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Pension flexibilities: the ‘freedom and choice’ reforms

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Inside:

Contents

Summary

Individuals with defined contribution (DC) pensions build up a pension fund using contributions, investment returns and tax relief. Before 6 April 2015, most people used their DC pension funds to purchase an annuity. This was strongly encouraged by the pension tax legislation in force at the time, which authorised lump sum or flexible payments in limited circumstances.

In Budget 2014 the Coalition Government announced that from 6 April 2015 people aged 55 and over would be able to make withdrawals from their DC pension pot "how they want, subject to their marginal rate of income tax in that year." Legislation for this was in the *Taxation of Pensions Act 2014.* To help people navigate the wider range of options, a guidance service – Pension Wise – was established - see Library Briefing Paper SN 7042.

Following press reports of perceived difficulties, the Government launched a consultation in July 2015 on whether individuals were able to access the new pension flexibilities easily and at a reasonable cost. An update from the FCA said that the overall majority of consumers had been able to do so, with some exceptions (PN15-28). In February 2016, the Government announced proposals for making the transfer process smoother and more efficient. It placed a duty on the FCA to impose a cap on early exit charges (*Bank of England and Financial Services Act 2016*, s35) and enabled this to be implemented in occupational schemes in Part 2 of *Pension Schemes Act 2017.*

The Work and Pensions Committee published a report on pensions freedoms on 5 April 2018. It found that there was "little evidence that savers were frivolously squandering their life savings" but that this did not mean that people were making well-informed pension freedom decisions. It proposed a two-pronged approach:

- **Protecting savers** by requiring providers to offer a "default decumulation pathway suitable for their core customer group" and allowing NEST to offer decumulation products, including a default drawdown pathway, from April 2019.
- **Empowering savers to choose** by requiring providers to offer single page pension passports and provide necessary information to the pensions dashboard, which should be hosted by the new single financial guidance body, funded an industry levy and in place by April 2019. (HC 917, April 2018, summary).

In its June 2018 Retirement Outcomes Review (RoR) report, the FCA found that:

- there are weak competitive pressures and low levels of switching. Most consumers choose the 'path of least resistance', accepting drawdown from their current pension provider without shopping around
- one in three consumers who have gone into drawdown recently are unaware of where their money was invested
- some providers were 'defaulting' consumers into cash or cash-like assets, but holding cash is highly unlikely to be suited for someone planning to draw down their pot over a longer period.

Following this, the FCA consulted on proposals to require providers to offer customers entering non-advised drawdown 'investment pathways' i.e. readymade drawdown investment solutions, appropriate to standardised objectives. It also proposed measures to: ensure that consumers entering drawdown only invested mainly in cash if they had taken an active decision to do so and; to measures improve transparency of charges (CP 18/17, PS 19/01; CP 19/5; PS 19/21). The FCA also recommended that the Government consider

'decoupling' tax-free cash, because many consumers focused on that at the expense of other pensions decisions at that point (ROR, para 1.38).

In a report published in July 2018, the Treasury Select Committee expressed concern that "the level and quality of consumer protection and default investment pathways associated with the pension freedoms do not appear sufficient at present." It recommended that the Government work actively with the FCA to identify opportunities to enhance both. It also said the Government should keep under review whether individuals started to purchase annuities in later retirement to protect against longevity risk. If not, it should consider intervening.

Other reading:

The plans for pensions dashboards are discussed in CBP 8407 (May 2019).

The decision not to allow annuity holders to sell their income stream to a third party is discussed in CBP-07077 Secondary annuities market (August 2018).

1. Background

The lifespan of private pensions can be divided into three stages (contributions, investment and withdrawal). At each stage there are tax implications for the individual concerned. The UK tax treatment of pensions follows and "exempt, exempt, taxed" (EET) model":

- (Exempt). Pension contributions by individuals and employers receive tax relief and employer contributions are exempt from national insurance contributions;
- (Exempt). No tax is charged on investment growth from pension contributions; and
- (Taxed). Pensions in payment are taxed as other income, but individuals are able to take up to 25% of their pension fund as a lump sum on retirement.[1]

The minimum age at which an individual can generally draw a pension (other than on ill-health grounds) is generally 55.[2]

Pension tax legislation provides for the tax treatment of payments to and from a pension scheme. The amount and type of benefit an individual can actually receive will depend on pension scheme rules.[3]

The last major reform of the system was the introduction of the pension tax simplification regime under the *Finance Act 2004 (FA 2004).* This replaced eight different tax regimes governing pensions with a single set of rules applying to saving across pension schemes and rules as to how pension savings are turned into benefits.[4] It categorised payments from schemes as either authorised or unauthorised. Unauthorised payments have an extra tax charge on them (55%), such that HMRC does not expect many to be paid. Schemes may also be liable for a sanction charge.[5]

Two main types of pension scheme

Defined contribution (DC) schemes in which people build up a pension fund using contributions, investment returns and tax relief. The amount of a person's fund will depend upon the level of contributions paid and investment income achieved. DC schemes are not defined in pension tax legislation which instead refers to 'money purchase' arrangement (*FA 2004,* s152).

Defined benefit (DB) schemes promise to pay pension benefits based on fixed factors, typically salary and length of service.

1 HM Treasury, Removing the requirement to annuitise by age 75, July 2010, para 2.3
2 *Finance Act 2004,* Part 4
3 HMRC, Registered Pension Schemes Manual (RPSM), page RPSM09200030
4 HM Treasury, Simplifying the taxation of pensions: increasing choice and flexibility for all, December 2002
5 An explanation of how these charges work is on the HMRC website: Unauthorised payments from pension pots. The unauthorised payments charge is provided for in sections 208-213 of the Finance Act 2004. The scheme sanction charge is in sections 239 to 241. Detailed guidance is in the Registered Pension Schemes Manual – see, for example, RPSM09205200 - Member Pages: Member Benefits: Taxation: Unauthorised Member Payments

1.1 What options do people have at retirement?

Before the rules changed on 6 April 2015, the pension tax rules were much more prescriptive about the payments an individual could take from their DC pension scheme.

Options before 6 April 2015…

Before the announcement of the 'freedom and choice' reforms in the March 2014 Budget, three-quarters of people with DC pension savings used them to purchase an annuity.[6] This was strongly encouraged by pension tax legislation, which applied a 55% tax charge on lump sum withdrawals except in limited circumstances.[7] The main exceptions to buying an annuity were:

- Taking small amounts of pension saving as a lump sum;[8]
- 'Income drawdown', which allows the individual to draw an income from their fund while leaving the rest of it invested. (However, except where the individual could show that they had other pension income over a set amount, there was a cap on the amount they could draw down each year.)

The effect of these rules was – as the FCA put it – to require individuals to "ensure that the funds in their pension last for the rest of their life."[9]

In 2013, before the announcement of radical changes in Budget 2014:

- Around 350,000 new annuity products were taken out;
- There were 6 million pension annuity policies in payment, receiving £13.3 billion in payments during the year;
- Just over half of all annuities were purchased through an alternative provider to the customer's existing pension provider.
- The average (mean) annuity in 2013 was bought with a pension fund of around £35,600, but the median was around £20,000, so half of people bought an annuity with less than this. 29% were bought with a pension pot of less than £10,000.[10]

And from 6 April 2015…

In Budget 2014, the Government said it would change the rules to enable individuals with DC pension savings to withdraw them "at a time of their choosing, subject to their marginal rate of income tax."[11]

Following changes to pension tax legislation in the *Taxation of Pensions Act 2014* the options available from 6 April 2015 are:

- Leaving your pot untouched;
- Taking a guaranteed income (an annuity);
- Taking an adjustable income (flexi-access drawdown);

6 HM Treasury, *Freedom and choice in pensions*, March 2014; ABI, *The UK Annuity Market: Facts and Figures*, February 2014
7 Finance Act 2004, s 166; Sch 29
8 Library Note SN 2181 Pension lump sums
9 Financial Conduct Authority, Retirement reforms and the Guidance Guarantee, July 2014
10 ABI, UK Insurance. Key Facts 2014
11 HM Treasury, Budget 2014, March 2014, para 1.165

- Taking the whole put as a lump sum or series of lump sums (uncrystallised funds pension lump sum - UFPLS);
- Some combination of the above.

In the case of a lifetime annuity or flexi-access drawdown, there will normally be the option of a 25% tax-free lump sum at the time of taking the pension. For UFPLS, 25% of each withdrawal would be tax free.[12] Where an individual has accessed their DC pension savings 'flexibly', the amount they can contribute annually to a money purchase scheme would reduce to £10,000 (see section 4.8 below).[13]

People already in 'capped' drawdown on 6 April 2015 can convert to flexi-access drawdown. Existing flexible drawdown funds became flexi-access drawdown funds.[14]

Information about the new rules is on the Pension Wise website. More detailed guidance is in HMRC's Pensions Tax Manual.

The different options are described in more detail below.

Flexi-access drawdown

Before 6 April 2015, legislation provided for two types of drawdown:

- **Flexible drawdown.** Provided an individual can show that they have other pension income of at least £12,000 a year (down from £20,000 on 27 March 2014), there is no limit on the amount they can draw down each year. [15]
- **Capped drawdown**. The amount an individual can draw down each year is capped at 150% of the value of an annuity that could have been brought with a fund of the same value (up from 120% on 27 March 14).[16] Investment reviews must take place every three years before the age of 75 and every year after that. At these reviews the individual's maximum withdrawal is reassessed, based on tables produced by the Government Actuary's Department.[17]

Part 1 of Schedule 1 of the *Taxation of Pensions Act 2014* provides for flexi-access drawdown funds.[18] There are no limits on withdrawals.[19] Apart from the option of the 25% tax-free 'pension commencement lump sum', withdrawals are taxed as pension income at the individual's marginal rate.[20]

The effect on those in drawdown arrangements on 5 April 2015 depended on whether they are in capped or flexible drawdown:

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12 Section 1 and Schedule 1
13 Schedule 1 Part 4
14 Schedule 1 Part 1
15 *FA 2004,* section 165 (rule 7);Schedule 28; HMRC's Registered Pension Schemes Manual, RPSM09103590
16 *FA 2004,* section 165 (rule 5); RPSM09103530
17 *FA 2004,* Schedule 28 (10); RPSM09103550
18 Explanatory Notes to Para 1 of Schedule 1
19 Ibid, para 61
20 HMRC, Pension Flexibility: Draft guidance on clauses for the Taxation of Pensions Bill, 21 October 2014, p15

- Existing **flexible drawdown** arrangements converted to flex-access drawdown funds on that date;
- Existing **capped** d**rawdown** arrangements continued and the member can designate additional funds to it. It will convert to a flexi-access drawdown fund if either: the individual's withdrawals exceed the cap; or they notified the scheme administrator that they want to convert to flexi-access drawdown and the administrator accepted this notification; or they transferred drawdown funds to a new scheme and notified the administrator they wanted them to be newly-designated from the date of transfer. [21]

Guidance is in the Pension Tax Manual – PTM062700 – Member benefits – pensions: drawdown rules applying from 6 April 2015.

Annuities

Before 6 April 2015 a DC scheme could only pay a lifetime annuity if it met certain conditions. These were that:

> b) it is payable by an insurance company,
>
> c) the member had an opportunity to select the insurance company,
>
> d) it is payable until the member's death or until the later of the member's death and the end of a term certain not exceeding ten years, and
>
> e) its amount either cannot decrease or falls to be determined in any manner prescribed by regulations made by the [HMRC].[22]

Part 2 of Schedule 1 of the 2014 Act removed some of these requirements for annuities purchased from 6 April 2015:

> […] the annuity must still be payable for life by an insurance company but the annuity can decrease and it can continue to be paid after the member's death if the member dies before the end of a guarantee period of any length specified in the annuity contract. In addition a member is no longer subject to the unauthorised payments charges if they have not had an opportunity to select the insurance company paying the lifetime annuity. [23]

Guidance is in the Pension Tax Manual – PTM062400 – Member benefits: pensions: scheme pensions: lifetime annuity.

Uncrystallised funds pension lump sum

The option of an 'uncrystallised funds pension lump sum' (UFPLS) is provided for in Part 3 of Schedule 1. For a payment to qualify as a UFPLS, it must meet certain conditions. For example:

- It must be paid on or after 6 April 2015 from uncrystallised rights held under a money purchase arrangement;
- The individual must have all or part of their lifetime allowance available;

21 FA 2004, Schedule 28 (8A), (8B) and (8C)
22 *FA 2004* section 165 (rule 4) and Schedule 28
23 Taxation of Pensions Act 2014 – Explanatory Notes, para 106-120

- It is not a pension commencement lump sum or trivial commutation lump sum;
- The individual must be aged at least 55 or meet the ill-health conditions; and
- Immediately before payment they represent rights that were uncrystallised (i.e. they are funds held in a money purchase arrangement that have not as yet been used to provide that member with a benefit under the scheme.[24]

To ensure than an individual cannot get a UFPLS that would give them a bigger tax-free amount than they could have been paid as a pension commencement lump sum, a UFPLS cannot be paid if they have:

- Primary or enhanced protection and a right to tax-free lump sum of more than £375,000 on 5 April 2006; or
- A 'lifetime allowance enhancement' factor and the available portion of their lump sum allowance is less than 25% of the amount of the payment. [25]

Normally 25% of a UFPLS would be tax-free, with the remainder taxed as income. Exactly how the payment is treated would depend on whether the individual is under or over age 75:

- Where the member is **under age 75**, 25% of the amount of the UFPLS would be paid free of income tax, and the remainder taxed at the individual's marginal rate;
- Where the individual is **aged 75 or over** and has more lifetime allowance than the amount of the UFPLS, then the lump sum would be taxed in the same way as if the member was under age 75. If they have less lifetime allowance than the amount of the UFPLS, then an amount equal to 25% of their available lifetime allowance can be paid tax-free, with the remainder taxable at the individual's marginal rate.[26]

The reason is that at age 75 all uncrystallised benefits would have been tested against the lifetime allowance already and any charge deducted at that time.[27]

The treatment of a payment in excess of the maximum that could be paid as a UFPLS would also depend on the individual's age:

- If the member is **under age 75** at the time of payment, it would be taxed as a lifetime allowance excess lump sum (at 55%);[28]
  If they are **over the age of 75**, it would be taxed as income.[29]

Guidance is in the Pension Tax Manual – PTM06330 – Member benefits: lump sums: uncrystallised funds pension lump sums (UFPLS).

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[24] PTM063300 - Member benefits: lump sums: uncrystallised funds pension lump sum (UFPLS)

[25] For an explanation of these protection arrangements, see PTM 090000 – Protection from the lifetime allowance charge

[26] Explanatory Notes, para 124-30; HMRC Pension Tax Manual, Member benefits: lump sums: uncrystallised pension fund lump sums

[27] Bill 97-EN

[28] *FA 2004*, s215

[29] Bill 97-EN

2. Policy development

2.1 Why were people required to annuitise?

An annuity is a financial product which provides a regular income, usually until death.[30]

Before April 2015, the pension tax system effectively required people to buy an annuity from age 75. It did this by imposing a tax charge of 55% on lump sums or flexible withdrawals except in limited circumstances.

The 'requirement to annuitise' dated back to the *Finance Act 1921*.[31] A requirement to annuitise between the ages of 60 and 70 was introduced by the *Finance Act 1956*.[32] The upper age limit was increased to 75 by the *Finance Act 1976*.[33]

The Labour Government continued this policy for a number of reasons:

- tax relief on pension contributions is provided so people can save for an income in retirement, not for other purposes;
- annuities pool people's risk, ensuring that they are the most financially efficient way of turning capital into an income stream; and
- annuities make sure that people continue to receive an income from their savings no matter how long they survive, thus reducing their possible future need for income-related support from the Government.[34]

Critics of the 'requirement to annuitise' argued that people should be able to exercise choice over their pension funds, provided they did not fall back on means-tested benefits. In opposition, a number of Conservative backbenchers introduced Private Members Bills. These proposed that people with pension funds large enough to buy an annuity providing a minimum retirement income above the level of means-tested support should be able to re-invest any residual funds in a "Retirement Income Fund" which they could use as they liked.[35]

What is an annuity?

The Money Advice Service explains that:

"An annuity is a type of retirement product that you buy with some or all of your pension pot. It pays a regular retirement income either for life or for a set period".

(MAS, What is an annuity?)

