Pension PlayPen response to NEST's consultation "the future of retirement"

Why Pension PlayPen is responding

Pension PlayPen is reluctantly responding to NEST's consultation; "reluctantly" as we have been asked these questions before in a number of different guises.

This is a very long consultation document and our response is necessarily long too. We have not responded fully to the suggestion in Q17 that we provide detailed consultancy to NEST, If NEST wants this help it should pay for it.

But we are responding because NEST is important and it is taking the issues around retirement seriously. There are many providers who need to be addressing these issues more urgently than NEST, we would have preferred to have spent our time consulting with those insurers. Part of the reason for making this response, is to use it in our conversations with other providers to help them create the product that Britain's middle-saving retirees need.

We hope that what we say may be useful to NEST too.

This response is also available digitally on this link;- http://wp.me/ppXQz-3Ak

Some general comments on NEST

In the past, NEST has operated what Pension PlayPen has considered an inadequate "at retirement service" for its members. This has been ok since very few people have retired from NEST and we sensed that the annuity carousel they have created was a pro-tem measure. We hope that this consultation will lead to a wholesale re-vamp both of the NEST at retirement strategy and the investment strategy both in the accumulation phase and (should it wish to provide its members a means of spending their pot, in the consumption phase.

We recognise that until 2017, when NEST is allowed to receive transfers, it will, for those wishing to exercise pension freedoms, be pretty useless. Most people who have been saving into NEST will only have been doing so for a matter of months and with the cap on contributions, it is unlikely that more than a handful of people will have their primary DC savings in NEST.

So the debate we are having in 2015, is theoretical, it is not until 2017 that any meaningful sums can be transferred into NEST, nor indeed – the amounts people have saved into NEST, be transferred into another retirement savings plan to be consumed elsewhere.

Our reluctance to respond is that Pension PlayPen could more constructively be having this conversation with insurers who have large amounts in accumulation and can take transfers-in.

It has been pointed out that NEST could in time become a general aggregator into which people who had not saved with NEST could take their DC pots and use NEST's administration and investment strategies to help them spend their money and make their money go further. For this to happen, NEST would need to change structure or the laws governing occupational trusts change. As we understand it, unless there is a change in the law to allow people to join a master-trust without their employer participating in that trust, they cannot access it. We are aware that there is an exception to this – the self-employed – who are allowed to join an accumulate savings in NEST but we are not aware they can join NEST to spend their savings.

In order for NEST to become a general aggregator to the Nation, it would have to become a Regulatory Own Fund (like the Pension Protection Fund). We think this could happen (and have said so in the past), it may well be that NEST remains a master trust to accumulate but has a separate structure – a Regulatory Own Fund structure- for decumulation. This would happen not just because of demands from consumers (fuelled by the Pension Freedoms) but because this is about the only way that a collective approach to spending (including longevity pooling) is going to work,

Changing retirement patterns

How will changing retirement patterns and provision affect what members need?

The report rightly points out that differing socio-economic groups want differing things. The question is what they need. They need enough money to keep them off the State and they want much more than that. If we are answering from the DWP's perspective, the National Insurance Fund needs people to be self-sufficient so they do not need total reliance on state benefits. People want to have a good time, spend what they want, when they want. NEST has to work out which master it is serving, We do not see NEST as a wealth management unit- we see it as a means to protect the National Insurance Fund, so it should be aiming to give people a supplementary pension (a funded non-guaranteed version of S2P)

How will changing retirement patterns and provision affect what employers want from DC schemes in the future?

The abolition of the fixed retirement age and the increasingly lower amounts arising from DB schemes, mean that employers will in future have to promote DC savings as the insurance people have when they choose to leave work when they want to wind down. The temptation for employers will be to overplay the short term ("you'll be fine – look at all that money!") and play down the longer term when failing health and spent savings are not so attractive.

Financial circumstances in retirement

We agree with the trends identified in this chapter. Our sister company, First Actuarial is involved in Financial Education in the workplace. It provides holistic education, helping employees to bring together the resources from private savings (including equity in property), DB (including state) and DC benefits.

Increasingly this work is involving the use of Digital Guidance (what elsewhere has been called a pension dashboard). Increasingly we see digital tools helping people to model their financial futures based on learnings about inflation, investment returns, the liabilities of house ownership, of day to day living and the unknowns- long term care needs and dependency in extreme old age.

