A review of the pensions landscape in 2017

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Op
Opinium

What people think, feel and do.

EXECUTIVE SUMMARY

This report is for anyone working in the world of pensions and explores consumers' circumstances, intentions and attitudes towards funding their retirement, as well as summarising the issues, options and potential opportunities for providers.

The pensions landscape has witnessed monumental change in recent decades and this has created significant challenges for all stakeholders: government, pension providers, employers, advisers, individuals and others:

- Pension freedoms have dramatically increased individuals' options on how to access their pensions and have shaken up the industry
- State pension ages are being progressively increased
- Auto-enrolment is increasing pension take-up and consumer exposure to equity and bond markets
- Defined benefit pensions have fast become an endangered species for many with deficits in large company pension schemes being the norm
- The low interest rate era is depressing investment returns and retirement income
- Increasing life expectancy also reduces annuity rates, as does low inflation

The prevalence of seemingly ever shifting goalposts from a pension tax and allowance perspective, together with the progressive increase in state pension age and the equalisation of pension ages for men and women make it hard to plan retirement income with certainty from both a provider and an individual perspective.

Worryingly, our insight reveals that there is a 27% (£6,445) shortfall in expected average annual retirement income compared to the amount consumers require to be 'financially comfortable' in retirement. This perceived shortfall is even more marked for the East of England (39%; £9,679) and for women (36%; £8,586).

For future generations retiring, a much more flexible mindset will be needed.

Consumers face an increasing number of options in building up their assets to provide income for their retirement but this has also meant that retirement planning has become more complex and fraught with uncertainty. Pension freedom opportunities, the likely retirement income gap, low investment returns, and increasing life expectancy present key challenges for government, regulators, providers and individuals alike.

Our report explores some of these challenges and opportunities facing the sector and how the pensions landscape is likely to shift in the future.

THE CURRENT STATE OF PLAY

Not enough income: the £6,445 retirement income 'gap'

One-in-six (16%) expect their annual income in retirement to be less than £10,000

The average pension pot size at retirement is £28,000, whereas at least £230,000 is required for the average household to retire on two-thirds of pre-retirement income[1]. Those retiring now will get the full new State Pension of £159.55 per week if they have at least 35 years of National Insurance contributions or credits. Some may get more if they have over a certain amount of Additional State Pension or if they delay taking the pension. Some will get less. Whilst there is currently a 'triple lock' guarantee from the government, meaning that the state pension will increase each year by the higher of: the increase in yearly earnings, the inflation rate or 2.5%, there are parliamentary murmurings that this guarantee will be too costly to maintain.

14% of people[2] retiring this year have made no provision for retirement. This means that many will be surviving on less than the Joseph Rowntree Foundation's Minimum Income Standard for a single pensioner of £182.98 a week required to support an acceptable standard of living in retirement.

Taking debt into retirement is increasing: a quarter (25%) of those planning to retire in 2017 expect to do so with outstanding debts, owing an average of £24,300[3]. This is a substantial increase on 2016, when one-in-five (20%) expected to retire in debt owing an average of £18,800.

Our research reveals that there is a large gap of £6,445 between the average annual income that people they think that they will have in their retirement and the amount that they consider they would need to have a comfortable retirement.[4]

The perceived annual retirement income gap

	What do you think your annual income will be in retirement?	How much annual income do you think you would need to be comfortable in retirement?
LESS THAN £10,000	16%	6%
£10,000 TO £15,000	16%	15%
£15,001 TO £20,000	12%	23%
£20,001 TO £25,000	7%	19%
£25,001 TO £30,000	6%	12%
£30,001 TO £35,000	3%	9%
£35,001 TO £40,000	1%	4%
£40,001 TO £45,000	2%	2%
£45,001 TO £50,000	1%	4%
OVER £50,000	1%	6%
DON'T KNOW	34%	n/a
AVERAGE (MEAN)	**£17,630**	**£24,075**