2.2 What were the exceptions?

Lump sums

Even before the introduction of the pension freedoms, there were exceptions to the requirement to annuitise. For example, some people

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30 HM Treasury, Freedom and choice in pensions, Cm 8835, March 2014, para 2.17
31 Mamta Murthi, J. Michael Orszag and Peter R. Orszag, *The Value for Money of Annuities in the UK: Theory, Experience and Policy* (1999)
32 Section 22 (2)
33 Section 30
34 DWP and Inland Revenue, Modernising annuities. A consultation document. February 2002; See also HM Treasury, 'Simplifying the taxation of pensions: increasing choice and flexibility for all', December 2002, para 5.45
35 These included David Curry's *Pension Annuities (Amendment) Bill 2001/02*, Edward Garnier's *Retirement Income Reform Bill 2002/03* and Adrian Flook's *Retirement Income Reform Bill 2003/04*

with 'small pots' or total pension saving below a certain value could take them as a lump sum.

Lump sum rules

The main circumstances in which a lump sum could be paid were set out in section 166 and Schedule 29 of the *Finance Act 2004*. Before 6 April 2015, they included:

- The 'pension commencement lump' sum – where people could take 25% of their pension saving as a tax-free lump sum at the time they start to draw their pension;
- 'Trivial commutation' – where people aged 60 and over with total pension saving below a set amount (£18,000 before 27 March 2014, £30,000 after that) could take it all as a lump sum; and
- 'Small pots' rules – where people aged 60 and over with 'small pots' (up to two small pots below £2,000 before 27 March 2014; up to three small pots below £10,000 after that date) could take them as a lump sum regardless of their overall levels of saving.[36]

Guidance is in HMRC's Pension Tax Manual – Member benefits: lump sums

For more on the development of these rules, see Library Briefing Paper SN 2181 Pension lump sums (August 2014)

Pension drawdown

People under the age of 75 had the option of an 'unsecured pension' (later called income drawdown) as an alternative to annuitisation.

From 2006, the Labour Government introduced the option of an 'Alternatively Secured Pension' (ASP) for people aged 75 and over. This was in response to the concerns of some religious groups who had principled objections to the pooling of mortality risk. The Government did not expect the option to be widely used, arguing that it was "likely to be an inferior choice for pension savers without dependents and who do not have a principled objection to the pooling of mortality risk."[37] There were limits on the amount that could be drawn down each year.[38]

In the run up to the 2010 General Election, both Conservative and Liberal Democrat parties had been arguing for a change in the rules.[39] The Coalition's *Programme for Government* included a commitment to "end the rules requiring compulsory annuitisation at 75."[40]

A July 2010 consultation document said that from April 2011, there would "no longer be a specific age by which people effectively have to

What is pension drawdown?

The Money Advice Service explains:

'Pension drawdown is a way of using your pension pot to provide you with a regular retirement income by reinvesting it in funds specifically designed and managed for this purpose. The income you will get will vary depending on the fund's performance. It isn't guaranteed for life.' (MAS, What is pension drawdown?)

For more on the policy background, see Library Briefing Paper SN-0712 Income drawdown (May 2014).

[36] *Registered Pension Schemes (Authorised Payments) Regulations 2009 (SI 2009/1171)* Finance Act 2004, s 166; Sch 29; Library Note SN 2181 Pension lump sums (August 2014)

[37] HM Treasury and Inland Revenue, Simplifying the taxation of pensions: the Government's proposals, December 2003

[38] *Finance Act 2004*, section 165 ; HM Treasury, Removing the requirement to annuitise by age 75, July 2010, para 2.5-7

[39] See, for example, Theresa May, Providing for Pensions. Principles and Practice for Success , Politeia, 2010; The Liberal Democrat Manifesto 2010

[40] The Coalition: our programme for government, 20 May 2010

annuitise." The option of income drawdown would be available throughout retirement, rather than just to age 75. However, there would be a cap on the amount that could be drawn down each year, except where an individual could show that had secured a sufficient minimum income to prevent them from "falling back on the state."[41]

The Government said it would review the level of the existing cap on withdrawals (120% of the value of an equivalent annuity) to see whether it remained appropriate when income drawdown was an option throughout retirement.[42] To ensure that people did not use pension saving as a "tax-privileged means for passing on wealth" any unused funds remaining on death at age 75 or over would be taxed at a rate designed to reflect the value of tax relief received.[43]

In December 2010, the Government said that people would need to be able to show they had at least £20,000 other secure pension income pa to be eligible for flexible drawdown.[44] Otherwise, the amount they could withdraw each year would be capped at 100% of a comparable annuity. Investment reviews would take place every three years before age 75 and annually after that. This was to "further mitigate" the risk of individuals exhausting savings in later life.[45]

In response to concerns that individuals might enter drawdown without a full understanding of the risks involved, the Government said it was committed to "ensuring consumers had access to financial advice to enable them to make appropriate choices."[46]

Although it was difficult to give a precise estimate of the number who might be able to take advantage of flexible drawdown, the Government estimated that of the 450,000 people who purchased annuities in 2009, less than 1% had a pension fund large enough to do so.[47] The changes were legislated for in the *Finance Act 2011* (s65).

In April 2013, the limit on annual withdrawals applying to those in capped drawdown was increased from 100% of a comparable annuity to 120%.[48] This was in response to concern from those in capped drawdown, who found the maximum amount they were able to withdraw reduced on review.[49] The rules were changed again in Budget 2014 (see section 2.3 below).

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41 HM Treasury, Removing the requirement to annuitise by age 75, July 2010, p9, para 2.15
42 Ibid, para 2.16-7
43 Para 2.9 and 2.22
44 HM Treasury, Removing the requirement to annuitise by age 75. A summary of the consultation responses and the Government's response. December 2010, para 1.2, 1.6-8 and 3.44-54
45 Ibid para 3.9-10
46 Ibid para 3.68-9
47 HM Treasury, Consultation on draft legislation - removing the requirement to annuitise from age 75, December 2010
48 HC Deb, 5 December 2012, c878; See also HM Treasury, Autumn Statement, Cm 8480. December 2012, para 2.58
49 HC Deb 20 Mar 2012 c618W; See HC Library Briefing Paper, SN0712 Pensions: income drawdown.

2.3 Why did annuities become less popular?

In the run-up to the announcement of the pension freedoms, there were two influential reports highlighting problems in the annuities market.

A report for the Financial Services Consumer Panel in 2013 found that many consumers did not feel the offered sufficiently good value for money to justify the effort of shopping around. This negative view had been exacerbated by annuity rates, which had fallen steadily over the past 20 years, due to increasing longevity and falling gilt yields, among other factors.[50]

It found that the "market does not work well for the majority of consumers." A key finding was that consumers were poorly placed to drive effective competition:

> 3.1 As in the market for DC workplace pensions, recently investigated by the Office of Fair Trading, consumers are poorly placed to drive effective competition amongst providers and distributors of annuities. There are many barriers inhibiting consumers' full engagement when they decide to annuitise: low financial capability; fear of product complexity and of making an irreversible, high-cost mistake; general distrust of professional advisers, and inability to find appropriate advice at acceptable cost. [51]

The FSCP recommended reform:

> Recent initiatives, such as the Code of Conduct introduced by the Association of British Insurers (ABI), and market developments, such as the online automation of the annuity purchase process, may prove helpful, but rely on effective enforcement by the ABI and may overload consumers with information. The chances of mass consumer detriment are, in our judgement, too high to trust to current market-driven solutions alone: hence our recommendations for further regulatory and government-led structural reform.[52]

In its *Thematic Review of Annuities* in February 2014, the FCA noted the complexity of the decisions consumers were required to make:

> There are a number of decisions that consumers must engage with to make a well-informed decision about buying an annuity. Alongside the timing of their retirement, they must also consider whether or not to take benefits through income drawdown, and if they choose an annuity, the 'shape' of annuity to purchase. Consumers often have not engaged in building up their pension savings and this affects how they engage with their retirement income choices.
>
> Once consumers are confronted with annuity choices they are faced with decisions that require them to consider their future circumstances, and attribute a future value to options such as

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[50] FSCP, Annuities and the annuitisation process: the consumer perspective. A review of the literature and an overview of the market, January 2013, p2-6

[51] FSCP, Annuities: Time for Regulatory Reform, December 2013; See also Annuities and the annuitisation process: the consumer perspective – A review of the literature and an overview of the market

[52] Ibid

> joint versus single life, guaranteed periods, inflation protection and death benefits. These decisions all require making judgements about what will happen in the future and the relative values placed on protecting their income against uncertain events. This is something that is very challenging, even for consumers with high levels of financial capability.[53]

It said that consumers found it "difficult to assess risk and uncertainty in financial products," resulting in a "general lack of engagement in the annuity purchase, with many consumers struggling to evaluate the options to find the best deal at retirement."[54]

It concluded that "some parts of the market were not working well for the majority of consumers":

> More specifically we have identified the following concerns:
>
> - The majority of consumers (60%) do not switch providers when they buy an annuity, despite the fact that we estimate 80% of these consumers could get a better deal on the open market, many significantly so.
> - We estimate that the aggregate benefits that consumers miss out on by not shopping around and switching is the equivalent of between £115m and £230m of additional pension savings. We recognise that this may not be realisable, as changes in switching behaviour would be likely to result in changes within the market.
> - In part consumers miss out on the benefits available from shopping around and switching due to their lack of engagement in pensions and annuities, the confusing trade-offs they face and the impact of behavioural biases that makes it difficult for consumers to make the right choices and may result in many of them not shopping around effectively.
> - There is also an incentive on providers to retain their existing pension customers, as overall the estimated levels of expected profitability of standard annuity business sold to existing pension customers is more than the expected profitability of annuity business sold on the open market.
> - The differences in retention rates (i.e. proportion of pensions annuitising with their pension provider rather than switching) between firms varies widely and some firms have relatively high retention rates and have active retention strategies that may increase customer loyalty and reduce the propensity to shop around.
> - There are particular groups of consumers where it appears that the market is not working well. There is an apparent lack of choice and ability to switch for those with small pension funds and lower annuity rates available to these consumers generally, which is likely in part to be due to the fixed costs of providing an annuity representing a larger proportion of the customer's funds.

53 FCA, Thematic Review of Annuities, TR 14/2 February 2014, p26
54 Ibid

- There is also a lack of access to enhanced annuity rates for some consumers annuitising with their existing pension provider and not shopping around.[55]

It decided to conduct a competition market study on products for retirement income.[56] The interim report of this study was published in December 2014 and the final report in March 2015 – see FCA website Retirement income market study.

2.4 Why the pension freedoms?

In his Budget 2014 speech, the then Chancellor of the Exchequer George Osborne said that in future no-one would have to buy an annuity:

> We have introduced flexibilities, but most people still have little option but to take out an annuity, even though annuity rates have fallen by half over the last 15 years. The tax rules around these pensions are a manifestation of a patronising view that pensioners cannot be trusted with their own pension pots. I reject that. People who have worked hard and saved hard all their lives, and done the right thing, should be trusted with their own finances, and that is precisely what we will now do: trust the people.[…] I am announcing today that we will legislate to remove all remaining tax restrictions on how pensioners have access to their pension pots. Pensioners will have complete freedom to draw down as much or as little of their pension pot as they want, anytime they want: no caps; no draw-down limits. Let me be clear: no one will have to buy an annuity.[57]

In advance of the reforms being introduced in April 2015, the Government would increase the size of pension that could be taken as a lump sum and widen access to income drawdown:

> 1.164. As a first step towards this reform, the Budget introduces a number of immediate changes, to allow people greater freedom and choice now over how to access their defined contribution pension. From 27 March 2014 the government will:
>
> – reduce the amount of guaranteed pension income people need in retirement to access their savings flexibly, from £20,000 to £12,000
>
> – increase the capped drawdown limit from 120% to 150% to allow more flexibility to those who would otherwise buy an annuity
>
> – increase the size of a single pension pot that can be taken as a lump sum, from £2,000 to £10,000
>
> – increase the number of pots of below £10,000 that can be taken as a lump sum, from 2 to 3
>
> – increase the overall size of pension savings that can be taken as a lump sum, from £18,000 to £30,000.
>
> 1.165. Under the current tax system, people are charged 55% if they choose to withdraw all of their defined contribution pension savings at the point of retirement. This means the majority of

55 Financial Conduct Authority, TR14/2 Thematic Review of Annuities, February 2014
56 Ibid p11; See also FCA, Retirement income market study: revised terms of reference, 9 June 2014
57 HC Deb 19 March 2014 c793

> people instead purchase an annuity and receive taxable income over the course of their retirement. Under the new system, an individual will be able to withdraw their savings at a time of their choosing subject to their marginal rate of income tax. The government anticipates that under these circumstances some people will choose to draw down their pension sooner in order to suit their personal situation. This will increase income tax revenue in the short to medium term.[58]

Further details of the Government's plans were included in a consultation paper Freedom and choice in pensions, Cm 8335, July 2014.[59]

How did people respond?

In debate on the Budget on 25 March, the then Shadow Work and Pensions Secretary, Rachel Reeves, said the Opposition would judge the proposals against three tests:

> First, is there robust advice for people who are saving for their retirement? Secondly, is the system fair to those on middle and lower incomes who want a secure retirement income? Thirdly, are the Government sure that the changes will not result in extra costs to the state, either through social care or by increasing housing benefit bills? We will continue to push for the reform of pensions, but it must be reform that works for people who have saved all their lives, who deserve security and confidence in retirement.[60]

The reforms were welcomed by Sir Edward Garnier, who had sponsored one of the Private Members' Bills on retirement income funds (see SN 712, section 2.4).[61] Other Conservative MPs welcomed the increased choice and thought it would act as an incentive to save.[62] Crispin Blunt thought financial services companies would innovate in response. The challenge was to "ensure the spirit of the reforms develops into a well-governed and safe experience to deliver good customer outcomes."[63] Douglas Carswell welcomed the change, while saying it would have "big implications" that we need to reflect.[64]

The then chair of the Work and Pensions Committee, Dame Anne Begg, asked about the future for annuities:

> Annuities are an excellent principle—someone saves into a pot and then buys something that lasts them to the end of their life. We do not know how long we will live after reaching pension age, so an annuity provides insurance: we know it will not run out before we reach the end of our life. It insures against old age. All of that is right. However—this is the big but—what if there is no

58 HM Treasury, Budget 2014, March 2014, para 1.164-5
59 See also, HM Treasury, Freedom and choice in pensions: government response to the consultation, Cm 8901, 22 July 2014
60 HC Deb 25 March 2014 c177
61 HC Deb 24 March 2014 c84
62 HC Deb 25 March 2014 c 185 [Margot James; Charlie Elphicke]; HC Deb 24 March 2014 c96 [Caroline Nokes]
63 HC Deb 25 March 2014 c197
64 HC Deb 20 March 2014 c981

> annuity market? What will the many people for whom an annuity is the right choice do then?[65]

Responding to the debate, the then Chief Secretary to the Treasury, Danny Alexander, said the Government believed that the "best people to trust with money are the people who earn that money in the first place."[66]

Outside Parliament, the fact that individuals will be able to decide what to do with their pension savings was welcomed by some. Ros Altmann (now Pensions Minister), said the message of the Budget was that the Government "does believe in the value of saving and wants to trust people who have put money into pensions to manage their money for themselves in retirement, with far fewer rules and restrictions." She said the beauty of the additional freedoms was that, as well as being popular with the public, they would bring in extra tax revenue in the near term.[67]

Michelle Cracknell of the Pensions Advisory Service welcomed the fact that individuals would have greater choice, although they would need help in making decisions.[68]

Others, such as the Low Income Tax Reform Group, welcomed the fact that the reforms should "should force providers to be more competitive in what they are prepared to offer pension savers."[69] The Association of British Insurers said the insurance industry looked forward to playing a key role in ensuring the reforms delivered better outcomes for customers, but that they represented a "significant challenge for everyone involved in helping people secure their retirement income."[70]

The Institute for Fiscal Studies said there were number of reasons why compulsory annuitisation might be a good thing. It could:

- reduce moral hazard (i.e. the risk that individuals exhaust their pension pots knowing they could receive means-tested benefits in retirement);
- help to prevent individuals exhausting their savings prematurely, for example, because they underestimate how long they are going to live;
- reduce the risk of 'adverse selection', whereby there is an increase in the price of annuities because those still wanting to purchase one are disproportionately those who expect to live a long time.[71]

The Pension and Lifetime Savings Association was concerned that increased choice would bring "with it a significant burden of responsibility for individuals to understand the choices they are

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65 Ibid c237
66 Ibid c255
67 Ros Altmann, UK Budget 2014: A watershed moment for pensions and savings, *Financial Times,*19 March 2014 (£)
68 The Pensions Advisory Service, Budget 2014, 19 March 2014
69 LITRG, Pensioners put in greater control over their own cash, 20 March 2014; See also, 'A brave new work for Britain's savers, Financial Times, 21 March 2014 (£)
70 'Budget 2014: ABI comments on changes to pensions, 19 March 2014
71 IFS, Budget 2014: pensions and savings policies, 20 March 2014

making."[72] The TUC feared that the reforms would not deliver a decent income in retirement.[73] Former Labour adviser John McTernan described the reforms as "the privatisation and personalisation of massive risk with huge unknowns."[74] EEF welcomed the principles of the new regime but was concerned it was being rushed.[75]

2.5 When did the Government legislate?

The changes to pension tax legislation necessary to implement the Budget announcement were made in the *Taxation of Pensions Act 2014*. This made changes to the *Finance Act 2004* and the *Income Tax Earnings and Pensions Act 2003.*

There was consultation on draft legislation between 6 August and 3 September 2014.[76] The *Taxation of Pensions Bill 2014/15* had its First Reading in the House of Commons on 14 October 2014.[77] A Public Bill Committee took oral evidence on 11 November 2014 before considering the Bill over three sittings on 18 and 20 November. Report Stage and Third Reading were on 3 December, immediately after the Autumn Statement.[78] Government amendments to the Bill included adding a new clause and schedule relating to the tax treatment of unused funds on death.

