people are saving more, and sooner, as future product innovation alone will not be enough to secure the necessary retirement income.
- Careful analysis shows that while there is currently **no obvious product gap in the supply side** of the retirement market, there are **challenges for customers that would benefit from policy solutions**, which are discussed in detail in Section V, Retirement Market Challenges.



The graphs derived from ABI Statistics for Section IV (Retirement Market Supply) are from an ad hoc data collection and not from our regular data collection series.

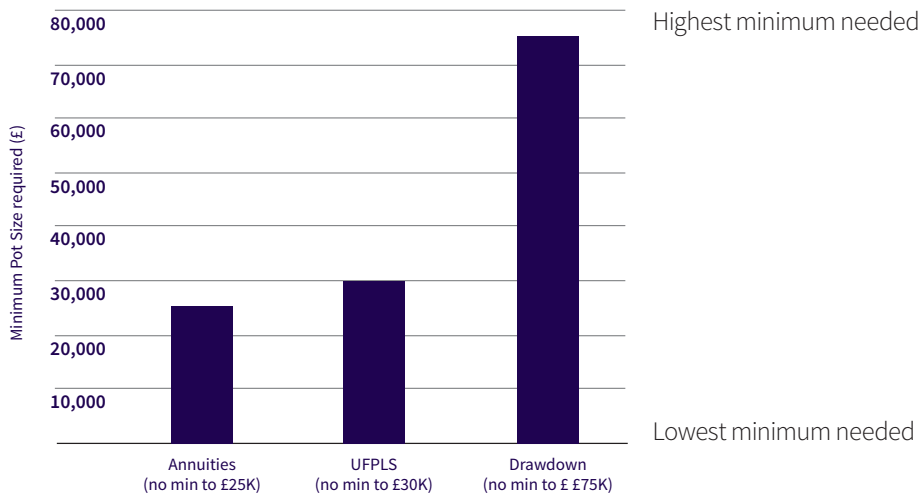
Chart 4.1 – Percentage of companies offering each product



Note: Includes firms who only offer retirement products, so Full-Cash Withdrawals are not possible for these companies, as there is no pre-existing pension pot.
 Note: Data covers ABI data providers

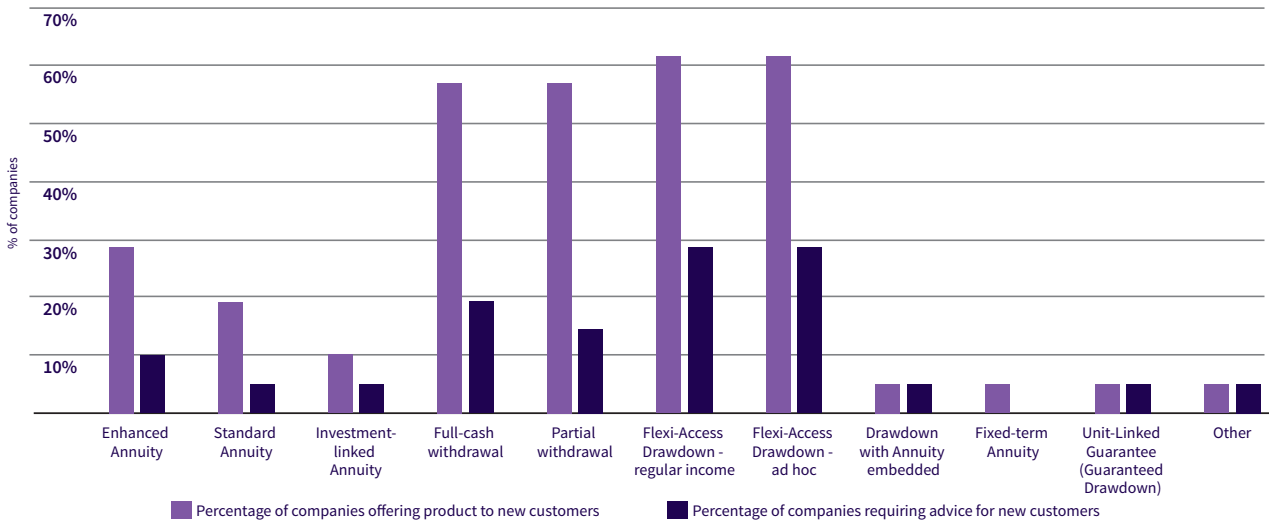
Key message: There are a wide range of retirement products offered for both new and existing customers, helping to ensure access to flexible options.