We cannot foresee any changes to these trends but we recognise that change is constant, we need a flexible approach to meet changing needs and DC design must help people to take control of their retirement wealth- better.

What conclusion s should be drawn from the evidence on spending and what else needs to be considered.

The chapter is very good. The central conclusion that people do not spend differently because they are retired is obvious but needs to be said. The problem is that we assume that because people have less chance of generating income from work, we must guarantee income from their saving. As the chapter suggests some people are hoarders and never spend to their means, some are profligate and over spend but most people are money saving experts who spend to their means, budget and plan.

For all three groups there are different answers. Those who want a high degree of certainty will look at guaranteed income solutions and more carefree people will avoid such solutions (and probably run out of money. People in the middle will accept a degree of uncertainty in a trade-off that has upside in greater returns on saving.

Financial Planners tell us that most people place themselves in the middle.

There is a further consideration, extreme poverty among people who have no rights to anything. These are people- often immigrants – who have little right to a state pension here or from elsewhere for whom we – as a society – have an obligation to keep from extreme hardship. It concerns us that their savings in NEST may be their only savings and that they are to be treated as the vast majority (despite their differing circumstances). We have read little about this group and know little about their spending patterns. Since NEST has probably a large number of such people on its books, we think it should spend time looking at their special needs.

We would welcome money spent by the DWP understanding the needs of this group and are glad that the consultation addresses this issue,

How can DC design align itself to general spending patterns?

Given that most people fall in the middle and are prepared to accept some risk (e.g. lower levels of guarantee) for more reward, collective solutions seem sensible. We know that there is a herd mentality to saving from the high take up of default options. This is not stupid- there is wisdom in the crowd. Similarly there is likely to be a default position which most people would accept, in terms of risk and reward in the investment of monies in decumulation.

We think that the problem with the old system was it channelled people towards an extreme position- the guaranteed annuity – which people rejected. We think the other extreme- absolute freedom – is equally unappealing. What needs to emerge is a collective approach that provides people with more income, better property rights in exchange for the loss of absolute certainty.

How are savers likely to act under the new freedoms?

As the report says, people can express their preferences but we should be wary of predicting their behaviour. Given most people have a poor understanding of how long they'll live, how long their money will last, the risks of taking income from a volatile investment and the costs of the unexpected (long term care from incapacity), there is a strong argument not to give people any freedom.

There needs to be a guided path that meets the needs of most people- a default solution around which those who do not know what they want can gather. Extreme solutions (annuities and bank accounts) exist, but what savers are looking for is the middle way. Behaviours will be shaped by the emergence of that middle way. The middle way will not emerge organically for many years. Speaking recently with Mark Hoban MP, he talked of a "five or ten year bloodbath of failure" to get there.

In order for a middle way to emerge, leadership needs to be shown. People will respond to strong leadership from people who they trust – Martin and Paul Lewis, Steve Webb, Ros Altmann- to name a few. NEST can also show leadership by getting it right.

Member behaviour risks that providers need to manage

We have just said there needs to be leadership. This needs to be shown not just by NEST but by other providers. The bias that is most prevalent in people's saving patterns is created by advice. Financial advisers do not generally give independent advice. The advice is skewed to suit their purposes. Typically they recommend solutions that earn them money and only recommend solutions like NEST- when there is no money to be earned by alternative strategies.

But IFAs show leadership, they are great influencers/salespeople. In the absence of leadership elsewhere, people will follow what leaders tell them to do- even when it is not in their best interest to do so.

Providers are conflicted. IFAs are their distributors and they can no longer treat them as their agents. Infact providers bend over backwards to please advisers so that they are not liable for the advice but see their products getting used.

The only way for this cycle of poor behaviours to be broken is for new leaders to emerge who promote product that is genuinely unbiased and is in the best interests of the consumer.

This delicate balance between letting a consensus default emerge organically and showing leadership to stop a blood bath of biased advice (not to mention scams) is one that we need to achieve in 2015. Otherwise we will fall back into chaos as we did in the years following the last great change- the introduction of personal pensions in 1987.

