Standard Life plc

Response to:

The future of retirement

A consultation on investing for NEST's members in a new regulatory landscape

November 2014

Response

We are pleased to make this contribution to the debate NEST would like to prompt on the retirement solutions for DC savers in the new regulatory landscape.

Member choices

The paper presents a wide range of interesting research and facts yet correctly highlights the significant uncertainty about what the individuals, whom pension reform brings in to retirement saving, will want to and will actually do with their savings. We do not believe the responses to the consultation will significantly offer any more certainty.

It would though be a safe assumption that individuals will continue to aspire to an income that will meet their needs on retirement and keep pace with their needs thereafter but at the point of retirement will choose what they understand to be the best option. Thus for example an inflation linked income may seem attractive but may not be chosen.

Taking the pension as ‘cash’ will be a popular option for some, particularly those with pots of c. £20k to £30k and NEST members reaching retirement in the immediate future with very small retirement funds. We expect continued demand for conventional lifetime annuities, but at significantly lower volume than before the budget reforms. Those choosing annuities may be offered different options than the conventional lifetime annuity, for example, increasing, decreasing, flexible or fixed term annuities.

However, we anticipate income drawdown is likely to be the income option of choice for most savers going forward and that this is likely to be the appropriate choice for NEST members with other sources of income. Our expectation is that there will continue to be significant demand for guaranteed or low volatility income solutions within the drawdown framework.

Risk Sharing

The Pensions Schemes Bill will provide for new forms of risk sharing, but past experience indicates that pooling or sharing risk inevitably becomes unpopular when the value it delivers comes to be questioned. Falling returns for endowments matched changing economic circumstances but triggered a move away from their use as a saving vehicle. Guaranteed annuities, and deferred annuities as a means for example to match defined benefit pension liabilities, have similarly gone out of fashion.

The With Profits model pooled and shared investment risk and had delivered good outcomes but in the face of lower returns in changed economic conditions the opacity, within which that sharing operated, attracted criticism. One of the features of the proposed collective defined contribution schemes will be greater transparency but there may be a risk this actually accelerates or prompts unpopularity, for example in times when either the value of benefits reduce or are seen to be shored up by the contributions of current members. Successful delivery of such a shared risk approach may require an understanding of the timescales required to achieve the necessary scale across members at all stages of the savings journey and an equitable approach to the costs and risks involved.

The level of income provided by today’s annuities is affected by the underlying economic conditions. The increasing use of annuities that recognise health and lifestyle factors that may reduce longevity, offers an opportunity for higher income levels but for those with better health this should reduce the benefits of pooling risk. Yet the guaranteed income for life that an annuity provides that would be among the certainties favoured by many within NEST’s member profile and we believe that an annuity would continue to be an appropriate option for many or for example its secure income could sensibly be replicated as a default feature of any drawdown option for those reaching age 80.

Better Outcomes

Questioning the value of annuities highlights the significant underlying problem of the insufficiency of contributions being made to retirement savings. NEST's research identified a retirement income of £15,000, as the tipping point for people feeling significantly more satisfied with their life after work. Getting people to build up enough savings to attain this would be a useful benchmark to aim for. Whether an individual would achieve this aim will be more influenced by the value of what is put in and the investment option to which it is allocated than by the shape of benefits ultimately available.

The achievement of better financial outcomes for savers in any DC pension would be supported by nudging consumers towards making sufficient contributions. A government-led campaign which, in simple terms, helps consumers understand what an achievable target income could be and how much typically needs to be saved would help build that nudge on top of the kick start provided by auto-enrolment and the communication of a quality member journey by schemes and providers.

About Standard Life

Established in 1825, Standard Life is a major long term savings and investment company, with around six million customers worldwide. At October 2014 the Group had total assets under administration of over £290bn.

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