Chart 4.2 – Range of minimum pot sizes required for different products



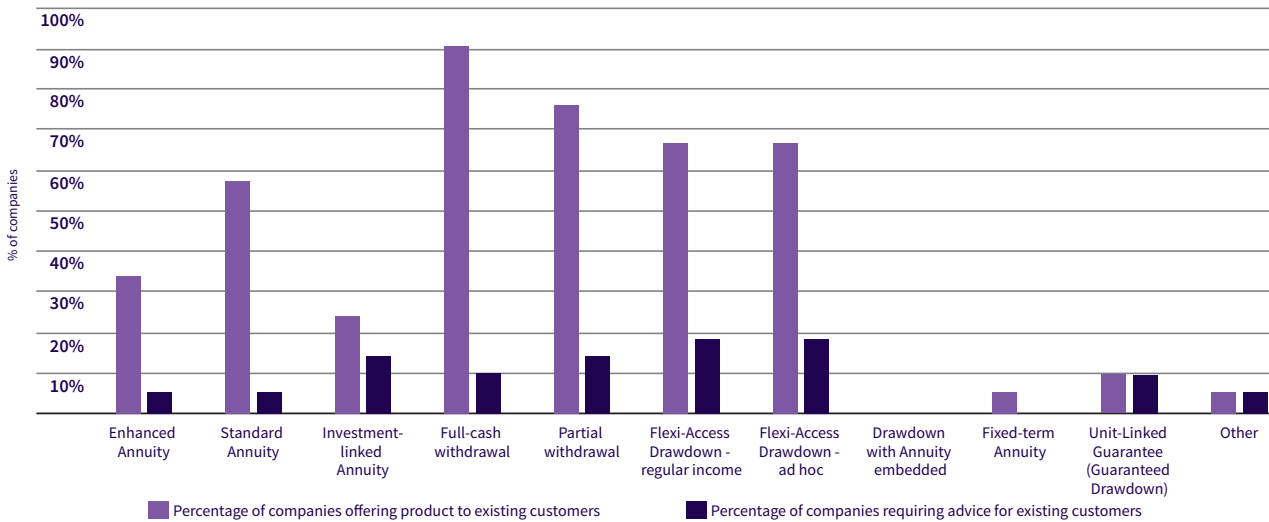
Key message: Even for those with the smallest pots, there are retirement options available. There is no minimum pot size needed to take any of the options, though this differs between firms and in some cases minimum pot sizes differ between new and existing customers.

Chart 4.3a – Advice required for new customers by product



Note: Includes firms who only offer retirement products, so Full-Cash Withdrawals are not possible for these companies.