The Bill (HL Bill 66) was given its First Reading in the House of Lords on 3 December 2014, when it was endorsed as a money bill.[79] It received Royal Assent on 17 December 2014.

Related changes to pension legislation – for example, the guidance guarantee and transfers from DB schemes - were in the *Pension Schemes Act 2015*, which received Royal Assent on 3 March 2015.

For detail on these Bills and their progress through Parliament, see: RP 14/57 Taxation of Pensions Bill (October 2014) and SN 7036 Taxation of Pensions Bill – debates in Parliament (February 2015); and RP 14/44 Pension Schemes Bill; SN07105 Pension Schemes Bill 2014-15- House of Lords stages (February 2015); and SN 7030 Pension Schemes Bill 2014-15 – House of Commons stages (December 2014); SN07042 Pensions: the guidance guarantee (March 2015).

What were the views of the different parties?

The manifestos produced by the political parties in advance of the 2015 general election showed general support for the principle of increased

72 NAPF comments on 2014 budget, 19 March 2014
73 TUC Pension changes go in wrong direction 20 March 2014
74 This pension reform is no liberation – and Labour must explain why', Comment is free, *The Guardian*, 24 March 2014
75 EEF response to Freedom and Choice in pensions consultation, June 2014
76 See Gov.UK - (Draft) Taxation of Pensions Bill
77 HM Treasury, 'Government creates further choice on pensions as reforms start their legislative journey,' 14 October 2014
78 For details see the Parliament website
79 HL Deb 3 December 2014 c1384; *Parliament Act 1911*, section 1; Parliament website – Glossary. Money Bills

flexibility, although there were concerns to ensure that individuals received adequate support in making decisions:

> "[…] we will allow pensioners to access their pension savings and decide whether or not to take out an annuity, so they can make their own decisions about their money."[80] *Conservatives*

> We have given people more freedom over their pensions by scrapping rules which forced people to buy poor value annuities.[81] *Liberal Democrats*

> We will keep the flexibility over how to access your pension savings that came into place this April, but we need to ensure that savers get a good deal. That is why we will cap fees and charges in financial products that savers use to draw down their pension savings, and we will ensure that proper guidance is available to ensure that savers are not ripped off, or hit by scams and mis-selling.[82] *Labour*

> We will […] back, in principle, proposals to give pensioners more flexibility over their pension pots. However, we must ensure adequate levels of advice and support.[83] *SNP*

> With greater freedom over personal pensions comes individual responsibility for retirement finance planning. Historically, people have had limited options of when to draw down funds from their personal plans. Most were forced to take out an annuity, paid out evenly, over the course of their retirement. Pensioners will now be making complex decisions about when and how much to take from their pension pots and, before doing so, they need expert advice to make sound, well-informed choices.[…] UKIP will fund a higher standard of independent advice available to all pensioners.[84] *UKIP*

Westminster Hall debate –November 2015

In a Westminster Hall debate on 17 November 2015, the then SNP pensions spokesperson Ian Blackford wanted to take stock of the pension freedoms introduced in April. He argued for the importance of keeping costs down and giving clear guidance that an income in retirement should be the default position.[85] The then Shadow Pensions Minister, Nick Thomas-Symonds, called for action "to ensure that people will be protected from scams, and that they can get the advice and guidance they need."[86] The then Economic Secretary to the Treasury Harriet Baldwin explained how the Government was developing the policy in the light of experience:

- Looking at how Pension Wise appointments could be better tailored to individuals (and in particular at those in the 50-55 age bracket) and at making the website more interactive;
- As part of the Financial Advice Market Review, looking at a package of reforms to "ensure the financial advice market works for everybody";

80 Conservative Party election manifesto 2015
81 Liberal Democrat Party election manifesto 2015 pensions
82 Labour Party General Election Manifesto 2015 – Older people
83 Scottish National Party – Manifesto 2015
84 Believe in Britain. UKIP Manifesto 2015
85 Ibid c117-123WH
86 Ibid c131WH

- Ongoing efforts to tackle scams.[87]

She said Pension Wise data would be published shortly.[88] There is now a Pension Wise dashboard on Gov.UK.

The FCA made recommendations to improve guidance for consumers in the final report of its Retirement Outcomes Review in June 2018 (para 5.43-9).

For more detail, see Library Briefing Paper CBP 7042.

87 Ibid c134-7WH
88 Ibid

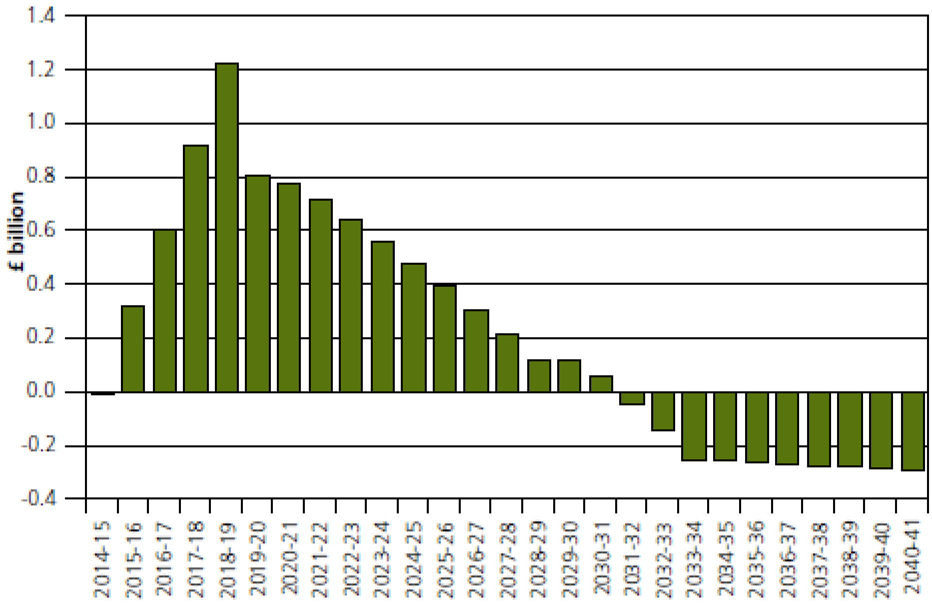
3. What has been the impact?

3.1 The Exchequer

Expected impact

In Budget 2014, the Government said it expected the measure to result in increased income tax receipts in each year until 2030. After that, a small reduction in tax receipts of around £300 million a year was expected in steady state:[89]

Chart 1.11: Projected tax impacts of pensions flexibility measures



Source: HMRC analysis.

The figures for each year to 2019-20 were:[90]

					Exchequer impact (£m)
2014-15	**2015-16**	**2016-17**	**2017-18**	**2018-19**	**2019-20**
-5	+320	+600	+910	+1,220	+810

Further policy decisions announced when draft legislation was published in August 2014 included:

- Allowing transfers from private sector defined benefits pensions and funded public sector defined benefits pensions;
- Imposing a reduced annual allowance of £10,000 for those who made flexible withdrawals.[91]

89 HM Treasury, Budget 2014, HC1104, 19 March 2014; See also HM Treasury, Policy costings, March 2014
90 HMRC, Pension Flexibility 2015 TIIN
91 draft Taxation of Pensions Bill, August 2014

Then on 29 September 2014, the Chancellor announced that the tax treatment of death benefits would change.[92] In the 2014 Autumn Statement, he announced similar changes to the tax treatment of joint-life and guaranteed annuities.[93] These subsequent changes did not "significantly alter the numbers published in the Budget".[94]

In debate in December 2014, the then Financial Secretary to the Treasury David Gauke explained that the Government had explored in more detail the potential increase in cost of salary sacrifice and welfare due to the reforms and accounted for these as changes to the forecast.[95]

The Office for Budget Responsibility (OBR) said there was a very high level of uncertainty around the central costing. The yield over the scorecard period – and the resulting costs in the longer term – would depend on take-up and on other behavioural responses.[96]

The then Shadow Pensions Minister Gregg McClymont made a freedom of information request for the analysis underpinning the reforms, but this was refused.[97] In debates on the legislation, the Opposition repeatedly pressed the Treasury to publish its analysis.[98]

In October 2016, the OBR reported that initial demand had been stronger than expected but had then slowed in line with the initial estimate.[99]

In October 2019, HMRC said that "in total, over £30 billion had been flexibly withdrawn from pensions since flexibility changes in 2015."[100]

3.2 Individuals

Expected impact

HM Treasury estimated that under the proposed changes around 30% of people (around 130,000 a year) in DC schemes would decide to drawdown their pensions at a faster rate than via an annuity. Furthermore, in the first four years, it was assumed that the stock of pensioners currently in capped drawdown would make additional withdrawals.[101] However, it said the extent of behavioural change was

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92 Gov.UK, Chancellor abolishes 55% tax on pension fund at death, 29 September 2014
93 HM Treasury, Autumn Statement, Cm 8961, 3 December 2014
94 HM Treasury, Autumn Statement – policy costings, December 2014, p46
95 HC Deb 3 December 2014 c376
96 OBR, Economic and fiscal outlook, December 2014. See also, p217, para A.9
97 Josephine Cumbo, 'Treasury refuses to reveal pension reform analysis', *Financial Times,* May 2014 (£); HC Deb 2 July 2014 c903
98 See SN 7036 Taxation of Pensions Bill – debates in Parliament (27 November 2014) section 4.4 and 4.5
99 OBR, Private pensions and savings: the long-term effect of recent policy measures, October 2016
100 HMRC, Flexible payments and pensions, October 2019
101 HM Treasury, Budget 2014 policy costings, March 2014, p11; HMRC, Tax Information and Impact Note - Pension Flexibility 2015, 14 October 2014

difficult to predict.[102] It would partly depend on how the market responded.[103] The impact on individuals would depend on how they responded, which was difficult to predict in advance.[104]

Impact in practice

On 12 July 2017, the Financial Conduct Authority (FCA) published the interim findings of its Retirement Income Market Study into how the market was changing since the introduction of the pension freedoms in April 2015. It found that:

> **Over one million defined contribution (DC) pension pots have been accessed since the reforms.** The pension freedoms have changed the way consumers access their pots:
>
> - **Accessing pots early has become 'the new norm'**: 72% of pots have been accessed by consumers under 65, most of whom have taken lump sums.
> - **Over half (53%) of pots accessed have been fully withdrawn:** 90% of these pots were smaller than £30,000. Over half of fully withdrawn pots were transferred into savings or investments. Overall, we did not find evidence of people 'squandering' their pension savings;
> - **Most consumers (94%) who fully withdrew their DC savings had other sources of income in addition to the state pension.** Consumers were mostly likely to state that a defined benefit (DB) pension would be their most significant source of income in retirement (24%), followed by the state pension (21%) and other DC schemes (10%). Only 3% of consumers identified their withdrawn pension pot as their most significant source of retirement income.
> - **Drawdown has become much more popular:** twice as many pots are moving into drawdown than annuities. Before the pension freedoms, over 90% of pots were used to buy annuities.[105]

Key findings of the Final Report of the Retirement Outcomes Review in June 2018 included that

- Over half (55%) of all pots accessed were fully withdrawn. However, these were most small pension pots (88% below £30,000), and **nearly all (94%) those who fully withdrew had other sources of retirement income**. Over half (52%) of the fully withdrawn pots were not spent but were transferred into other savings or investments.
- Since April 2015, there had been a substantial shift away from annuities and towards taking drawdown without advice: "**Twice as many pots have been used for drawdown than to buy an annuity.** A third (32%) of these were accessed without advice, compared to 5% before the freedoms."

[102] HM Treasury, Freedom and choice in pensions, Cm 8835, March 2014, para 6.14; HM Treasury press release, 'One month to pension freedoms', 6 March 2015
[103] Oral evidence: Pension reforms, HC 1248, Wednesday 30 April 2014, Q37 [Steve Webb]
[104] OBR, Economic and fiscal outlook, December 2014, para A.6 and A.9
[105] FCA, Retirement outcomes review: at a glance, June 2017

- Many consumers, particularly when focussed on taking their tax-free cash, took the "path of least resistance" and entered drawdown with their existing provider.
- At this stage, there was not much evidence of consumers drawing down their pension wealth at unsustainable rates. However, this was clearly something to watch as pot sizes increased and DC pension savings became a more central part of may consumers wealth.[106]

1.10 While commentators have flagged the risk of consumers drawing down their pension wealth at unsustainable rates, we have not at this stage seen much evidence of this. However, this is clearly something to watch, particularly as pot sizes increase and DC pension savings become a more central part of many consumers' pension wealth.

Consumers need further support and protection

1.11 For many, retirement income choices start with a decision to access tax-free cash rather than other questions. At that point, consumers face a range of complex decisions such as which provider to use, where to invest their remaining pot and how quickly to drawdown. They also need to think about how long they expect to live. We found many consumers who do not take advice struggle with these decisions, and many end up in investments that may not be right for them, including in cash.

1.12 Our research found that around one in three consumers who have gone into drawdown recently are unaware of where their money was invested. Others only had a broad idea

More than 60% of consumers not taking advice were not sure or only had a broad idea of where their money was invested

1.13 We saw that some providers were '**defaulting' consumers into cash or cash-like assets**. Overall 33% of non-advised drawdown consumers are wholly holding cash. Holding funds in cash may be suited to consumers planning to drawdown their entire pot over a short period. But it is highly unlikely to be suited for someone planning to draw down their pot over a longer period. We estimate that over half of these consumers are likely to be losing out on income in retirement by holding cash.

1.14 Someone who wants to drawdown their pot over a 20 year period could increase their expected annual income by 37% by investing in a mix of assets rather than just cash.

Consumers in cash could get an income from their pot up to 37% higher over 20 years by moving to a mix of assets.

106 FCA, Retirement outcomes review: final report, MS16/3, June 2018

> 1.15 Our evidence also suggests that if firms offer consumers a more structured set of options – making the decision simpler to navigate – it can improve the investment outcomes for consumers, better aligning with their objectives in retirement.
>
> 1.16 We are also concerned about the high proportion of consumers fully withdrawing their pension pots to move savings elsewhere. In many cases, keeping money in a pension would have resulted in better returns, on average, and in paying less tax. Some consumers might also lose out on employer contributions and other benefits as a result. We found this behaviour was partly driven by a lack of trust in pensions, stemming from a range of factors including past pension scandals (where consumers tend not to distinguish between DB and DC) and frequent changes to pension rules and tax treatment.[107]

In its 2019 State of the Market report, the ABI said that overall the reforms had:

> […] driven a move away from traditional guaranteed income products at retirement to more flexible cash and drawdown options. Initially this was seen through a large decrease in annuity sales as customers showed a preference for drawdown products and cash withdrawals. Now the effect has broadened, as both savers in defined benefit schemes and in personal schemes with defined income benefits have also started to give these up, instead opting for flexible decumulation products.