1. Independent Review of Retirement Income: Report (IRRI) March 2016
2. https://www.pru.co.uk/press-centre/no-pension-release/
3. https://www.pru.co.uk/press-centre/retirement-debt-on-rise-again/
4. Online survey conducted by Opinium Research of 1,230 employed and self-employed adults between 4th and 8th November 201

There are also significant regional and gender variations in retirement income expectations and requirements[5]:

- Those living in the East Midlands expect an annual retirement income of £14,352 which is only 59% of the £24,260 that Londoners expect.
- To be comfortable in retirement, residents of Wales say they would need an annual income of £19,138 which is 63% of the £30,159 amount specified by Londoners.
- The biggest shortfall in the annual income expected and the annual income required to be comfortable is the lot of the citizens in the East of England who would need an additional £9,679 annually.
- While men and women specify a roughly equivalent annual income to be comfortable – the average man specified £222 more – there's a much larger gap between the annual retirement income expected with men citing £3,902 more.

The perceived annual retirement income gap

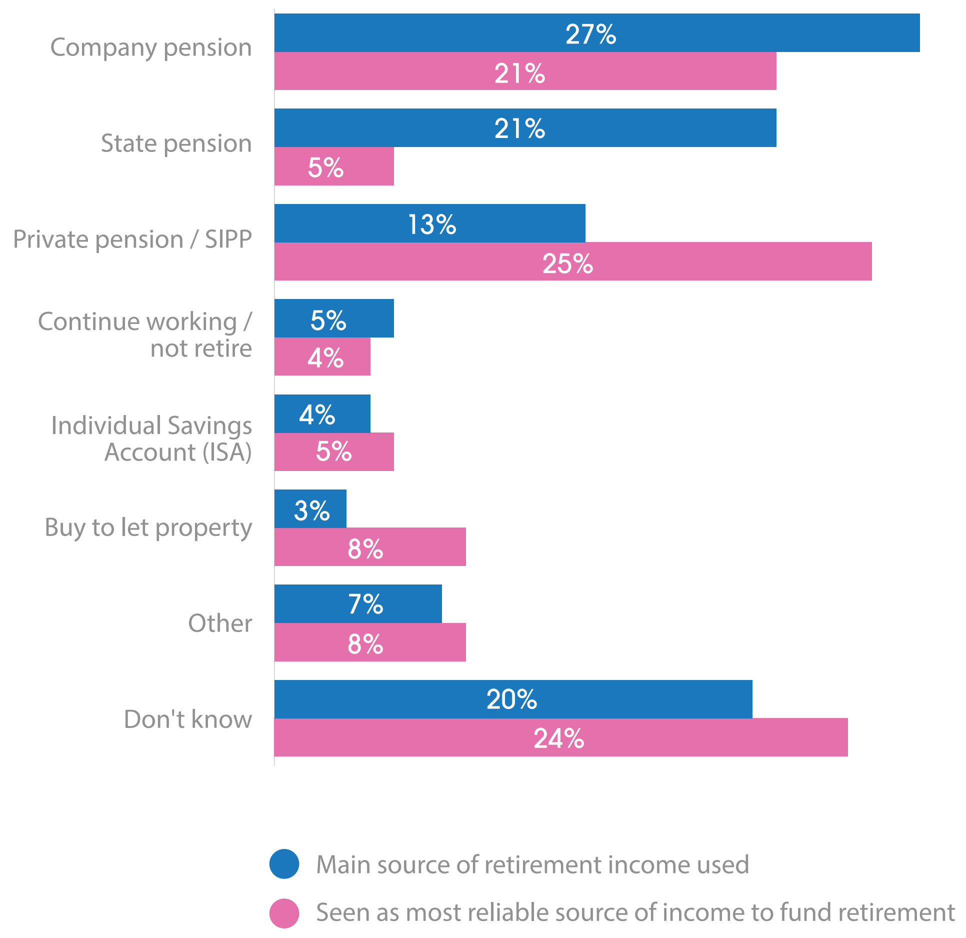
	What do you think your annual income will be in retirement? Average (mean)	How much annual income do you think you would need to be comfortable in retirement? Average (mean)	Perceived annual income 'gap'. Average (mean)	Perceived annual income 'gap' percentage. Average (mean)
EAST	£15,321	£25,000	£9,679	39%
EAST MIDLANDS	£14,352	£21,685	£7,333	34%
NORTH WEST	£17,346	£24,442	£7,096	29%
SOUTH WEST	£15,857	£22,947	£7,090	31%
SOUTH EAST	£18,991	£25,578	£6,587	26%
NORTH EAST	£17,153	£23,278	£6,125	26%
LONDON	£24,260	£30,159	£5,899	20%
YORKSHIRE & HUMBERSIDE	£15,154	£20,907	£5,753	28%
SCOTLAND	£16,865	£22,309	£5,444	24%
WEST MIDLANDS	£17,962	£22,476	£4,514	20%
WALES	£14,792	£19,138	£4,346	23%
AGED 18 TO 29	£17,917	£25,135	£7,218	29%
AGED 30 TO 39	£19,536	£25,557	£6,021	24%
AGED 40 TO 49	£17,216	£23,674	£6,458	27%
AGED 50 TO 59	£15,569	£22,063	£6,494	29%
AGED 60 TO 69	£15,552	£21,941	£6,389	29%
FEMALE	£15,422	£24,008	£8,586	36%
MALE	£19,324	£24,230	£4,906	20%
ALL	**£17,630**	**£24,075**	**£6,445**	**27%**