Chart 4.3b - Advice required for existing customers by product

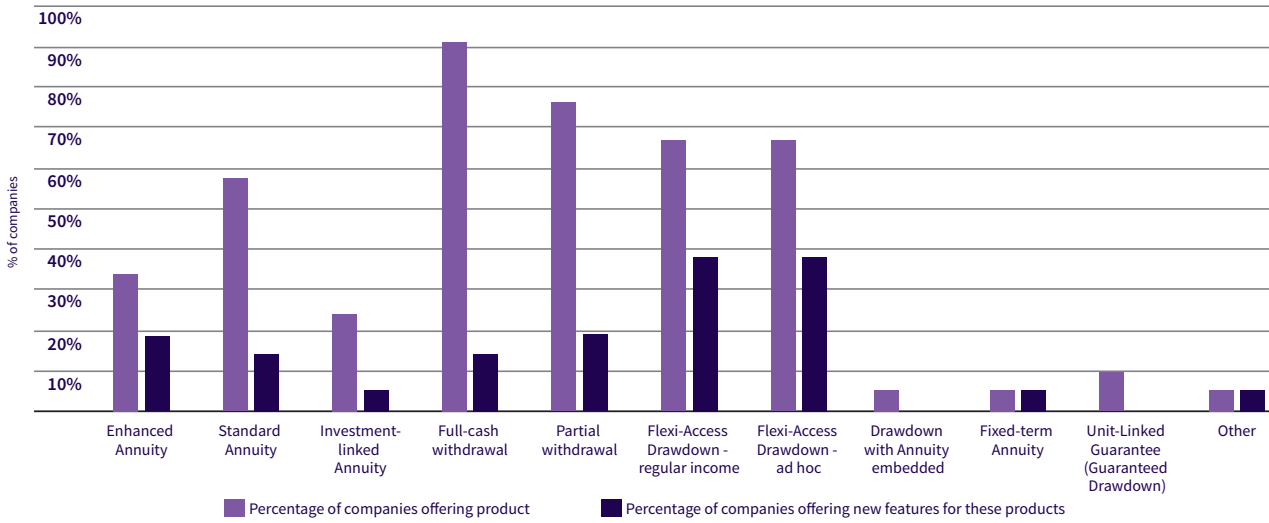


Note: Includes firms who only offer retirement products, so Full-Cash Withdrawals are not possible for these companies, as there is no pre-existing pension pot.

Note: Figures include firms who require advice on withdrawals over a certain amount.

Key message (4.3a and 4.3b): For both new and existing customers, there are product options that do not require advice, allowing flexibility for even those with the smallest pots – who may not be able to afford advice – to choose the retirement solution most suited to their needs.

Chart 4.4 – New product features introduced since April 2015



Key message: There has been product innovation since 2015, with additional hybrid products combining guaranteed and flexible income being added to the market, and new features, particularly to help people pass their pension on to beneficiaries.

V. Retirement Market Challenges

- Tensions between **freedom and responsibility** are the source of many of the challenges in the new retirement market. Consumer engagement throughout the retirement journey is necessary to make flexibility work in the interest of customers who must make complicated decisions about their retirement – how much to withdraw, when, and how the remainder should be invested, based on what they want from retirement and the risks they are willing and able to take.
- The main challenges in making these **investment and withdrawal** decisions are that:
 - there is a common behavioural bias to take cash immediately, although studies show that guaranteed income products – annuities – tend to be economically good value; and
 - decisions about investments and withdrawals over a lifetime are complex and personal to the individual.
- There are specific challenges associated with taking **lump sums** that may be of concern: Guarantees were given up on 52% of DC pots with a guaranteed annuity rate or deferred annuity when accessed in Q2 and Q3. Most of those guarantees were given up to take a lump sum; 46% of all full withdrawals were made by under-60s over this same period; and according to research from Citizens Advice, one in eight consumers had unexpected impacts on tax or welfare payments.³
- Flexibility also presents new challenges for potentially **vulnerable customers**. For example, because more people are now able to take a flexible income, but are also living much longer, more people may not have the capacity to make the necessary, but complex retirement decisions later in life, and it may lead them to become bigger targets for scams.
- Additionally, while there is not an obvious default option in retirement, there still need to be solutions for people **who do not want to or cannot make decisions**. If consumers do not engage, they will not be automatically placed into a retirement product. The pot will just stay untouched until action is taken. However, any default settings will mean that outcomes will be at odds with some people's plans and wishes.
- The **macro-economic context** also remains a challenge, with low interest rates and market uncertainty. Many DC pots may not be big enough to withstand shocks while making withdrawals. Ultimately, people will need to save more to be able to make the most of flexible options in retirement.
- The ABI's work on the Pensions Dashboard, consumer engagement research, rules of thumb and nudges, vulnerable customers, and our work on pension language, are all examples of the industry's proactive attempts to work with policy-makers to address new retirement market challenges by helping to inform customer retirement decision-making (please see Section VI for details). However, there are additional actions that can be taken.
- When ready, customers in the retirement market are able to choose from a range of products, but these are not **necessarily easy to compare**, particularly across different types of flexible income products. The ABI would like to explore with Government, regulators and the wider industry how this can be addressed.