HMRC produces regular figures on Flexible payments from pensions. In October 2019, it said that in total, over £30 billion has been flexibly withdrawn from pensions since flexibility changes in 2015.[108]

3.3 The market

Expected impact

The Government identified the fact that the annuities market was "currently not working in the best interests of consumers" as one of the motivations for its reforms.[109] It expected its reforms to stimulate innovation and competition in the market:

> […] with providers creating new products to satisfy individual consumer needs and meet new social challenges such as funding care later in life […]. It will also expand the market to allow further development of existing products, such as deferred annuities.[110]

Witnesses to the Treasury Select Committee shortly after the 2014 Budget said that the impact of the reforms on the annuity market was difficult to predict. The FCA said that "predictions that the annuities market would effectively disappear due to the changes might be too pessimistic". The ABI expected initial market contraction followed by recovery:

> In the next five to 10 years [you will see] lower levels of annuity take-up, but as people move through their retirement process, a

107 FCA, Retirement outcomes review: final report, MS16/3, June 2018
108 HMRC, Flexible payments from pensions. Official statistics, October 2019
109 Cm 8835, Foreword
110 Ibid, para 3.19

> recovery and growth again in the annuity market, because its positive aspects continue to be positive—the certainty it gives people and their ability to plan for the future, and they know that they will not run out of money.[111]

Annuity rates might continue to worsen under certain circumstances:

> If you have a healthier pool of customers, they will live longer. If they live longer, clearly the rate that the market as a whole can offer will become less attractive. One factor certainly could apply: if the only people who take annuities are a particular type of individual that will shape the annuity pool and the pricing. But I do not think contraction in itself is likely to be the issue.[112]

In November 2014, the FCA said it expected the market to develop over time.[113] In the interim report of its retirement income market study, the FCA said it expected product innovation to be focused in a number of areas, including:

- 'Managed drawdown products' offering a limited selection of funds while managing investment and volatility risk;
- Hybrid guaranteed products offering varying degrees of guarantees on capital and income – including variable and fixed-term annuities;
- Uncrystallised fund pension lump sums (UFPLS) - providing the ability to stay in accumulation pot while drawing income.[114]

In the final report of its retirement income market study, published in March 2015, the FCA said it expected to see more new products emerging, for example combining features of annuities and income drawdown. It noted that while customers would welcome this increased flexibility, there was a risk that greater choice and more complex products would "reduce consumer confidence and appetite to shop around, thereby weakening competitive pressure." Its proposed remedies included annuity quote comparisons, replacing wake-up packs and the ABI Code and in the longer run, the development of the 'pensions dashboard.'[115]

Impact in practice

The pension freedoms have been the backdrop to Financial Conduct Authority's Retirement Outcomes Review, launched in July 2016. The purpose of the review was to assess the role of competition in a market where products and options for accessing retirement income have become more fragmented. It looked at how consumers and firms have been responding to the pension freedoms; focusing particularly on those consumers who do not take regulated advice.[116]

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[111] Treasury Select Committee, Budget 2014, 13th report 2013-14, HC 1189, May 2014, para 149
[112] Ibid para 150
[113] PBC Deb 11 November 2014 c5 Q2
[114] FCA, Retirement income market study: interim report, MS14/3.2, December 2014, chapter 8
[115] FCA, Retirement income market study: final report, MS 14-3.3, March 2015, para 1.11-2
[116] Andrew Bailey, Speech 17 September 2018

In the interim report of its Retirement Outcomes Review, The FCA said emerging issues included annuity providers leaving the open annuity market, which might weaken the effectiveness of competition over time. If competition was not working effectively and consumers made uninformed decisions, this could lead to harm in the form of: paying more in charges or tax, choosing unsuitable investment strategies, missing out on valuable benefits or investment growth, or running out of pensions savings sooner than expected. [117]

In the final report of its Retirement Outcomes Review, the FCA confirmed that it had not seen significant product innovation for mass-market consumers so far.[118]

Following consultation (CP 18/17), the FCA said in July 2019 that it was policy paper PS 19/21 (July 2019) said it was issuing new rules and guidance to:

- introduce 'investment pathways' for consumers entering drawdown without taking advice
- ensure that consumers entering drawdown only invest mainly in cash if they take an active decision to do so
- require firms to send annual information on all the costs and charges paid over the previous year to consumers who have accessed their pension.[119]

The FCA also recommended that the Government should consider the merits of 'decoupling' tax-free cash from other pension decisions:

> Many consumers focus solely on taking their tax-free cash at this time and do not engage with the decision of what to do with the rest of their pot. Separating the decision to take the tax-free cash from the need to move into drawdown will let consumers put off deciding what to do with the rest of their pot, until they are ready to focus on it. However, this would require major changes to the pension tax regime and we recognise that there are detailed policy and practical issues which the Government would need to consider.[120]

Chief Executive of the FCA, Andrew Bailey, gave an overview of the FCA's conclusions on the pension freedoms in a speech on 17 September 2018. He thought they were the right approach but that "we have transferred the responsibility for a very complex area of decision-making to individuals, and we need to do all we can to help people make those decisions."[121] In October 2019, Executive Director of Strategy and Competition, Chris Woolard, argued that "we need to think about simplification for consumers, not adding layers of rules or advice in some kind of cat and mouse game."[122]

[117] Ibid
[118] FCA, Retirement Outcomes Review, June 2018
[119] CP 18/17 (June 2018); PS 19/21 (July 2019)
[120] FCA, Retirement Outcomes Review, June 2018, para 1.38
[121] Pensions – a view from the FCA, 17 September 2018
[122] Speech, October 2019

4. Issues

4.1 How are outcomes being monitored?

The Work and Pensions Committee took evidence on what data was needed if the reforms were to be monitored as part of its inquiry into the pension freedoms. Teresa Fritz of the Financial Services Consumer Panel suggested asking people if they would participate in a research programme at the point of accessing Pension Wise. In terms of what information was needed, she said:

> Crucially, we need to know of the people accessing Pension Wise: what are they going to do with their money? Where does that pension pot sit in their overall retirement income? Are they spending all of their retirement income, and if so, on what and why? For the people not accessing Pension Wise: why aren't they accessing Pension Wise? But the same questions, and that may have to be from the providers.[123]

Chris Curry of the Pensions Policy Institute also wanted to see information and data made available to allow independent analysis of what was happening over time.[124]

The then Economic Secretary to the Treasury Harriet Baldwin told the Committee that the Government did not have data showing what individuals actually did:

> In terms of the breakdown of what people do, I am not sure that either the Treasury or the DWP gets that sort of information. We have been relying to quite a large extent on what the ABI has been collecting in terms of data and what people are deciding to do overall.[125]

The Committee concluded that limited conclusions could be drawn from the existing information:

- Industry statistics provided a helpful snapshot of the initial aggregate progress of the reforms but where inevitably focused on "service metrics rather than testing outcomes for consumers".
- Initial customer satisfaction was not necessarily a good indicator of eventual outcomes.[126]

It described the Government's reticence in publishing statistics on the effects of its pension freedom policy as "unacceptable" and unconducive to effective policy:

> […] it would be fortunate in the extreme if such radical change operated as hoped without any need for adjustment. Regular collection and reporting of the take up of guidance and advice options on offer, and the decisions taken, is imperative. This

[123] Work and Pensions Committee, Oral evidence: Pensions freedom guidance and advice, HC 371, Monday 7 September 2015, Q9-10
[124] Ibid Q20
[125] Ibid Q103
[126] Work and Pensions Committee, Pension freedom guidance and advice, First Report of Session 2015-16, HC371, 19 October 2015, para 13-15

> should also provide some assurance that another mis-selling scandal is not on the horizon.[127]

It recommended that the Government publish statistics on a quarterly basis on Pension Wise and the advice and pensions markets on a quarterly basis and called for a rolling research programme to track the longer-term consequences of pension freedom decisions.[128] In its response, the Government said it was right that the FCA took a leading role in requesting data, monitoring the market and taking enforcement action where appropriate. A working group including government representatives, the regulators and industry and consumer representatives was co-ordinating data collection to ensure key indicators were being captured and monitored.[129]

In its 2018 report on the pension freedoms, the Work and Pensions Committee recommended that the Government set out what the long-term objectives for the reforms were and how it would monitor and report on performance outcomes against those objectives.[130] In response, the Government said the key priorities for the reforms were:

> 1. Giving people more choice to provide them with greater flexibility in later life;
> 2. Supporting consumers to make informed decisions about their retirement; and
> 3. Enabling a more competitive, innovative retirement market.
>
> The achievement of these objectives will mean that individuals will be able to plan for and design a secure retirement that meets the needs they themselves have identified.[131]

Arrangements were in place to monitor the impact of Pension Wise and retirement income data from a number of sources. The FCA was conducting its Retirement Outcomes Review:

> The Government monitors the impact of Pension Wise in providing support to individuals making decisions about their retirement savings. Service usage data is published monthly on its performance platform. In addition, an independent service evaluation carried out by Ipsos Mori showed customer satisfaction with Pension Wise at 94%. This study also showed that 97% of customers either already had, or said they were likely to, recommend Pension Wise to others. Over nine in ten appointment customers (93%) felt informed of their pension options after their Pension Wise appointment and 94% also felt confident in their ability to avoid scams. Given the success of Pension Wise, the Government will be taking steps to encourage more take up, building on the requirements in the *Financial Guidance and Claims Act.*
>
> The Government also monitors the retirement market using data from a number of sources. As stated in the Government response

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127 Ibid, para 16
128 Ibid para 18
129 HM Treasury, Pension freedom guidance and advice: government response to the Work and Pensions Committee's first report of session 2015-16, Cm 9183, December 2015
130 Work and Pensions Select Committee, Pension Freedoms, 9th report of 2017-19, HC 917, 5 April 2018
131 Pension freedoms: Government response to Committee's Ninth Report

to the Work and Pensions Committee's first report of session 2015–16, a working group coordinates data collection following the pension freedoms. The group comprises regulators, arms-length bodies, industry and consumer representatives, and performs an advisory function to help government departments identify key indicators that need to be captured, to better understand how individuals are accessing their savings and industry is responding to the freedoms. The group will next meet in July to discuss the outputs from the FCA's Retirement Outcomes Review final report.

HMRC publishes a quarterly statistical release detailing the number of transactions using pension flexibility and the amount of money withdrawn. This allows the Government to assess the extent to which individuals are accessing their pensions flexibly.

Since the introduction of the pension freedoms the FCA has been collecting retirement income data from pension, annuity and income drawdown providers. This allows the FCA to track market trends and monitor the potential for consumer harm in the retirement income market. The FCA is currently also undertaking a review to assess how the market is evolving and to address any emerging issues.[132]

Data sources

HMRC - flexible payments from pensions

FCA – regular Retirement Income Market Data and published the final report of its Retirement Outcomes Review in June 2018.

The ABI produces annual State of the Market reports. Reports in previous years include ABI pension freedom statistics – one year on factsheet (August 2016); The new retirement market: the evolution continues (April 2017).

UK Insurance and Long-term Savings Key Facts, November 2017.

4.2 What was done to help people access the new options?

Pension tax legislation provides for the tax treatment of payments to and from pension schemes. The payments that can be made in practice will depend on scheme rules. To ease implementation of the reforms, the Government made changes to the legislation:

- **Enable schemes to make schemes to make flexible payments, even where scheme rules did not allow them to**.[133] It decided against mandating schemes to provide flexible payments because this would be 'disproportionate'.[134] This

[132] Government response to Committee's Ninth Report of 2017-19, HC 1231, 22 June 2018

[133] Taxation of Pensions Act 2014, Schedule 1, para 79. Explanatory Notes, para 179; For more detail, see HC Library Briefing RP 14-57 *Taxation of Pensions Bill* p47

[134] Cm 8901, July 2014, para 2.15

permissive approach was supported by the Pension and Lifetime Savings Association (PLSA) and by the ABI.[135]

- **Strengthen the rights of individuals to transfer savings between DC schemes at any age up to retirement.**[136] This was to ensure that individuals with uncrystallised flexible benefits had the option to transfer their rights to another pension scheme.[137] So, if their existing provider did not offer a particular product, they had the right to move to a scheme which did.[138]

Regarding transfer rights, there are a number of important legal and regulatory obligations on the ceding scheme.[139] There are few explicit requirements on the receiving scheme with regards to the transfer process and no statutory requirement on pension schemes (except for stakeholder pensions) to accept transfers in. The rules of many occupational pension schemes may restrict or prohibit transfers in.[140]

Concerns

On 13 June 2015, the then Secretary of State for Work and Pensions, Iain Duncan Smith said he was concerned that "some firms still appear to be dragging their feet."[141] Industry representatives said it was important to allow time for a robust market to develop.[142]

The Prime Minister pledged to keep a "careful eye" on the pension flexibilities on offer and the associated charges.[143] On 17 June 2015, the Chancellor of the Exchequer announced an investigation into how to remove the barriers to people accessing their money and a possible cap on charges.[144]

4.3 Consultation on transfers and early exit charges

The Government would consult on options to address any excessive early exit penalties and for making the process for transferring one scheme to another quicker and smoother.[145] The consultation document published on 30 July 2015:

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135 NAPF response to Freedom and choice, June 2014; ABI response to Freedom and choice, June 2014
136 PQ 2224, 2228 and 2229 [pensions] 18 June 2015; Pension Schemes Act 2015, s67 and Schedule 4
137 HC Deb 25 November 2014 c 813
138 PQ 2224, 2228 and 2229 [pensions] 18 June 2015
139 For an explanation, see HM Treasury, Pension transfers and early exit charges, July 2015, Annex B
140 Ibid para 3.12
141 Iain Duncan Smith: I'll make sure the pension freedoms work, *The Telegraph*, 13 June 2015; See also, 'Pension freedoms scandal: savers blocked from using new rules', *The Telegraph*, 5 June 2015; 'Government must act to uphold new pension freedoms', Which? 8 June 2015
142 NAPF comments on yesterday's House of Lords debate on pension drawdown charges, 10 June 2015; 'Insurers dealing with unprecedented customer demand following the introduction of the pension reforms', ABI, 10 June 2015
143 'David Cameron threatens crackdown over-55s barred from accessing pensions', *The Telegraph*, 8 June 2015
144 HC Deb 17 June 2015 c309-10
145 HM Treasury, Chancellor presses industry on pension freedoms, 17 June 2015

- considers the issues around early exit charges, to ensure that people are not facing unjustifiable charges when moving scheme or accessing their pension savings flexibly within their scheme as part of the new freedoms;
- seeks views on how the process for transferring pensions from one scheme to another could be made quicker and smoother; and
- explores issues and concerns in relation to the provision and need for financial advice when making certain transfers.[146]

In debate in the House of Lords, Labour Peer Baroness Drake was concerned that the focus should be on individuals making appropriate decisions, and on charges.[147] The then Pensions Minister Baroness Altmann described the response of the pensions industry so far as "most disappointing," with too many firms "not offering many of the new options to their customers, or they are imposing hefty charges, lengthy delays or exit penalties on those wishing to transfer to other providers."[148]

On 19 June, the ABI published an action plan to "help customers get most from pension freedoms."[149]

Findings from the regulators

To support the Treasury consultation, the regulators conducted an evidence-gathering exercise.[150] In mid-September, the FCA said the evidence gathered so far suggested that:

> […] the great majority of funds can be used to access the full range of options provided by the government's reforms, and where new contracts are required most do not carry an exit charge. However, there are a minority for whom the full range of options is not available or who face possible exit charges.[151]

Most providers required consumers transferring in from another provider to take advice which went beyond the statutory requirements:

> Most providers require consumers transferring into their pension products from another provider to take advice, particularly among the largest firms […], which goes beyond statutory requirements. Usually, legislative and regulatory requirements were noted as the reasons for requiring advice […], though more detailed comments also referred to firms' strategies and product structures. Many consumers seeking to transfer their Defined Contribution (DC) pension would find that their transfers were not accepted by a significant number of providers, particularly where they wished to transfer safeguarded pensions […].Similarly, only a quarter of providers (and only 15% of the largest 15) said that they would

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146 HM Treasury, Pension transfers and early exit charges: consultation, July 2015, para 1.10
147 HL Deb 18 June 2015 c1261
148 Ibid c1275
149 ABI, Freedom and Choice Action Plan, 19 June 2015
150 The new pension flexibilities – update from the FCA, 1 July 2015; Statement on evidence-gathering in support of Government consultation on flexible pension access, PN15-28, July 2015
151 FCA Letter to Economic Secretary to the Treasury, 15 September 2015

> accept transfers from Defined Benefit (DB) pensions in all circumstances.[152]

Some 16% of consumers would face an exit charge:

> 3,416,000 (84%) of consumers eligible to access their pension savings are not charged on exit, despite the administration costs faced by firms in facilitating a cash payment or transfer. Of the remainder, 358,000 (around 9%) of consumers aged 55 or over would face a charge of 0% to 2%, 165,000 (4%) would face a charge of 2% to 5% and around 147,000 (around 3-4%) would face a charge greater than 5%.[153]