[5] Online survey conducted by Opinium Research of 1,230 employed and self-employed adults between 4th and 8th November 2016

Too much reliance on a State Pension - an opportunity for greater support from providers

Looking at the main sources of income in retirement goes some way to explain the pensions gap.

Our research shows, that despite private pensions being seen the most reliable source of income by 25% of all UK adults compared to 5% who think a state pension is, the reality looks quite different. Only 13% of consumers will have the luxury of using a private pension to fund their retirement income. Instead a much larger proportion (21%) will be relying on a state pension.



Comparing perceptions of most reliable sources of retirement income vs. their usage

The pensions gap and an over reliance on the state pension, clearly highlights a need for people to take greater responsibility for their future retirement income much earlier.

Almost a third (29%) of the people surveyed said they will struggle with their finances in retirement and only 18% said they would be able to live comfortably. Worryingly, this sentiment was more marked amongst younger generations who are feeling the squeeze more acutely, juggling both rising living cost, house prices and the ability to save for the future.

Government, regulators and providers all have an opportunity to take a range of measures to educate and support people along the retirement journey; providing stability and better access to pensions, improving pension information and introducing financial education to incentivise saving much earlier.

The big shake-up - pension freedoms – but little evidence of Lamborghinis

For providers supporting future waves of people retiring, the pension freedoms introduced in 2015 has led to an even greater need for this support. Pension freedoms have significantly increased options granted to pension holders for accessing their pension pot and gone are the days of the obligatory annuity.

One year after pension freedoms were introduced statistics[6] revealed that £4.3 billion has been paid out in 300,000 lump sum payments, with an average payment of £14,500 and £3.9 billion has been paid out via 1.03 million drawdown payments, with an average payment of £3,800.

There were predictions that some people might use the pension freedoms to blow their pension pot on a Lamborghini, and whilst this might be wide of the mark, the ABI's findings did sound a note of caution by saying "there are signs a minority may be withdrawing too much too soon and at rates that would see their money run out in a decade or less, if they are reliant on their pension pot as their main source of income. Indeed, in the last quarter (Q1, 2016), four per cent of pots had 10% or more withdrawn, and many others are taking their whole pot in one go. However, the vast majority of savers are taking a sensible approach, with 57% pots with 1% or less withdrawn during the most recent quarter."

