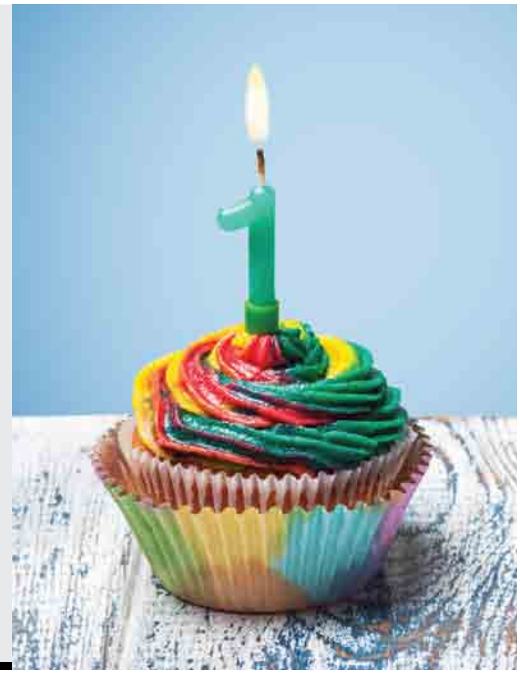
Summary

- Despite there being a high degree of positivity around the freedom and choice reforms, there are still concerns that people are receiving inadequate information about accessing their pots.
- The Treasury has highlighted planned measures to improve support, including a new guidance service, a 'pensions dashboard' and allowing individuals to withdraw up to £500 tax-free from a DC pot to help pay for financial advice.
- People tend to access all of their DC fund when they have additional sources of retirement savings elsewhere.
- Trustees have expressed concerns that signposting members to a flexible retirement option could be seen as having acted as an introducer to a product provider, or even as having given unregulated advice.
- Concerns over fraud have risen as fraudsters can simply persuade people to draw their money out as part of the pension freedoms.
- It was hoped that, as well as delivering a huge shake-up to the annuities industry, the changes would stimulate product development, but there does not seem to be much evidence that this has happened.
- The introduction of the Lifetime ISA has muddied the waters over future trends in pension saving.



Freedom and choice: One year on

Chancellor George Osborne's pensions freedoms shook the pensions industry. David Adams investigates the effects of these reforms one year on from implementation

Two years after George Osborne's pensions freedom bombshell, and one year since they came into effect, how have consumers and the pensions industry fared? The man who was Pensions Minister until May 2015, Steve Webb, is now Royal London's director of policy and external communications. He was not closely identified with the pension freedoms in 2014 – this was usually thought of as Osborne's policy – but he insists it was not foisted upon him. It was a truly joint Conservative/LibDem policy, he says, a consequence in part of his push to reform the failing annuities market; and needed to support the introduction of auto-enrolment.

But the way the freedoms were introduced, without any prior warning, let alone any kind of consultation, is harder to defend. PTL managing director Richard Butcher describes freedom of choice as "a policy constructed seemingly without the benefit of any evidence".

"As a consequence we had no idea how it was going to turn out," he says. "But actually the experience has been pretty positive so far. The early evidence is that people are doing fairly sensible things."

For Barnett Waddingham senior consultant Malcolm McLean, the biggest concern is not people being irresponsible with their pension savings – it is their money, after all – but inadequate information for those accessing their pots. "Even now I don't think everybody understands that if you pull out a lot of money, not only do you have to pay tax on it, but you may go up into a higher tax bracket," he says. The issue of guidance and/or advice remains a major concern.

A spokesperson for the Treasury highlights planned measures to improve support, including its new guidance service; a consultation on a Pension Advice Allowance that would let individuals withdraw up to £500 tax-free from a DC pot to help pay for financial advice; and its proposal to launch a 'pensions dashboard' by 2019: "a digital interface where an individual can view all their retirement savings in one place".

Aviva senior policy manager for pensions and investments, Alistair McQueen says most Aviva customers who could have accessed their pension pots have done nothing. "Of the people choosing to access their money the number one action is to take all of their money as one lump sum, but a majority are accessing funds of less than £10,000," he says. "People are tending to access all of a DC fund when they have additional sources of retirement savings elsewhere."