The Pensions Regulator (TPR) found that the average transfer time taken across the member universe was 25 days (mean). The median time was 11 days.[154] Regarding transfers-in, it said that:

> Two thirds of schemes (64%) allowed ***existing*** members to transfer-in benefits from a DC scheme and half (52%) allowed existing members to transfer-in from a DB scheme.
>
> Around a quarter of schemes allowed existing members to transfer-in benefits except where a transfer of safeguarded benefits had been requested: 26% in the case of transfers-in from DC schemes and 24% from DB schemes. […]
>
> Two thirds of schemes (63%) allowed ***new*** members to transfer in benefits from a DC scheme and close to half (46%) allowed new members to transfer in from a DB scheme.[155]

Regarding the requirement to take advice, a third of schemes (33%) said they required all members to take independent financial advice before transferring out of their scheme to access retirement options and a further 14% said they require certain members to do so. Almost a fifth (17%) required all members to take independent financial advice before transferring in to their scheme to access decumulation options and a further 9% required certain members to do so. A fifth of schemes (20%) said they require all members to take independent financial advice before moving from accumulation to decumulation within the scheme, with a small number (3%) saying "certain members".[156]

A minority of schemes (11%) said they applied exit charges.[157]

Response to the consultation

In its response to the consultation in February 2016, the Government announced that it would act to limit early exit charges. This was because:

> […] there are significant numbers of individuals currently eligible to access their pensions flexibly who find themselves facing early exit charges which are at a level (either in absolute terms or

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152 FCA pension freedoms data collection exercise: analysis and findings, September 2015 , para 1.4
153 FCA pension freedoms data collection exercise: analysis and findings, September 2015
154 TPR, Survey on flexible pension access, September 2015, para 1.2.2
155 Ibid, para 1.2.2.1
156 Ibid, para 1.2.3
157 Ibid, para 1.2.4

> relative to the size of their pension) that present a real barrier to their accessing their pension savings in this way. [158]

It legislated for this the *Bank of England and Financial Services Act 2016.* Section 35 place a duty on the FCA to:

> […] make rules requiring relevant firms to limit the early exit charges imposed in relation to contract-based schemes, at a rate (or rates) set by the FCA, following further cost-benefit analysis in relation to the appropriate level of any cap.[159]

The FCA published a consultation paper in May 2016.[160] In November, it said it remained of the view that:

- A cap of 1% of the member's benefits in relation to existing contracts delivers the appropriate protection required by the duty. It strikes a proportionate balance between benefits, in terms of reducing the deterrent effect of early exit charges, and costs to firms of applying the cap.
- A cap of 0% for new contracts prevents the emergence of early exit charges in future, with little financial impact for most firms. The consultation responses support our findings that a) exit charges are no longer a feature of the majority of recent personal and stakeholder pension schemes; and b) the implementation of the Retail Distribution Review ('RDR') in effect removed any real justification for their inclusion in new contracts.[161]

In parallel, DWP launched a consultation on *Capping early exit charges for members of occupational pension schemes*. An impact assessment analysed the impact of a cap set at various levels between 2% and 10% of the value of an individual's pension pot. The Government made provision in the *Pension Schemes Act 2017* for regulations to over-ride contractual terms in occupational pension schemes where these conflict with the regulations. The intention was to enable the cap on early exit charges to be implemented.[162] In line with the proposals by the FCA in relation to personal and stakeholder pension schemes, the cap on early exit charges for members of occupational pension schemes will be:

- 1% for existing members of occupational pension schemes
- 0% for new members of occupational pension schemes.[163]

Easing the transfer process

The Government's July 2015 consultation document noted that the complexity of the legislative framework, and the fact that schemes might need to free up assets, meant the transfer process was likely to

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[158] HM Treasury, Pension transfers and early exit charges: response to the consultation, February 2016
[159] Ibid para 2.16
[160] FCA proposes cap on early exit charges, 26 May 2016; CP 16/15 Capping early exit pension charges, May 2016
[161] FCA, Capping early exit pension charges: feedback on CP16/15 and final rules, November 2016, para 1.18
[162] For more detail, see Library Briefing Paper CBP-07874 Pension Schemes Bill 2016-17, July 2017
[163] DWP, Introducing a cap on early exit charges in trust-based occupational pension schemes, March 2016, para 2.15

take months rather than weeks. However, any decision to streamline the process would need to take account of the important role the legal requirements played in protecting members. [164] It asked for views on:

- how the statutory process for pension transfers is currently operating for those with flexible benefits, and how it might be made smoother and more efficient
- the benefits and risks of adopting a separate transfer process for flexible benefits, and what such a process might look like
- whether respondents had any evidence of receiving schemes either not accepting pension transfers under the new freedoms, or putting in place procedural barriers to prohibit or limit some types of transfers.[165]

In February 2016, the Government said it had received suggestions on what could be done to make the process smoother and more efficient, in three areas:

- improved scheme administration, through greater standardised and use electronic transfer processes to help make processing easier
- streamlining the due diligence process, including establishing a whitelist of trusted pension providers
- improvements in member guidance and communication for individuals that may find the transfer process confusing[166]

It set out how these proposals would be taken forward, which might include some changes to legislation.[167]

Being required to take advice

The Government also looked at whether people were being required to take independent advice where this was not necessary.[168]

There is a statutory requirement to take 'independent appropriate advice' before transferring or converting 'safeguarded benefits' worth £30,000 or more into 'flexible benefits.' Safeguarded benefits are primarily benefits in defined benefit (DB) schemes but may be benefits such as guarantees or other promises in other types of schemes.[169] The application of these rules to people with safeguarded benefits is discussed in Library Briefing Paper CBP 8382.

In its consultation on pension transfers and early exit charges, the Government said that while it appreciated that there might be circumstances where providers might require independent advice, it

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[164] HM Treasury, Pension transfers and early exit charges - consultation, July 2015, p14-5
[165] HM Treasury, Pension transfers and early exit charges – government response to consultation, February 2016
[166] Ibid, p8
[167] Ibid p9
[168] 'Pension freedoms scandal: savers blocked from using new rules', *The Telegraph*, 5 June 2015; HM Treasury, Pension transfers and early exit fees, July 2015, para 4.10
[169] *Pension Schemes Act 2015* s48; TPR, DB to DC transfers and conversions, April 2015

wanted to avoid a situation where they felt forced to require advice where this was not necessary. It asked the regulators to gather evidence on how the advice requirement was being applied and how it interacted with schemes and providers' decisions on requiring advice.[170]

The FCA found that there were other circumstances in which firms required to take people advice – for example, in relation to certain products, such as SIPPS, which had been designed with a view to being accessed through a financial adviser.[171] In December 2016, it said that while it was important that consumers could utilise the new options available, it was also important that they had the appropriate level of protection when deciding what to do. It expected the market to evolve over time.[172]

4.4 What is in place to support decision making?

Although many have welcomed the principle of allowing more choice, there were also concerns that it would place a significant burden of responsibility on individuals, requiring them to make complex decisions, taking account a mix of longevity, inflation and investment risk, and the implications of withdrawals for tax, entitlement to means-tested benefits and help with social care.[173] They will also have a wider range of options to choose from, including products that may be complex and difficult to compare in terms of value for money.[174]

Pension Wise

The Government recognised that, in expanding the range of choices available, there was a corresponding need to help consumers navigate those choices, so that they could make good decisions which suited their needs and circumstances.[175] It therefore proposed to introduce a new guidance guarantee so that from April 2015 "everyone who retires with a defined contribution pension will be offered free and impartial face-to face guidance on their choices at the point of retirement."[176]

The then Pensions Minister Steve Webb, explained that the new service would provide guidance, not advice:

> […], so it is not formal, detailed, or product-specific; you can go and buy that if you want to, but this is familiarising people with the options they have and some of the concepts, even.[177]

[170] HM Treasury, Pension transfers and early exit charges: consultation, July 2015, para 4.10-11
[171] FCA Pension freedoms data collection exercise: analysis and findings, Sept 2015, para 4.6)
[172] The new pension flexibilities: update from the FCA, Dec 2016
[173] See, for example NAPF comments on 2014 budget, 19 March 2014
[174] FCA, *Retirement income market study: interim report,* December 2014, p6
[175] HM Treasury, *Freedom and choice in pensions,* Cm 8835, March 2014, para 4.7-9
[176] HM Treasury, *Budget 2014,* HC 1104, March 2014
[177] HC 1248, 30 April 2014, Q23 and 30 and 41; *Financial Services and Markets Act 2000,* as amended by the *Pension Schemes Act 2015,* s47 and Sch3

The FCA – which is responsible for setting the standards for guidance and the monitoring compliance with them – said the guidance would:

> […] inform, educate and help empower pension savers. It will equip consumers with information about their options when accessing their pension savings. The guidance will give consumers key facts and information about the consequences of the relevant options, for example taxation. It will also set out other issues the consumer should consider based on the information the consumer puts into the discussion; for example, the needs of the family where a consumer has a spouse or dependants. It will provide clear next steps and appropriate signposting to further sources of information or advice. [178]

The service - Pension Wise - is being delivered by: the Pensions Advisory Service (TPAS) (phone) and Citizens Advice (face-to face). In addition, HM Treasury worked with the Money Advice Service to develop the service as a whole and its digital elements.[179]

The Government legislated to bring these three organisations together in a single financial guidance body in the *Financial Guidance and Claims Act 2018*. Under section 3 its functions will include:

- Pensions guidance – providing information and guidance on occupational and personal pensions to members of the public;
- Debt advice – providing information and advice on debt to members of the public in England; and
- Money guidance – providing information and guidance designed to enhance people's understanding and knowledge of financial matters and their ability to manage their own financial affairs.

It was launched in January 2019 as the Money and Pensions Service. In the short-term information and guidance is still available from the previously existing bodies.

With the aim of increasing take-up of pensions guidance, the Government included provision in the 2018 Act. Section 18 requires the Financial Conduct Authority to make rules:

- Requiring the trustees or managers of personal and stakeholder pension schemes to refer individuals seeking to access or transfer benefit pensions to the SFGB; and
- Providing that the trustees or managers must ensure that the individual has received guidance or opted out of receiving guidance before they can access or transfer their pension benefits. Rules can specify how the confirmation that the individual wants to opt out must be given.[180]

Section 19 requires the Secretary of State to place corresponding requirements on occupational pension schemes.

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[178] FCA, *Retirement reforms and the Guidance Guarantee*, CP 14/11, July 2014, para 2.1

[179] HM Treasury, Delivery pensions guidance: January 2015 update, 12 January 2015

[180] Explanatory Notes, para 101-5

Explaining the new provisions when the legislation was before the House of Lords, Baroness Buscombe said discussions with key stakeholders had brought out two key issues:

> The first was that any requirements should be based on the presumption that people have not already accessed Pension Wise guidance. The second was that, if people are to opt out of accessing such guidance, it might be desirable for that opt-out decision to be made and communicated to a body other than their own pension scheme.[181]

Measures to improve access to advice are discussed in Library Briefing Paper CBP-07042.

Retirement risk warnings

In February 2015, the FCA announced a 'second line of defence' – whereby, as well as recommending guidance, providers would be required to ask consumers about circumstances related to the decision they are making, such as health, lifestyle choices and marital status.[182] Guidance was provided in:

- FCA, *Retirement reforms and the guidance guarantee: retirement risk warnings*, PS15/4, (February 2015) (for personal pensions).
- The Pensions Regulator, *Essential guide to communicating with members about pension flexibilities* (April 2015) (for work-based pensions).

In October 2015, the FCA launched a consultation on proposed changes to its rules and guidance (CP 15/30). In its response in April 2016, the FCA confirmed that it considered the retirement risk warnings to be a proportionate response to its concerns about the risk of poor financial outcomes if people accessed savings without fully understanding the consequences. However, it would allow some flexibility regarding the timing of the steps.[183]

In January 2019 it said risk warnings had little impact because consumers get them after they have made their decisions. In future, wake-up packs should include generic risk warnings:

> We proposed that firms should use their judgement about what risk warnings would be most helpful, using information they already hold about the consumer if available. We said that firms would need to disclose the key assumptions they used to decide which warnings were appropriate. We proposed guidance about the risk factors that firms should think about when making this judgement.
>
> 2.37 We also proposed that a specific risk warning should be included in the 'wake-up' packs received between the ages of 55 and the intended retirement date. This is a clear, prominent statement saying that accessing the pension fund at that point may not be the best option.[184]

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181 HL Deb 1 May 2018 c1995-6
182 HM Treasury, Freedom and Choice in pensions, CM 8835, March 2015, para 5.3
183 FCA, PS16/12 Pension reforms – feedback on CP15/30 and final rules and guidance, April 2016, p29
184 PS 19/01, January 2019, para 1.13

In November 2019 it said that in future, new and existing requirements would mean that, before they access their pension, all consumers would receive:

- at least one 'wake-up' pack, setting out the different options available at retirement, such as purchasing an annuity or moving into drawdown retirement risk warnings, to ensure the consumer is alerted to issues such as the tax and benefit implications of taking cash from their pension
- several prompts to access the free, impartial guidance currently offered by Pension Wise, or to take advice, so consumers get the help they need
- clear information in a Key Features Illustration about the costs and charges associated with moving into drawdown
- a strong nudge to shop around when purchasing an annuity.[185]

4.5 Default pathways

Some commentators have argued that the 'nudge' approach to encouraging saving, through auto-enrolment, should also be adopted at the 'decumulation stage' where people start to draw their savings.[186]

In a report on how the UK pensions market might evolve to support flexible retirement, the Pensions Policy Institute (PPI) commented that the focus of regulation in the UK had been the introduction of standards for Pension Wise guidance and requirements on providers to deliver 'retirement risk warnings'. It noted that other liberal regimes had gone further. Australia, for example, was considering rules to ensure retirement defaults for members with some provision for managing longevity risk.[187]

In evidence to the Work and Pensions Select Committee's 2015 inquiry into the pension freedoms in 2015, the Pensions and Lifetime Savings Association said there was a clear role for default pathways:

> We believe savers should have ready access to good value, flexible products in retirement as a matter of course. Today's polarised choice between advised or DIY routes fails to deliver this. The saver's default pathway should be easy access to a quality-accredited solution whether provided by their scheme or elsewhere. Guidance and advice would then work to help an individual saver test whether better options were available elsewhere in the market given their individual circumstances and preferences.[188]

On the other hand, the FCA said there was a real question about what a fair default would be given the wider range of options available and

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185 FCA, Retirement outcomes review: investment pathways and other changes to our rules and guidance, November 2019

186 National Association of Pension Funds Manifesto 2015, page 24

187 PPI Transitions to retirement: how might the UK pensions landscape evolve to support flexible retirement? April 2015, Executive Summar

188 PLSA evidence to the Work and Pensions Select Committee, September 2015

changing retirement patterns. Furthermore, once people started to draw down savings, their level of engagement was likely to increase.[189]

The then Economic Secretary to the Treasury Harriet Baldwin indicated that she did not expect to be legislating for this in the near future:

> We are really trying to approach this as a way where we have given people these freedoms, we have given people access to information and guidance and what we are seeing so far in terms of the reaction of people to having those choices is that they are making more active and informed choices, so we welcome that.[190]

The Work and Pensions Committee concluded that legislation for default options should only be introduced if "long-term monitoring of the consumer outcomes from pension freedom indicates that it is necessary."[191]

However, in a later inquiry on the issue in 2018, the Committee recommended that the Government take forward FCA proposals to introduce default decumulation pathways:

> **22.*We recommend the Government takes forward FCA proposals to introduce default decumulation pathways. Any provider offering drawdown would be required by FCA rules to offer a default solution that is targeted at their core customer group. The same charge cap that applies to automatic enrolment schemes, 0.75%, should apply to default drawdown products. Similarly, the remit of Independent Governance Committees to scrutinise value for money in the accumulation phase should be extended to default drawdown products. These protections should be in place by April 2019.*[192]**

It said NEST should be allowed to offer retirement (decumulation) products:

> **30.NEST is a growing success story. It has more than five million members, including many on low incomes, each embarking on private pension saving. Under the existing framework, all those members will be required to take active decisions about their life savings at retirement, many after a career of passive saving. NEST is currently highly restricted in the support in can offer those members at retirement as it cannot offer decumulation products. Concerns that allowing NEST to offer such products would hinder competition in the market would carry greater weight were there evidence of a functioning market currently. Indeed, the evidence from automatic enrolment suggests NEST may drive better retirement outcomes by forcing other providers to offer greater value or risk savers switching over to NEST to get a better retirement deal.**
>
> ***31.We recommend that the Government allows NEST to provide decumulation products from April 2019, provided it***