[6] ABI pension freedom data

Smaller pots are generally taken as lump sums with an average pay out of £14,500. Larger pots are typically used to get a regular retirement income, with an average fund investment of £60,000.

In the first 9 months of pension freedom[7]:

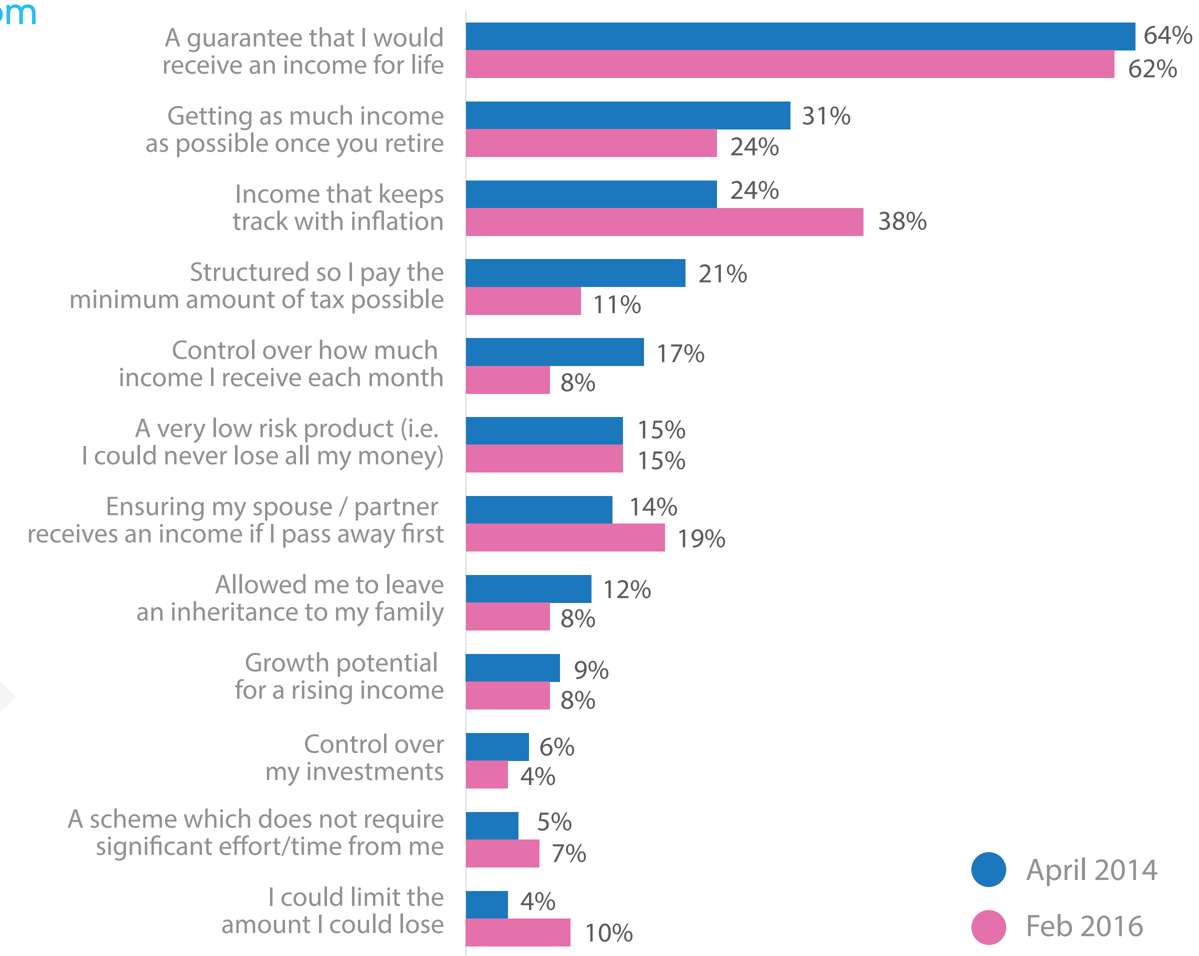
- £4.3bn paid out in just over 300,000 cash lump sum payments, an average payment of nearly £14,500
- £3.9bn paid out via 1.03m income drawdown payments, an average payment of £3,800
- £4.2bn invested in around 80,000 annuities, making the average fund invested nearly £52,500
- £6.1bn invested in 90,700 income drawdown products, an average fund of just over £67,500.