Behaviour treads

Hargreaves Lansdown has studied the behaviour of 27,000 self-managing drawdown customers since the introduction of the freedoms.

Head of pensions research Tom McPhail reports that they are tending to withdraw money at a sustainable rate, around 3.6 per cent per year, while cash reserves tend to be around 20 to 25 per cent of portfolio values: a prudent cash buffer.

So how well have schemes and sponsoring employers responded to the changes? In autumn 2015, as part of a broader research project on governance, LifeSight, the DC master trust run by Willis Towers Watson, surveyed 99 fiduciaries of DC schemes of various sizes. Two out of three either already had a drawdown option in place or planned to offer one by the end of 2016.

A large majority of the trust-based schemes (67 per cent) had reviewed default investment strategy, compared to just 33 per cent of contract-based schemes, although 59 per cent of the latter were either planning or considering doing so before 2017. Over a third of both contract and trust based schemes were still targeting annuities in their default strategy, far more than the 10 per cent of trust schemes and six per cent of contract schemes targeting drawdown. But 44 per cent of contract schemes and 23 per cent of trusts were targeting a blend of the two.

"I would argue that a blend doesn't suit everybody," says LifeSight managing director Fiona Matthews. "We need to proactively engage people saving for retirement to help them think about whether they should be funding for annuity, drawdown or cash."

In March 2016 The Pensions Regulator (TPR) released research based on interviews with 17 of the largest DC occupational schemes (which account for 68 per cent of all occupational DC scheme members) conducted in the second half of 2015.

Demand from members in these schemes to exercise the pension freedoms was low. TPR attributes this to the fact that many are either too young to exercise these freedoms and/or have very small pots, particularly in schemes established primarily for auto-enrolment. Some schemes are hybrids: originally DB with DC sections added later, where members are likely to have safeguarded benefits and may be allowed to maximise their tax-free lump sum from their DC pots before releasing DB benefits, making it less likely they would want to use the freedoms.

Another reason for a lack of action at some schemes is that employers were unwilling to allow the necessary changes to trust deeds and rules, because they see their pension scheme as an important employee benefit specifically designed to provide an income in retirement. Trustees also told TPR they were concerned that signposting or guiding members to a flexible retirement option could be seen as having acted as an introducer to a product provider, or even as having given unregulated advice. TPR's research also revealed the extent to which the pace of legislation has outstripped the capabilities and capacity of service providers, including administrators and investment managers who are struggling to catch up.

Even so, while only 12 per cent of the schemes provided full and partial drawdown options already, another six per cent said they will provide these options within 12 months and another 41 per cent plan to provide them via a third party within a year.

Fraud, product development and consumers

There were fears that the freedoms could help fraudsters. "Fraud is easier now – fraudsters can simply persuade people to draw their money out as part of the pension freedoms," says McLean, highlighting a recent case in Scotland involving millions of pounds and 300 victims.

But TPR executive director for defined contribution, governance and administration, Andrew Warwick-Thompson, says he has not seen any compelling evidence of an increase in fraud; and Alistair McQueen says Aviva's figures show a downward trend. However, counters McPhail, it can sometimes take at least six months for fraud to come to light.

It was hoped that, as well as delivering a huge shake-up to the annuities industry, the changes would stimulate product development, but there does not seem to be much evidence that this has happened.

Matthews points out that the industry has not really had a great deal of time to dedicate to product development – and that uncertainty related to the government's consultation on changing the tax relief rules may also have held development back. But the main reason for the slow pace of development is a lack of demand from DC members who are currently likely to have only small pots, says Warwick-Thompson.

Finally, while some cynicism about the purpose of the pension freedoms policy is understandable, has it encouraged people to save for retirement?

Webb thinks the publicity around them has made pensions "more interesting" for consumers, while helping keep auto-enrolment opt-out rates low. Others agree, with varying degrees of enthusiasm.

The only cloud on the horizon is the Chancellor's announcement of the Lifetime ISA in his latest Budget, which has "muddied the waters", Butcher says.

Osborne's Budget day announcements certainly force the industry – and consumers – out of their comfort zones. But whether they will also help to close the savings gap is something we won't know for a few years yet.

Written by David Adams, a freelance journalist