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[189] Oral evidence: pension freedom guidance and advice, HC371, 16 September 2015, Q99

[190] Ibid Q124

[191] Work and Pensions Committee, Pensions freedom, advice and guidance, First report of Session 2015-16, HC371

[192] Work and Pensions Select Committee, Pension Freedoms, HC 917, April 2018

> ***remains assured of NEST's ability repay its start-up loan. This should include establishing a default drawdown pathway, in line with our wider recommendation. In keeping with the spirit of pension freedoms, savers would remain entitled to move their money wherever they wished.***[193]

The Government said it would await the FCA's report of its Retirement Outcomes Review.[194]

In this report, published in June 2018, the FCA said a lesson learned from Australia was that active government intervention might be needed to stimulate the growth of "mass market hybrid products with annuities embedded within them."[195] It proposed more structured 'investment pathways' – which would offer readymade drawdown investment solutions, appropriate to standardised objectives:

> 1.39 At the point consumers enter drawdown they need to achieve two things. First, they need to decide what they want to do with their pension pot and what kind of investment solution is appropriate for that. Second, they need to get a good deal on their drawdown solution.
>
> 1.40 Our evidence suggests that a more structured set of options would help consumers engage with their investment decision, consider their retirement objectives, and match their drawdown solution to these. So we think that providers should offer three ready-made drawdown investment solutions ('investment pathways') within a simple choice architecture.
>
> 1.41 These investment pathways are intended to be broadly appropriate for consumers with fairly straightforward needs, which reflect the following standardised consumer objectives:
>
> • I want my money to provide an income in retirement
>
> • I want to take all my money over a short period of time
>
> • I want to keep my money invested for a long period of time and may want to dip into it occasionally.[196]

The option of a charge cap in investment pathways remained open.[197]

In July 2018, the Treasury Select Committee said investment pathways did not go far enough:

> 37.**The level and quality of consumer protection and default investment pathways associated with pension freedoms do not appear sufficient at present. There are associated concerns that scams are appearing and evolving faster than regulators and guidance bodies can adapt. The Government should be actively involved in working with the FCA and the guidance bodies to identify opportunities to enhance consumer protection and introducing default pathways to**

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193 Ibid

194 Government response to the Work and Pensions Select Committee's report on Pension Freedoms, HC 1231, June 2018

195 FCA, Retirement Outcomes Review – final report, July 2018. For more on the Australian system – see Annex to this note

196 FCA, Retirement Outcomes Review, MS 16/1.3, June 2018

197 CBP18/17 Retirement Outcomes Review: proposed changes to our rules and guidance, 28 June 2018

> **ensure that people do not make poor choices in retirement. It can start by responding to the FCA's suggestion that it consider allowing people to access their tax-free cash separately from the rest of their pensions.**[198]

It said the Government should keep under review whether individuals started to purchase annuities in later retirement to protect against longevity risk. If not, it should consider intervening:

> 58.**It is desirable for individuals to be able to insure against risks over which they have little control, including longevity risk. The introduction of pension freedoms—and the associated sharp decline in demand for annuities—may have reduced the extent and effectiveness of collective longevity risk pooling in the retirement market. It has been suggested that retirees will instead choose to purchase annuities at later points in their lives than they did before pension freedoms, which could offset some of the reduction in risk pooling. If this is correct, we can expect to see a partial recovery in annuity sales going forward. The Government should monitor this situation as it evolves, and may need to intervene in future if evidence of sufficient risk pooling does not emerge.**[199]

In its response, the Government said it would work with the FCA and the industry to monitor developments:

> The pension freedoms were designed to give people more choice, to provide them with greater flexibility in later life and to enable a more competitive, innovative retirement market. It is therefore right that consumers are able to take their own decisions about their income in retirement, including deciding whether to purchase an annuity. As the committee highlights, people may choose to utilise the pension freedoms to purchase annuities at a later stage than previously and it may be that a blended solution, offering a combination of an annuity and drawdown, is appropriate for those consumers. Working with the FCA and industry, we will continue to monitor developments in the annuity market, including the impact on collective longevity risk pooling.[200]

In January 2019, the FCA launched a further consultation on proposals to require providers to offer *investment* pathways to customers entering non-advised drawdown. These would be a range of investment solutions – with carefully designed choice options – to help them choose investments that broadly meet their objectives:

> 1.6 Our proposed investment pathways remedy is aimed at consumers who, having received the above prompts to take advice or guidance, decide to access their pensions through drawdown without taking advice. These consumers then need to make a further decision on how to invest the funds that move into drawdown. Our work in the ROR showed that we need to take further action to help consumers with this:

198 Treasury Select Committee, Household finances: income savings and debt, HC 565, July 2018 para 154
199 Ibid
200 Household finances: income savings and debt: Government response, October 2018

> • Many consumers were solely focused on taking their tax-free cash and were insufficiently engaged with the decision around how to invest the remaining funds that moved into drawdown.
>
> • Our research found that around one in three consumers who had gone into drawdown since the introduction of pension freedoms were unaware of where their money was invested. Many others only had a broad idea.
>
> • We also saw that some providers were 'defaulting' consumers into cash or cash-like assets when they moved into drawdown. Overall, 33% of non-advised drawdown consumers are wholly holding cash. Holding cash may suit consumers planning to draw down their entire pot over a short period. But it is highly unlikely to be suited for someone planning to draw down their pot over a longer period. We estimate that over half of these consumers are likely to be losing out on income in retirement by holding cash.
>
> 1.7 These findings strongly suggest that a significant number of non-advised consumers are likely to hold their funds in investments that will not meet their objectives for how they want to use that money in retirement.
>
> 1.8 In CP18/17 we said that we believe that offering these consumers a range of investment solutions – with carefully designed choice options – is the best way to help them choose investments that broadly meet their objectives. We described these as 'investment pathways'.[201]

Other proposals included ensuring cash was an active decision and a requirement to provide actual charges information (i.e. requiring firms to tell consumers each year how much in charges they had actually paid in that period, in pounds and pence and inclusive of transaction costs).[202]

In July 2019, it announced that from August 2020 firms would be required to provide investment pathways, appropriate to their desired retirement outcomes, for consumers in non-advised drawdown.[203]

On 17 December 2019, it announced that Independent Governance Committees would be required to have oversight of pathway solutions and seek outcomes whereby pathway solutions offer value for money.[204]

What role could NEST play?

The National Employment Savings Trust (NEST) was set up under the *Pensions Act 2008* as a low-cost pension saving scheme for any employer who wanted to use it to fulfil their auto-enrolment duties. Its statutory framework allows it to offer, from age 55:

- payment of a lump sum or the purchase of a lifetime annuity policy, or both, or

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[201] FCA, CP19/5: Retirement Outcomes Review: Investment pathways and other proposed changes to our rules and guidance, April 2019

[202] Ibid para 1.12-4

[203] ROR: feedback on consultation CP 19/5: our final rules and guidance, PS 19/21, July 2019

[204] Independent governance committees: extensions of remit, FCA PS 19/30, Dec 2019

- transfer of the cash equivalent of the member's pot to another pension scheme, subject to certain conditions.[205]

In June 2015, in response to the pension freedoms, NEST published its retirement blueprint in response to pension freedoms. Based on evidence that most pension savers ultimately wanted "an income when they stop working, but that access to ad-hoc cash lump sums is important", it set out three building blocks to cover three phases of later life: from mid-60s to mid-70s, mid-70s to mid-80s and mid- 80s and beyond. These were:

- an income drawdown fund
- a cash lump sum fund
- a later life protected income fund.[206]

In July 2016, DWP asked whether it should change the legislation to allow NEST to evolve in response to the pension freedoms:

> 27. The pension freedoms have created a whole new landscape. This means we need to take a fresh look at whether or not the current framework for NEST means its Trustees can continue to provide the right offer for its members. There are a number of considerations including, whether the current framework accommodates the needs of a society with increasing life expectancy, the need for financial guidance and education, changing views towards work and retirement and differing levels of pension wealth.[207]

In its response, published in March 2017, the Government said it wanted to allow the industry more time to respond.[208]

In its 2018 report on the Pension Freedoms, the Work and Pensions Select Committee recommended allowing NEST to provide default decumulation products:

> **30.NEST is a growing success story. It has more than five million members, including many on low incomes, each embarking on private pension saving. Under the existing framework, all those members will be required to take active decisions about their life savings at retirement, many after a career of passive saving. NEST is currently highly restricted in the support in can offer those members at retirement as it cannot offer decumulation products. Concerns that allowing NEST to offer such products would hinder competition in the market would carry greater weight were there evidence of a functioning market currently. Indeed, the evidence from automatic enrolment suggests NEST may drive better retirement outcomes by forcing other providers to offer greater value or risk savers switching over to NEST to get a better retirement deal.**
>
> **31.*We recommend that the Government allows NEST to provide decumulation products from April 2019, provided it***

205 Ibid ch 3
206 NEST launches its retirement blueprint in response to pension freedoms, 29 June 2015
207 DWP, NEST – evolving for the future – a call for evidence, July 2016
208 DWP, NEST: Evolving for the Future: Government response, 2 March 2017, Executive Summary and Chapter 4

> ***remains assured of NEST's ability repay its start-up loan. This should include establishing a default drawdown pathway, in line with our wider recommendation. In keeping with the spirit of pension freedoms, savers would remain entitled to move their money wherever they wished.***[209]

The Government did not take forward the recommendation saying that it would "first need to be satisfied that this decision was consistent with the principles set out in that call for evidence, which balance the needs of NEST employers and members and the sustainability of NEST itself with a concern to ensure that NEST continues to have an overall positive effect on the market."[210]

4.6 What are the implications for means-tested benefits?

An issue of debate when the legislation was before Parliament was what implications flexible access would have for entitlement to means-tested benefits.

In its response to the consultation, the Government said it would look further at the notional income rules for pension drawdown products (for both benefits and social care) to ensure these were consistent between drawdown products and annuities.[211] In the Autumn Statement in December 2014, it announced that it would:

> […] change the notional income rules applied to pension pots which have not been accessed, or have been accessed flexibly, from 150% to 100% of the income an equivalent annuity would offer, or the actual income taken if higher. [212]

In April 2014, the then Financial Secretary to the Treasury, David Gauke, explained the existing rules for how pension savings should be treated for means-tested benefits:

> Under existing rules the capital value of pension investments is disregarded when assessing entitlement to working age income related benefits. Actual pension payments are deducted from both income-based and contributory benefits. When an individual is over the qualifying age for pension credit and has a pension fund that they have not yet accessed, a notional income is deducted from any benefit entitlement.[213]

In January 2015, the then Treasury Minister Lord Newby explained that the intention was for the same principles to remain in place:

[209] Work and Pensions Committee, Pension Freedoms, HC 917, April 2018
[210] DWP, NEST: Evolving for the Future, March 2017
[211] HM Treasury, *Freedom and choice in pensions: the government's response to consultation*, Cm 8901, July 2014
[212] HM Treasury, Autumn Statement 2014, December 2014, HC 8961, para 2.66
[213] HC Deb 1 April 2014 c626W; SI 2002/1792, reg 18; SI 2006/2014, reg 41; *State Pension Credit Regulations 2002 (SI 2002/1792)*, reg 18 and *Housing Benefit (Persons who have attained the qualifying age for State Pension Credit) Regulations (SI 2006/2014)*, reg 41.

> On guiding principles, the Government want to ensure that someone's decision to use a flexible pension product does not significantly impact on how their means are assessed for social security purposes or social care charging purposes. Our intention is for the principles of the current rules to remain in place after April this year.[214]

A more detailed explanation was provided in writing - DEP 2015-0071

There is an explanation of the rules on Pension Wise and a DWP produced a factsheet: Pension flexibilities and means-tested benefits in March 2015. The issue is also covered in DWP leaflet, A detailed guide to Pension Credit for advisers and others (Jan 2019), p23ff.

And help with social care costs?

Another issue is help with the costs of social care. In evidence to the Work and Pensions Committee in April 2014, the then Pensions Minister Steve Webb said the Government was not seeking to change the fundamental position:

> Just to be clear, the intention of the Budget reforms is not to change the fundamental position of someone who has saved for a pension. If I have saved for a pension and I have got a £50,000 pension pot, and I put it into a new flexible pension-type product that has got the capital and I draw some income from it, the intention is not to change the treatment of the capital in that product. If I can just quote what the Chancellor said: "I am absolutely clear that we want to make sure that this does not have an impact". We are working through exactly how we do that, because the Department of Health have to do this; we have to do it for Pension Credit and so on, and the Treasury have to think this through, but the intention is the status quo ante. It is not that we have come up with this clever wheeze that suddenly everyone has got masses of capital so we can means-test them for social care and save some money. That is not the intention.[215]

In January 2016, the Government said it had "assessed the potential effect of the [pension freedoms] on the cost to local authorities of residential care to be small compared to overall expenditure on residential care."[216]

4.7 Why is there a limit on contributions to a DC pension after flexible access?

When the Coalition Government introduced flexible drawdown in 2011, it said individuals in this type of arrangement would not be able to accrue further tax-relieved pension savings. This was to prevent "recycling" of tax relief (where an individual uses their tax-free lump

[214] HL Deb 27 January 2015 c169; See also, Oral evidence: Pension reforms, HC 1248, 30 April 2014

[215] Oral evidence: Pension reforms, HC 1248, 30 April 2014; The Government has produced a factsheet on charging under the *Care Act 2014*

[216] PQ22919 22 January 2016

sum to make further tax relieved pension contributions).[217] For this reason, people in flexible drawdown have an annual allowance of nil.[218]

In its consultation on *Freedom and choice in pensions,* the Government said the new flexibilities should not be exploited by individuals to achieve tax advantages that were not intended. A particular concern was that, if no action was taken, individuals could "divert their salary each year into their pension, take it out immediately and receive 25% of it tax-free, thus avoiding income tax and National Insurance Contributions on their employment income."[219]

It thought prohibiting any further contributions would be disproportionate: it wanted to encourage further pension saving, particularly in the context of Automatic Enrolment."[220]

It decided to limit contributions to a DC pension after flexible access to £10,000:

> [...] under the new system:
>
> - those currently in flexible drawdown who have an annual allowance of £0 will from April 2015 be subject to a new annual allowance limit of £10,000
> - those who choose to draw down more than their tax-free lump sum from a defined contribution pension will still be able to benefit from further tax-relived pension saving, and make further tax-free contributions to a defined contribution pension of up to £10,000 per year. This means that following their first flexible withdrawal, an individual will be able to contribute up to £10,000 a year with tax relief to a defined contribution pension. This covers 98% of pension savers over the age of 55.[221]

Initial level of the MPAA - £10,000

A 'money purchase annual allowance' of £10,000 was provided for in Part 4 of Schedule 1 of the 2014 Act.

The effect is that once an individual has accessed their savings 'flexibly', the amount they can contribute to a money purchase pension scheme reduces to the level of the MPAA (currently £10,000). HM Treasury explains when this applies:

> 2.6 Accessing a pension flexibly means taking benefits from a money purchase (cash balance or DC) pension pot through:
>
> - A flexi-access drawdown fund (whether or not having also taken a tax-free lump sum), which can be either
>   - income withdrawal, as and when required
>   - a short-term annuity

[217] HM Treasury, Removing the requirement to annuitise at age 75. A summary of consultation responses and the Government's response, December 2010, para 3.30
[218] *FA 2004*, s227A; RPSM06105070; Cm 8901,para 2.28
[219] HM Treasury, Freedom and choice in pensions: Government response to consultation, Cm 8901, July 2014, para 2.27
[220] Ibid, para 2.29
[221] Ibid, para 2.31

- A lifetime annuity that allows actual or possible decreases in the amount of annuity payable
- A one off payment, known as an "uncrystallised funds pension lump sum" is paid for the first time – one quarter of which is tax free.[222]

There MPAA can also be triggered in other, less common circumstances.[223]

Other types of pension options do not trigger the MPAA. For example:

- Payments of a 'small lump sum' (a pension pot of up to £10,000 can be exchanged for a lump sum, 25% of which is tax-free);
- Withdrawals from a capped draw down arrangement set up before 6 April 2015 (which does not exceed the maximum capped amount).[224]

If an individual who has triggered the rule, goes on to contribute more than £10,000 in a year to a money purchase pension scheme, they are subject to a tax charge. HMRC explains:

> The charge may not exactly match the relief given - it may be more or less. This depends on how much taxable income the individual has in the tax year in which the annual allowance is being tested and the amount of the individual's pension input amounts subject to the annual allowance charge for that tax year.
>
> To find out the amount of the annual allowance charge the individual needs to add the amount of the excess pension savings to the amount of their taxable income. The amount of pension saving:
>
> – over the individual's higher rate limit will be taxed at 45 per cent (50 per cent for 2011-12 and 2012-13)
>
> – over the individual's basic rate limit but below the member's higher rate limit will be taxed at 40 per cent
>
> – below the individual's basic rate limit will be taxed at 20 per cent
>
> If the individual is filing their tax return online the individual inputs their calculated excess pension savings amount and the online system will work out the amount of the tax charge for them.[225]

If a person is subject to the MPAA and is also accruing defined benefit (DB) rights, their total annual allowance remains at £40,000:

> DC savings are subject to the MPAA and, if these exceed the MPAA, any excess is charged to tax. However, the AA available for DB is also reduced to £30,000 (plus any unused AA carried forward) and the DB savings are tested against this alternative annual allowance, so no savings are tested twice.[226]

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222 HM Treasury, Reducing the money purchase annual allowance, 23 November 2016
223 Ibid para 2.7
224 Ibid para 2.8
225 PTM05110 – Annual allowance: essential principles
226 HM Treasury, Reducing the money purchase annual allowance: consultation, November 2016

An individual subject to an annual allowance charge of more than £2,000 may be able to ask the scheme to pay it in return for a reduction in benefits.[227]

Further detail is in HMRC's Pensions Tax Manual – money purchase annual allowance.