Member behaviour risks needing to be managed

A mark of leadership is strength of conviction and "good leadership" needs to have conviction for the right reasons. NEST has not always shown conviction in its behaviour. The wretched decision to pander to political pressure and introduce an investment strategy for young savers that focussed on low volatility is such an example. Here good sense lost out to political show-boating. There was no evidence that people would have jumped out of NEST if they'd been exposed to volatility when young and there still isn't.

This is relevant to this argument. What people want (as has been observed in the consultation) is everything. They want guarantees of high growth and the opportunity to take money how they want when they want. They want inflation protection and they'd like protection for spouses and dependents too. But they know as well as we do, that you can't have it all. Leadership is needed to help them understand that. Leadership is needed- as with the construction of accumulation defaults – to manage the risks of "present bias" and "certainty bias" as well as the hosts of risks associated with running a growth strategy for people in the early years of retirement.

If providers are not prepared to be showing leadership and managing these risks, they are not doing their (well paid) jobs. By "Providers" we mean the owners of master trusts, insurance companies, trustees, IGCs and advisers who are vertically integrated into these roles.

Other risks (than those listed) in managing funds in retirement

There is a general risk for all providers and trustees which is not spelt out. It is the risk of them getting it wrong ("f*** up risk" as we call it). This risk is associated with trust. If a football team plays badly and the manager is trusted, he can explain why things went wrong, take the blame and come out stronger. So long as it doesn't happen again and again when people lose trust. If things go wrong and the manager is seen to blame someone else, then trust can easily be lost.

What is important is accountability. Much of the distrust of financial services has resulted in people saying things, those things not happening and there being no one left to take account. Even worse, the blame has been passed from place to place to the infuriation of the public.

The risk I'd add to the list is "accountability", if the public sees another financial product with no one accountable for its delivery, they will walk away. It is again a matter of leadership.

What gets engagement for DC Savers?

We should not despair! Millions tune in to watch Martin Lewis has a prime-time TV slot, millions use his web-site. People are not lazy about money, they just want to deal with people who are on their side.

Martin Lewis has proved it can be done. Alvin Hall proved it could be done at Morrisions, First Actuarial prove it can be done.

Key to getting people to believe you are on their side is to demonstrate independence and integrity. Also key is to be funny (engaging) and relevant (content and delivery).

Many people under the age of 30 do not even watch TV anymore, all their engagement with information is through a phone or tablet or laptop. Even at school they are learning more from the websites they are directed to than they are in class.

These kids are the retirees of 2065 but those retiring now have different ways of engaging. The trusted source of information is the workplace and if it's not the workplace, it's a providers. Because at least employers and insurance companies are going to be around in a few years' time and the people who you talk to who are working for such institutions are taken to have independence and integrity.

TPAS has a similar reputation, a reputation which will hopefully be enhanced by its delivering the guidance guarantee.

But all generations are learning to use technology in one way or another and the techniques by which people engage with Candy Crush should tell us how we can get engagement with DC. Gamification is popular because it rewards people instantly for the tiny steps (moving from screen to screen etc.). Social media is engaging as it allows people to shout about their minor triumphs ("I've just beaten Barcelona on FIFA").

For people to be able to engage with their DC pensions, they are going to have to be as accessible as CandyCrush or Twitter and they are going to have to compete with them for their time and attention.

We live in a digital age where TV is already old-fashioned, the idea that we will be learning from what drops through our letter boxes in ten year's time is an odd one. Already some of us are more likely to open an email than a letter.

How can we help mitigate the risks of cognitive decline among the oldest?

It is helpful sometimes for providers of financial services to take a step back. Car manufacturers are not responsible for the use of cars by those too old to drive.

The responsibility for the financial decisions of those in cognitive decline passes within a family to the person fittest to act under a power of attorney. If there is no-one to do this, then a lawyer is generally appointed. In extreme cases, there is no one, in which case there is only the social services provided by the State.

Lock down of financial products in later age is sensible. Many will buy an annuity when they feel they can no longer be bothered or able to manage drawdown. Many will never consider themselves cognitively able to manage their freedoms and opt for a collective or guaranteed solution (the point of the DA agenda).

So long as the option to lock down into an annuity or transfer into a collective decumulation scheme is there, we should do no more (as providers). At this point our social duties towards the truly elderly need to take over.