³ Citizens Advice (2016) Life after pension choices: Consumer reflections on pension freedoms and thoughts on the future.
Retrieved from: <https://www.citizensadvice.org.uk/Global/CitizensAdvice/Families%20Publications/LiferafterpensionchoicesPDF.pdf>



- The ABI supports the Financial Advice Market Review recommendations. Driving forward the implementation of these recommendations, and fostering innovation in this area, must remain key to helping make advice more accessible and affordable, especially for those with small pots. We would like to see prompt clarity over the definitions of advice and guidance, and bold, effective rules of thumb and nudges to help providers and others give consumers more help to inform their retirement decisions.
- Quality guidance is also essential. We support the creation of a Single Financial Guidance Body that builds on and enhances the guidance available in the lead up to retirement and beyond. It is important for stakeholders to continue to work together to promote both the value and the uptake of advice and guidance, including automated advice.
- This is a market with long-term products and a policy with long-term consequences. This is in part why **the reforms and market needs time and stability to settle**. While retirement goals and outcomes are highly personal and change over time, **evaluation of the freedom and choice policy requires government departments and regulators to come together to reach a common view of what a good outcome should be, and requires a longitudinal study of the behaviour and wider financial circumstances of customers accessing their pension to establish trends over time. These and other policy recommendations** are formally set out in a framework of principles for the new retirement market in the concluding section.
- It is important to recognise that not everyone will reach outcomes that are unquestionably the best for them. However, addressing these challenges will go a long way to encourage consumers to trust and engage with their pensions, helping to ensure that as many people as possible reach their retirement goals.



VI. ABI Actions to Address Challenges

The ABI proactively seeks to contribute solutions to the retirement market challenges, as evidenced by the following projects. We will continue to identify where the ABI can actively help to ensure that the retirement market is functioning properly.

ABI Action	Project Description
Consumer Engagement Research	<p>Sponsoring PPI research on what kinds of engagement work, when and how. The work segments the population by life stages, characteristics and by current levels of engagement, with an objective to better understand which behavioural techniques might assist people to achieve better pension outcomes. Launch scheduled for July 2017.</p> <p>We are also working with a consumer research agency to consider whether saving habits can be improved by developing a consistent way of communicating pension savings, so that consumers: understand the benefits of saving into a pension; can simply compare saving into a pension with other saving vehicles; and are, ideally, incentivised to save more. Launch scheduled for summer 2017.</p>
Vulnerable Customers Guide	<p>A guide for anyone operating in the retirement market, building on the work shared with us by ABI members. The guide includes definition and analysis of the problem, principles that firms can sign up to, examples of what works well as well as case studies, learning from similar exercises and applying their principles to the retirement market. Launch scheduled for later in 2017.</p>
Pensions Dashboard	<p>Managed by the ABI on behalf of the wider industry and with the sponsorship of HMT, it is a proof of concept for the technical infrastructure to deliver online services which will show customers all of their pension entitlements together in one place. The prototype was demonstrated in March 2017.</p>
Rules of Thumb and Nudges	<p>Submitted ABI recommended Rules of Thumb and Nudges to the Financial Advice Working Group in December 2016.</p>
Making Retirement Choices Clear (Pension Language Guide)	<p>Seeks to remove jargon from pension language. In the process of being incorporated into consumer communications by providers. Launched April 2015, supporters implement principles from April 2017.</p>



VII. Conclusions

To help ensure the best possible retirement outcomes for the UK, the ABI recommends a series of principles to inform policymaking, based on the ABI's analysis of the new retirement market, as well as its challenges.

Box 7.1 – Principles for the new retirement market

Principle

- | | |
|----------|---|
| 1 | Pensions policy needs to have a joined-up strategy across Government, to have a period of stability, and it needs to have clearly articulated goals. |
| 1a | There should be a clear, long-term, sustainable and joined-up strategy articulated for UK pensions policy – based on a consensus driven approach across Government – which should be in collaboration with welfare, savings, housing and health policy. |
| 1b | There should be a period of stability during which there are no fundamental changes to pensions policy. Any changes must be within the context of the overall long-term strategy articulated and in the best interests of the consumer. |
| 1c | There should be an articulation of what a good outcome looks like, based on both (a) consensus of what a pension is for and (b) a definition of what minimum standard of living is acceptable for the UK. |
| 2 | Pensions policy and regulation need to promote an effective market that is focused on engaging customers to deliver good outcomes. |
| 2a | Policy interventions should focus on customer behaviour and promote engagement where it is needed – such as in making investment and withdrawal choices. |
| 2b | Industry, regulators and consumer representatives should work together to promote engagement, such as developing a framework to compare flexible income products. |
| 2c | Trust- and contract-based schemes should be regulated consistently, including where they put in place solutions for those that do not engage with pensions. |





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