Reduction in the MPAA to £4,000

In the Autumn Statement on 23 November 2016, the Government launched a consultation on plans to reduce the MPAA from £10,000 to £4,000 from April 2017. It explained:

> 3.7 The MPAA should be set at a level that focuses government support on those who genuinely need, rather than simply choose to draw on their savings and who subsequently find themselves bale to re-build their pension.
>
> 3.8 While setting the MPAA at £10,000 initially has helped to deliver a smooth introduction of the pension flexibilities, the government does not believe that a £10,000 MPA is needed or appropriate on an ongoing basis. The government intends to reduce this to £4,000, from April 2017.[228]

In terms of the impact on individuals, it said that only three per cent of individuals aged 55 or over make DC contributions of more than £4,000 a year.[229] It said that if a person wished to re-build savings beyond £4,000, there are other products into which they can save – such as an ISA.[230] It estimated that the change would save the Exchequer £70 million over the years 2017 to 2020, rising to £75 million a year from 2020.[231]

Initial comment

Former Pensions Minister Steve Webb said the change flew in the face of efforts to make retirement more flexible:

> As soon as someone draws a pound of taxable cash using the pension freedoms, the amount they can save in a money purchase pension would be slashed from £10,000 to £4,000. This will have a profound impact on their ability to go on working and contributing worthwhile amounts to a pension. Starting to draw taxable pension cash becomes even more of a cliff-edge than at present. We should be trying to make combining work and drawing a pension easier not harder.[232]

He asked about the position of people who had already drawn on their pension, expecting to go on saving £10,000 per year.[233]

The Low Income Tax Reform Group (LITRG) expressed concern that the MPAA was more likely to cause problems at its reduced rate:

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227 Ibid
228 HM Treasury, Reducing the money purchase annual allowance: consultation, November 2016
229 Ibid, para 3.9-12
230 Ibid para 3.16
231 HM Treasury, Autumn Statement 2016 policy decisions, November 2016, Table 2.1
232 'Totally unfair': what pensions industry makes of cut to money purchase annual allowance, Money Marketing, 23 November 2016
233 Ibid

> […] with pensions freedom, an individual might decide to take money out of their pension (currently allowed at age 55) – for example, to pay off their mortgage or other debts. They might then decide to use their new-found surplus in disposable income to put money back into pensions to provide a nest egg for their old age when they eventually decide to reduce their hours or stop working. The money purchase annual allowance of £10,000 is unlikely to catch out too many people who might do this. But reducing it to £4,000 – equating to savings of £333 a month – is much more likely to cause problems for these people; especially if thinking about it in terms of someone choosing to save money they might have previously been paying on a mortgage.[234]

Government response to consultation

In its response to consultation in March 2017, the Government said the reduction in the MPAA to £4,000 would go ahead from April 2017. It said it had not received evidence that this would "impact on the successful roll out of automatic enrolment" or that it would "impact disproportionately on different groups.[235]

In terms of the issues raised, it said many – particularly individual respondents – had said that any restriction on ongoing contributions should apply to personal contributions only, not to the employer contribution. However, the Government said this would enable individuals to get around the rules by requesting larger employer contributions via salary sacrifice:

> 2.2 The MPAA applies to aggregate employer/employee contributions. It is common for employers to allow employees to sacrifice salary for an employer pension contribution and a person who accesses their pension savings flexibly is likely to have greater scope for salary sacrifice than would otherwise have been the case. In such circumstances, rather than using their salary to meet everyday expenses and then recycling pension savings, they are able to live off their pension and request larger employer pension contributions. This is, in effect, indirect recycling.
>
> 2.3 The MPAA will continue to apply to aggregate pension savings.[236]

A number of respondents suggested that rights to an MPAA of £10,000 should be protected where people had accessed benefits flexibly before the reduction to £4,000 was announced. However, the Government thought this would be disproportionately complex:

> 2.17 The government accepts that some individuals may have planned to contribute up to £10,000 a year, but the number in this group is small. Median DC contributions are less than £3,000 for men aged 55+ and less than £2,000 for women in the same age group. To apply different MPAAs, dependent upon when a benefit was last flexibly accessed would be disproportionately complex, both operationally and in relation to disclosure requirements. There would also be a need for transitional

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234 People drawing pensions 'flexibly' might be caught by new 'less flexible' rule on further pension saving, LITRG press release, 23 November 2016; Reducing the money purchase annual allowance, LITRG, 13 February 2017

235 HM Treasury, Reduction the money purchase annual allowance: consultation response, March 2017, para 1.9

236 Ibid, para 2.2-3

> requirements for the year in which a person subject to the £10,000 MPAA became subject to the £4,000 MPAA.[237]

It confirmed that the proposed level of the MPAA was appropriate:

> 2.28 Many respondents suggested that £4,000 is too low, arguing that individuals on modest earnings could be affected. However, there were others who considered £4,000 reasonable or even too high.
>
> 2.29 The MPAA seeks to balance the competing interests of preventing recycling, while allowing scope to rebuild some pension savings. An MPAA of £10,000 offers scope for a higher-rate taxpayer to reduce their tax bill by £1,000 a year. A £4,000 MPAA does not prevent higher-rate taxpayers from recycling, but does reduce the incentive for doing so and is unlikely to affect many basic-rate taxpayers.
>
> The MPAA will reduce from £10,000 to £4,000.[238]

Finance (No 2) Act 2017

Provision for a reduction in the MPAA to £4,000 was included in the *Finance (No. 2) Bill 2016/17.* However, along with other clauses this was dropped from the Bill following the announcement of the General Election on 18 April 2017.[239] Following the election, the Government said that a Second Finance Bill, containing all of the measures that had initially been dropped, would be introduced to this effect "as soon as possible after the summer recess".[240]

Provision for the reduced MPAA was included in clause of the Finance Bill (HL Bill 102). Draft Explanatory Notes state that:

> 1. This clause reduces the money purchase annual allowance (MPAA) from £10,000 to £4,000 with effect from 6 April 2017. Individuals who flexibly access or have already flexibly accessed registered pension scheme savings will be subject to a £4,000 MPAA.[241]

A Tax Information and Impact Note, Reducing the money purchase annual allowance, was published on 8 March 2017.

It is now in section 7 of the *Finance (No. 2) Act 2017*.

4.8 Who should individuals inform after flexible access?

Part 6 of the Act provides for the passing on of information, both to administrators and scheme members when individuals have flexibly accessed their pension savings. The intention is to ensure that, where an individual has flexibly accessed their pension savings:

- Schemes of which they are a member are aware of this;

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237 Ibid
238 Ibid
239 HC Deb 25 April 2017 cc1013-59
240 HCWS47, 13 July 2017; The background to this is discussed in more detail in Commons Library Briefing CDP-2017-0014 Finance Bill 2017-19 (September 2017)
241 Finance Bill – Explanatory Notes, September 2017, p17

- The individual gets the right information to declare on their self-assessment tax return and calculate the annual allowance charge due; and
- HMRC is provided with sufficient information to ensure the right amount of tax is paid.[242]

The Government's initial intention was to require scheme members who had flexibly accessed their savings to notify the scheme administrators of any other scheme of which they were a member within 31 days.[243] However, some commentators expressed concern that this was impractical. Ros Altmann (before she became Pensions Minister) said:

> To insist on people notifying all past pension schemes that they have taken some money under flexible access would place an impossible or unreasonable burden on too many people. The fines they would face are also draconian. Many may have only a small sum in an old pension scheme they have lost track of.[244]

In response, the Government amended the Bill at Report Stage to simplify the reporting requirements. Individuals would only be required to inform schemes to which they were contributing, or contributed to in future and the time limit for reporting was extended to 91 days.[245]

Debate

The question of whether the Government had done enough to protect the Exchequer was raised in consultation and in debates in Parliament.

The Association of Accounting Technicians (AAT), for example, argued that although the new measures would reduce the potential for unforeseen tax leakage, they would not stop it altogether:

> We note that the consultation response states that the reduced annual allowance will not impact 98 percent of the population and are concerned that this highlights how minimal its deterrent effect will be.[246]

Such concerns were shared by journalist John Greenwood who said:

> 5. The freedom to access pots entirely once an individual reaches age 55, creates an opportunity for anyone over that age to avoid liability for both employer and employee National Insurance, as well as income tax.
>
> 6. I have calculated that in excess of £20bn could be lost in the first year of this new policy if everyone over 55 takes advantage of this new option. I have presented this figure to numerous experts in the pensions industry, and none have suggested that the potential loss is not of something of that order. In the course of my job I regularly speak to the most senior professionals in the pensions industry and I am yet to get a kickback on the figures I have put forward. I do not believe that everyone over 55 will take

242 Bill 97-EN, para 50 and 178-87; HMRC, Pension Flexibility 2014 – Tax Information and Impact Note, 14 October 2014

243 It would have done this by means an amendment to the *Registered Pension Schemes (Provision of Information) Regulations 2006 (SI 2006/576)* – see new regulation 14ZB – see HC Bill 97, Schedule, part 6

244 Written evidence submitted by Ros Altmann (TP 03)

245 HC Deb 3 December 2014 c385

246 AAT, 'Comments on the draft legislation on the Taxation of Pensions Bill published on 6 August 2014,' 27 August 2014, para 1.7

> advantage of this loophole, but even if 10 per cent do, that is still a £2bn loss in the first year, a considerably worse outcome than the £300m net gain predicted by the Budget documentation.[247]

On the other hand, organisations such as the National Association of Pension Funds welcomed the rules as a pragmatic approach:

> We also welcome the pragmatic approach towards the risks of tax avoidance, which should enable to costs and burdens on schemes to be limited. To achieve this, the implementation of the reduced £10,000 'money purchase annual allowance' and the £30,000 'alternative annual allowance' must be kept as simple as possible.[248]

The ABI said:

> Ministers have made the right decision on how to balance greater freedom and choice with the need to prevent tax avoidance. They are to be commended for listening to provider advice about how best to tackle the problem without creating new loopholes.[249]

At Public Bill Committee Stage, the then Shadow Economic Secretary to the Treasury Cathy Jamieson asked what analysis the Government had done on this issue:

> I am sure that the Minister has done that work. I am sure that the Treasury has done that analysis and that all the loopholes and issues have been considered, brought together and presented to Ministers before the policy is taken forward. However, we have not seen that and we do not know the finer detail. It would be helpful to know it.[250]

The Minister disputed the estimates that had been given in evidence and argued that the Government's approach took the right balance. However, it would keep the issue under review:

> The hon. Member for Kilmarnock and Loudoun drew attention to the evidence provided by John Greenwood to the Pension Schemes Bill. He identified significant sums. As the hon. Lady made clear, they are not numbers that we recognise, but some of the assumptions that he used in reaching a very large number required everyone between the age of 55 and state pension age—5 million people—to be employed and taking advantage of the option to sacrifice salary into a defined contribution scheme.
>
> Each individual would reduce their salary significantly and the employer would pay the rest of their salary into their pension. Each individual would pay an entire year's worth of sacrificed salary into their pension. It would be paid monthly, but they would live off their reduced salary for a whole year before accessing their salary as a lump sum after the end of that year. It was also assumed that the individuals would have enough annual allowance left to do that on top of their employer's current contributions. It is a very unlikely set of assumptions. […]

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[247] Written evidence by John Greenwood, pensions journalist (TP10), November 2018
[248] NAPF, 'Response to draft guidance on clauses for the Taxation of Pensions Bill', 3 September 2014
[249] 'ABI response to HM Treasury Freedom and choice in pensions announcement on the Guidance Guarantee' 21 July 2014
[250] PBC Deb 18 November 2014 c74

> We will keep the matter under review. Our desire is to prevent a significant loss to the Exchequer. We do not want the provisions to be exploited by widely marketed schemes that make use of that particular arrangement, and we believe we have got the balance right. The benefits of engaging in such contrived arrangements are restricted, so the appeal of making use of them in an industrialised, widespread and widely marketed way is severely diminished.[251]

On 10 November 2015, Money Marketing reported that HMRC had refused to respond to an FOI request about the number of people who had reported accessing pensions flexibly.[252]

4.9 How is UFPLS regulated?

The FCA said it was considering how to regulate the new ability for consumers to withdraw money directly from their pension scheme over time (uncrystallised pension fund lump sum or UFPLS), an issue which had not featured in the consultation paper published in July:

> 4.14 The July Consultation Paper did not cover the new ability for consumers to withdraw money directly from their pension scheme over time (uncrystallised pension fund lump sum or UFPLS). We are discussing how we should regulate this form of withdrawing money from a pension with stakeholders. Our view is that the risks and issues for consumers are broadly similar to those with income drawdown products. Our intended approach will therefore be to treat these options consistently in our regulation of income drawdown products and we urge firms to treat it as such as we work with the industry on developing the rules.