What is the role of default strategies in the new regime?

Default strategies perform the same role in the new world as they did in the old – they are how Providers show leadership to those who are unable or unwilling to lead themselves.

Should we have more than one default?

By definition there can only be one default – most people use it. There can be a number of core strategies that suit different types of people and they can lead to different places – cashing out- guarantee purchase- pure equity drawdown etc..

However the point of a default is to pave the way for most people and most people do not want to be confused by "different types of most people". If we had a system of financial guidance that worked like the NHS so that people did what they were told, we could have triage. But we don't.

We don't get people to form into orderly queues based on market segmentation and so there can only be one default, the rest is down to choice.

A default retirement age?

Most people like order in their life. They want break points which are given to them. So they know when to go to school, when to go to college, get a job, retire…the only one that they won't know is death.

There is nothing wrong with this. There's nothing wrong with a state retirement age so long as people know it's a guide to behaviour not a social imperative. Most people know it's their life and not the Government's and those who simply want to be told when to retire are discovering that isn't happening any more.

So the concept of a default retirement age will decline in time, unless there is another change in the rotation of these things (which is quite likely). We can only plan for what we know today and we have a default retirement age – let's keep using it.

As said above, let's try to stick to the one default!

Should purchasing an annuity income be part of retirement planning?

We purchase annuity income every time we pay national insurance, this is nothing special. The issue is whether we should be forced to exchange our retirement savings for retirement income. Until recently the answer was yes. At the budget, the Chancellor changed that so no one needed to buy an annuity or even have drawdown as income.

We are where we are and international comparisons are not that helpful. We simply want to accept the rules have changed and show leadership in creating a new structure which ultimately will be determined by freedom of choice among those retiring.

Fixed term, iterative purchase and phased annuities?

These are choices, helpful choices- that will appeal to some, but they are not the main event. Those wishing to explore these choices should be able to do so, either by internet shopping or via an adviser. The most that a scheme like NEST can do, is to make people aware of their existence, their purpose and where people can find out more about them.

Frankly there is not time in a Guidance Guarantee session to look at this detail of choice, these need to be searched for.

Deferred annuities?

The problems with deferred annuities were properly demonstrated with the demise of the Equitable Life. If a deferred annuity market emerges, it will be because of demand but we have seen no demand for long term care products (which are generally based on deferred annuities) and unless there is a change in consumer behaviours, we see deferred annuities as having a very limited market.

Other ways for member to hedge longevity risk?

Members can choose to hedge longevity risk by joining a longevity pool,, currently no such pools exist but they could create themselves if we create Collective DC schemes into which people transfer their DC pots.

Does investing through retirement have advantages?

For the average person, a strategy that provides a decent balance between growth and security is sensible. Growth comes from investment, security from insurance. Purchasing insurance for upwards of 30 years (which is the aim of an annuity) is not what most people want to do or need to do. The uncertainty of income in their working life is substantial, it is unreasonable to suppose that at the point of retirement they turn totally risk-averse.

The long term advantages of a growth strategy underpinning retirement income include the steady income stream available from real assets (property and equities), linking the retirement income stream to GDP (what underpins long-term property and equity income growth) and the avoidance of political interference that can artificially depress the debt market (see QE).

For those totally risk averse, the option of the annuity is always there as is the option to spend your pot (the other extreme). We would argue that the default option should be invested for the future.

Ideas for designing a default drawdown strategy for NEST

NEST is a commercial organisation that competes in the market with other providers. It is not appropriate for it to expect consultants to provide this service gratis. If NEST wants advice on how to design its default, it should pay for it.

Risk Sharing

NEST should not consider sharing risks between those currently saving for retirement and future generations of savers. It should consider offering those who arrive at retirement, the option for them to pool investment risk and have their assets managed collectively.

Combining risk sharing and normal DC

It would not be a bad idea for NEST to set up a separate CDC scheme for employers who wanted to operate their workplace pension as a CDC plan though we think that most employers would still work within the DC framework. We think that CDC is more likely to be popular as an in retirement option with people transferring DC benefits into a pool at retirement.

People are rightly nervous about the risks of risk-sharing between generations and for that reason, employers will be concerned about their use as the default workplace option.

Henry Tapper

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