It would also look at non-advised sales of income drawdown and UFPLS:

> **4.15** Drawdown itself may be used quite differently in the new environment. As we assess the impact on the requirements that relate to drawdown, we will consider how to ensure consistent protection for consumers and review requirements on firms where money is taken directly from the pension. One particular area we will explore is non-advised sales of income drawdown and uncrystallised pension fund lump sums. A number of respondents raised concerns here as currently most drawdown products are sold with regulated advice.
>
> **4.16** Our discussions with industry have identified an immediate issue in relation to the projection requirements for drawdown products. Our current projection rules assume a regular income is being taken over time and may therefore produce confusing or irrelevant information for customers using products more flexibly. We have been working with the industry on a short-term solution to this issue. We intend to offer a modification of our rules by consent16 so that we can test how the projection rules work for the new flexibilities. We invite any firms who want to find out more about this to get in touch with us.[253]

[251] Ibid c77-8
[252] HMRC withholds data on pension freedoms fines, *Money Marketing,* 10 November 2015
[253] FCA, PS14/17: Retirement Reforms and the Guidance Guarantee including feedback on CP 14/11, November 2014 para 4.14

In February 2015, it said it would require firms to give appropriate retirement risk warnings to consumers who had decided to access their pension savings on an execution-only basis. The risk warnings would relate to how the consumer wanted to access their pension savings.[254]

In the review of its rules in summer 2015, the FCA said it would look at requirements to provide projections relating to annual income and total fund, based on different payment patterns. It would:

> […] expect advisers to take sustainability of income into account where they are advising clients to take uncrystallised pension fund lump sums to ensure they are providing suitable advice.[255]

In July 2017, the FCA said that only a small proportion of consumers were opting for the UFPLS option.[256] This trend has continued.[257]

4.10 What is the minimum pension age?

The current pension tax rules set a minimum age at which a pension can generally be drawn, other than on ill-health grounds. The minimum pension age is currently 55.[258] In March 2014, the Government said it proposed to increase this to 57 in 2028 and then to align it with the State Pension age so that it is always ten years below.[259]

It asked for views on whether this should apply across pension schemes – including public service schemes. It also asked whether there was a case for a further increase, for example, so that the minimum pension age was five years below the SPA [260]

The State Pension age (SPA) is increasing. The SPA for women started to increase from 60 in April 2010 and will reach 65 in November 2018, bringing it into line with that for men. The equalised State Pension age will then rise to 66 by October 2020 and then to 67 between 2026 and 2028.[261]

In its response to the consultation, the ABI supported the proposal to increase the age at which individuals could take their pension saving from age 55 to 57 by 2028. It also thought it was worth exploring the option of aligning the minimum pension age to the SPA.[262] The PLSA said it made sense for the normal minimum pension age to increase as the age at which people can access their state pension benefits increases.[263] However, neither organisation thought the gap between

[254] FCA, Retirement reforms and the guidance guarantee: retirement risk warnings, February 2015
[255] Ibid p32
[256] FCA, Retirement outcomes review. Interim Report, July 2017, MS16/1.2, para 3.26, Figure 12
[257] FCA, Retirement Outcomes Review, June 2018, para 2.5
[258] *Finance Act 2004,* Part 4, section 279 (1)
[259] HM Treasury, Freedom and Choice in Pensions, March 2014, Cm 8835, chapter 4
[260] Cm 8835, chapter 3
[261] *Pensions Act 1995,* Schedule 4 as amended by the *Pensions Acts of 2011* and 2014. For more detail, see SN 6546 State Pension age 2012 onwards
[262] ABI publishes its response to HM Treasury's Freedom and choice in pensions consultation, 11 June 2014
[263] NAPF response to consultation on freedom and choice, June 2014

the minimum pension age and the SPA should be reduced to five years, arguing that this was unnecessarily restrictive.[264]

The Pensions Policy Institute said it was unclear the extent to which the minimum pension age acted as a signal to access pension saving early. However, an earlier age could lead people to exhaust their private pension savings too soon.[265]

The National Union of Teachers did not think the minimum pension age should be aligned with the SPA, arguing that the two thresholds had different functions:

> The State Pension age is the age at which the state believes that an individual can no longer be reasonably expected to work. Access to the basic state pension and other state pensions, in theory at least, allows the individual to stop work and have a retirement free of poverty.
>
> The minimum age at which people can draw private pension rights rests on a different concept. Until this Budget, pensions have been a tax-privileged savings arrangement the main purpose of which was to provide income for the individual in retirement. Within an economic framework, management of this trade-off between work and leisure is a matter for individual preferences. It relates to how long the individual wishes to work, not how long he or she can work.[266]

It said that in any case, there were already mechanisms to deter people drawing their private pensions too early (actuarial reduction in DB schemes and lower annuity rates in DC).[267]

On the question of whether any increase in the minimum pension age should apply across public service schemes, organisations such as the ABI and NEST argued that they should, on grounds of simplicity and fairness.[268] However, trade unions representing public sector workers disagreed. The Fire Brigades Union (FBU) said firefighters relied on the ability to access their pensions early:

> Members of the firefighters' pension schemes rely on the ability to retire from age 50 in the 1992 FPS and from 55 in the NFPS. This is a key element of these schemes to reflect the physical requirements of the firefighters' role. Increasing the minimum pension age to 57 would severely limit this ability and adversely affect the link to the occupational requirements of the job.[269]

In its response to the consultation, the Government said that around half of respondents agreed with the government's proposal to raise the minimum pension age to align it 10 years below SPA. A significant

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264 Ibid para 35; ABI response to freedom and choice, June 2014
265 PPI Freedom and choice in pensions: the minimum pension age, Briefing Note Number 67, 18 June 2014; Other countries considered included Australia, United States, New Zealand and Ireland
266 NUT response to HM Treasury Freedom and Choice in pensions consultation, 9 June 2014
267 Ibid
268 ABI Response to freedom and choice, June 2014; NEST response to freedom and choice consultation, June 2014
269 'Freedom and choice in pensions. Further response from the Fire Brigades Union', June 2014; See also NASUWT consultation response, Freedom and Choice in Pensions 11 June 2014, para 16

majority opposed moving it to 5 years below[270] It confirmed that it would increase the minimum pension age to 57 in 2028.[271]

The change would apply to those public service pension schemes where the normal pension age is linked to the State Pension age (i.e. not to firefighters, the police and armed forces). Further consideration would be given to the position of individuals who had a right to access those benefits from an earlier age:

> 2.39 **Therefore, the government does not intend to apply the minimum pension age increase to those public service schemes for Firefighters, Police and the Armed Forces.** The government is clear that the change should apply to public service pension schemes, where pension ages are linked to State Pension age, and to those in the private sector
>
> 2.40 Some individuals have built up savings with a right to access those benefits from an earlier pension age. The government recognises that they will be affected by an increase in the minimum pension age, and is considering the nature and extent of any protection that might be required for those individuals. The government will be guided by simplicity and fairness, both for individuals and for schemes, in designing any protection that may be introduced.
>
> 2.41 Recognising that there are further issues to explore in designing an increase to the minimum pension age, subject to the will of Parliament the government will legislate for these changes in the next Parliament.[272]

[270] HM Treasury, Freedom and choice in pensions: the government's response to consultation, Cm 8901, July 2014, para 2.3
[271] Ibid, para 2.36
[272] Ibid

5. Appendix – lessons from overseas?

5.1 Overview

When the pension freedoms were before Parliament, questions were raised about what the UK could learn from experience in other countries, such as Australia and the United States where annuity purchase is not compulsory.

The Pensions Policy Institute (PPI) produced a report in 2014 comparing international retirement systems and the role of annuitisation. If found that countries with higher levels of annuitisation "all offered higher annuity rates than would have been expected given market conditions." They tended to have restrictions on access but this was "clearly not the only determining factor." In countries with lower levels of annuitisation, annuities were not perceived as a "good deal". They tended to have fewer restrictions on access. The role played by the state pension as a fall-back was unclear. In terms implications for the UK, PPI said:

> International experience indicates that in some countries, people still choose to annuitise even in the absence of restrictions on accessing DC savings.
>
> These case studies show that even without compulsion, those who are financially conservative and risk averse are still attracted to the security offered by annuities.
>
> A consumer survey found that guaranteed income was one of the top priorities for consumers in investment decisions, alongside tax efficiency. The high rate of annuitisation in Switzerland shows this particularly. **In the UK in future, those who are risk averse may still opt to purchase lifetime annuities with their DC savings.**
>
> In Singapore, annuities and life insurance products are valued because they offer bequest options for those who die at younger ages, and longevity insurance options for those who live a long time. **If the UK annuity market builds guarantees into annuity products which can allow bequest options and long-term guarantees of payouts in later life (longevity insurance) annuities may remain popular with those who have DC savings.**
>
> The industry may want to explore product development for people who might wish to use part of their DC savings to provide security for themselves and take the rest as a lump sum or invest it in other products. **Partial annuitisation could play a bigger role in future if people wish to use only part of their DC savings in order to secure guaranteed income or insure against longevity.**
>
> In Denmark, decisions about annuitisation are made earlier during the saving process. **If UK pension schemes encourage decision-making during the saving period and build an option into schemes to preselect income drawdown or annuity options then there could be lower take up of the full withdrawal option by DC savers in future than would otherwise be expected. These options may also prove to be**

> **more tax efficient for those who would otherwise be pushed into a higher tax band by taking a lump sum.**
>
> Annuities which provide protection for disability are valued in Israel where annuitisation levels are relatively high. **Those qualifying for higher annuity rates (e.g. enhanced annuities) but who are still risk averse and might be uncertain how long they will live for could still find annuities attractive in future. Alternatively, new elements of health or disability insurance could be built into annuities to make them more attractive.** [273]

In a report published in November 2015, the Social Market Foundation looked at two countries with the most similarities to the UK pension system – Australian and the USA. It said the evidence from both countries was that very few bought an annuity and that people who draw down their pots do so at varying rates. It found three types of behaviour that were common among retirees:

1. 'Cautious Australians' who preserve their capital by reducing it by less than 1 per cent a year.
2. 'Quick-spending Australians' who consume pension funds quickly with four-in-10 running out by age 75.
3. 'Typical Americans' who on average consume pension savings quite quickly with an average withdrawal rate of 8% per year.[274]

Using modelling from the Pensions Policy Institute, it looked at the implications for UK retirees, were they to copy these types of behaviour. Headline findings were that:

4. Retirees emulating the 'Typical American' or 'Quick-spending Australian' would exhaust their pensions by year 17 and year 10 respectively – long before they reached average life expectancy.
5. Those who use the new rules to access pension cash early in retirement may maintain their working-life standard of living for a while, but risk it falling sharply in later life compared to those who choose sustainable income and more even consumption.
6. State Pension and Benefits may keep retirees above the definition of poverty, but their incomes risk sinking towards poverty levels if too much pension is taken too early.
7. Retirees following the 'Cautious Australian' path of under-consumption face a very low risk of running out of savings, even if they live longer than average. But this comes at the cost of reduced incomes and lower living standards throughout retirement.
8. For UK retirees choosing income drawdown, variable investment returns can result in uncertainty of income in retirement and of the age at which pension savings run out.

[273] PPI Briefing Note Number 66, Freedom and Choice in Pensions: comparing international retirement systems and the role of annuitisation, May 2014

[274] Social Market Foundation, Golden Years? What freedom and choice will mean for UK pensioners, 3 November 2015

9. Decumulation choices also affect fiscal risks to the state associated with the costs of claims of means-tested benefits. For instance, if a man with a pension pot of £184,000 takes the 'Quick-spending Australian' decumulation path, this would cost the state over £10,000 more by the point of average life expectancy (age 87) than had they bought an annuity.

It recommended that the Government create a two-tier 'Early Warning System' to understand what retirees are doing with their pension savings and to identify emerging long-term risks both to consumers and the taxpayer.[275]

5.2 Australia

The Australian pension system has three tiers:

- A means-tested Age Pension funded through general taxation revenue;
- The superannuation guarantee, a compulsory employer contribution to private superannuation savings; and
- Voluntary superannuation contributions and other private savings.

Most participants in the superannuation guarantee programme are in defined contribution schemes and at retirement most benefits are taken as a lump sum, at least in part. [276]

The Australian system is regarded by some as among the best in the world, having achieved high individual savings rates and broad coverage at a reasonably low cost to the government. However, weaknesses include incentives to reduce savings to collect means-tested state benefits, low levels of financial literacy and weak annuity markets.[277]

A succession of Government-established reviews have considered the lack of products to ensure against longevity risks as a weakness and have made recommendations to address this.

In 2009, the Future Tax System Review said the "lack of products that retirees can purchase to insure against longevity risk is a structural weakness in the system":

> While superannuation generates assets for retirement, current arrangements do little to ensure that those assets can be used for income purposes throughout the years of retirement. As people live longer, there is a growing risk that individuals will exhaust their assets before they die. The lack of products that retirees can purchase to insure against longevity risk is a structural weakness in the system. Better retirement income products should be available for purchase so a person can ensure an income higher than the Age Pension throughout their retirement. [278]

[275] Ibid
[276] OECD Pensions at a glance 2013 – Country profile - Australia
[277] Australia's Retirement System: strengths, weaknesses and reforms, Prof Julie Agnew, Center for Retirement Research at Boston College, April 2013
[278] Australia's Future Tax System – the Retirement Income System : Report on Strategic Issues', May 2009

Recommendations of its final report published in May 2010 included "government support for the development of a longevity insurance market within the private sector" and that Government should "consider offering an immediate annuity and deferred annuity product that would allow a person to purchase a lifetime income".[279] The review team did not think the purchase of annuity products should be made compulsory unless there was strong evidence that people were unable to make decisions in their best interests.[280]

In 2010, the Super System Review chaired by Jeremy Cooper found that the retirement income product market was under-developed:

> The retirement income product market has been under-developed, largely reflecting the relatively small balances that many retiring workers hold as a consequence of the quite recent introduction of the compulsory SG Act system (being less than 20-years old). Australians have historically favoured lump sum superannuation benefits, partly because that is all that most funds have offered.
>
> Currently, the market is dominated by account-based products in which the risks associated with investment markets and inflation (and longevity) are directly borne by the member. There is a need with an ageing population for more retirement products to be available for members

It recommended requiring trustees to offer retirement products, to consider these risks when developing post-retirement investment strategies and to pro-actively offer advice to members planning for, or already in, retirement.[281] In response, the Government said it would allow trustees to "offer retirement income stream products that were in the best financial interests of members" and would consult on whether this should be mandated at some time in the future.[282]

In a 2014 journal article Jeremy Cooper said the failure to address the retirement income phase meant Australian retirees continued to be exposed to "excessive volatility and uncertainty about the durability of their savings and how much sustainable spending cash flow they can expect in retirement."[283]

In December 2014, the Murray Financial System Inquiry found that:

> An efficient superannuation system is critical to help Australia meet the economic and fiscal challenges of an ageing population. The system has considerable strengths. It plays an important role in providing long-term funding for economic activity in Australia both directly and indirectly through funding financial institutions, and it contributed to the stability of the financial system and the economy during the global financial crisis.

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[279] Australia's future tax system. Final Report: Overview, May 2010, Chapter 12: List of recommendations, para 21-2

[280] Ibid, Part 2: Detailed analysis; Chapter A: personal taxation; A2

[281] Super System Review, Final Report, Chapter 7; Review into the Governance, Efficiency, Structure and Operation of Australia's Superannuation System

[282] Stronger Super, Government response to the Super Review, 2010, Exec Summary

[283] Are defined contribution pension plans fit for purpose?, Jeremy R Cooper, Seattle Law Review, 37(2)2014

> However, the superannuation system is not operationally efficient due to a lack of strong price-based competition. Superannuation assets are not being efficiently converted into retirement incomes due to a lack of risk pooling and over-reliance on individual account-based pensions.[284]

The review's recommendations to strengthen the superannuation system included:

- Setting a clear objective for the superannuation to provide income in retirement; and
- Requiring superannuation trustees to pre-select a comprehensive income product in retirement for members to receive their benefits, unless members choose to take their benefits in another way. [285]

In its response in October 2015, the Australian Government said it would legislate to allow trustees to help guide members at retirement and improve outcomes for retirees. It would also enshrine the objective of the superannuation system in legislation. This would help "align policy settings, industry initiative and community expectations." [286]

The Australian Government has introduced measures to support the industry in developing new innovative retirement income stream products for members.[287]

From 1 July 2017, the Government extended the tax exemption on earnings in the retirement phase to products such as deferred lifetime annuities and group self–annuitisation products.

Extending the tax exemption to deferred or pooled income stream products will encourage providers to offer a wider range of products. This will provide more flexibility and choice for retirees and help them to manage consumption and risk in retirement better – particularly longevity risk, to avoid people outliving their savings.[288]

The Australian Government consulted in May 2018 on its plan to require superannuation fund trustees to develop a retirement plan for members and to pre-select a comprehensive income product.[289] The Government plans introduce a retirement income covenant in the *Superannuation Industry (Supervision) Act 1993*, requiring trustees to develop a strategy that would help members achieve their retirement income objectives. The covenant will require trustees to offer Comprehensive Income Products for Retirement (CIPRs): products that provide individuals income for life, no matter how long they live. The aim is that this will focus the industry on providing a higher standard of living for retirees.[290]

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[284] Murray Financial System Inquiry, December 2014
[285] Financial System Inquiry, Executive Summary, December 2014, Chapter 2: superannuation and retirement incomes
[286] Government Response to the Financial System Inquiry, Superannuation Measures
[287] ASIC, Cross-agency process for retirement income stream products, 2017
[288] An Australian Treasury factsheet is available on this topic
[289] Australian Treasury, Budget 2018-19, Fact Sheet 3.4 Retirement Income Framework
[290] Australian Government, Retirement Income Covenant Position Paper, May 2018

In the final report of its Retirement Outcomes Review, the FCA said it had looked at the positive aspects of the Australian system, as well as the challenges faced when drawing up its own proposals:

- In Australia many consumers who go into simple drawdown are not making the most of their retirement incomes. In response, the Australian Government is developing a framework for the Comprehensive Income Products for Retirement. This aims to balance flexibility with a regular and stable income stream. We believe investment pathways will similarly help consumers manage their pot.
- Australian consumers appear to have earlier opportunities to engage with their retirement decision. The Government announced in the 2018-19 Budget the development of 45 and 65 year checks to encourage more people to prepare for retirement, including how to build and more effectively use their superannuation. Through our remedies, we are aiming to increase consumer engagement by ensuring wake-up packs are sent earlier, are simpler, and more frequent.
- There are several ways to compare products in Australia, but there are no drawdown comparator tools in the UK. This is why we are working with MAS and ABI to introduce a drawdown comparator tool. We are learning from the Australian experience about the best way to develop this to allow for good comparison.[291]

[291] FCA, Retirement outcomes review, chapter 5 [box: lessons learned from Australia]

BRIEFING PAPER

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