[7] ABI pension freedom data

Despite the introduction of pension freedoms, guaranteed secure income remains popular

The March 2014 announcement of pension freedoms came as a shock to the pensions industry and it left the providers with little time to determine what people want and to develop innovative products given that the gestation period for a new product is typically 12 to 18 months.There has been a slow release of new propositions on to the market but it didn't help that there are ingrained issues: people can be wary of annuities but many like the guaranteed secure income they offer. Similarly, profits are out of favour but smoothing is popular, as research undertaken below shows.

Desired features from retirement income products



Partnership (March 2016)

A pension is no longer the sole source of income for most people – a range of possibilities

Guaranteed income that annuities offer remain popular amongst consumers and our research shows that a pension is still the main source of income amongst UK adults.

However, despite this, given the increasing number of options and lack of certainty over many aspects surrounding retirement planning, it is not surprising that many people are using a range or mix of differing vehicles to meet their income requirements. Apart from pensions (their own or their partner's) these include:

ISAs

- Adults held £267 billion in ISA and PEP stocks and shares in April 2016 and a further £251 billion in Cash ISAs[8]. While it is difficult to gauge what proportion of these holdings are earmarked for retirement income the amount must be substantial.

- In the 2015/16 tax year £21.4 billion was invested in stocks and shares ISAs and £58.8 billion in Cash ISAs[9].

- Lifetime ISAs were launched in April 2017 for savers aged between 18 and 40 who will get a 25% bonus (max £1,000 per year) on each annual contribution until they reach 50. It's intended to help people get on the housing ladder or to save for retirement.

Main residence (downsizing)

- Almost half (46%) of over-45 homeowners see the wealth built up in their property as a key part of their retirement income plans. Seven-in-ten (69%) say that their home is worth more than their pensions, savings and investments combined[10].

Buy-to-let property

- There was gross lending of £14,900 million on buy-to-let property purchases and £25,100 million buy to let remortgages in 2016[11]. However, buy-to-let landlords are being increasingly targeted as a tax raising cash cow by various government policies.

[8]https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/547220/Table_9.6_Published_August_2016.pdf, [9]https://www.gov.uk/government/statistics/number-of-individual-savings-accounts-isas-amounts-subscribed-to-each-component-and-average-subscription, [10] Aviva Real Retirement Report (July 2016), [11] Council of Mortgage Lenders,

Equity release

- 27,534 new equity release plans were agreed in 2016 and total activity of £2.15 billion saw the market exceed £2 billion for the first time. The market has almost trebled in size in the five years since 2011 when it recorded £789 million[12].

- Whilst 61% of equity release withdrawals are by drawdown, typical uses for the proceeds are: home/garden improvements 63%; repaying unsecured debts (31%); holiday (29%); helping family/friends (24%); repaying mortgage (22%); help with regular bills (13%)[13].

Delaying retirement

- More than half (51%) of those planning to retire in 2016 are either already working past their respective State Pension age or would consider doing so, with 22% of those scheduled to retire in 2016 having postponed their plans because they cannot afford to stop work[14].

Utilising other investments or assets

- These could include the likes of art, cars, antiques, wine.

[12] Equity Release Council, [13] Key Retirement UK Equity Release Market Monitor 2016, [14] Prudential 'Class of 2016' (February 2016)

SO WHAT DOES THE FUTURE LOOK LIKE FOR PENSIONS?

With the pension gap rising and future generations facing greater uncertainty and a wider array of options to fund their retirement, we explore the top five issues which are facing the pensions landscape and what this might mean for the future.

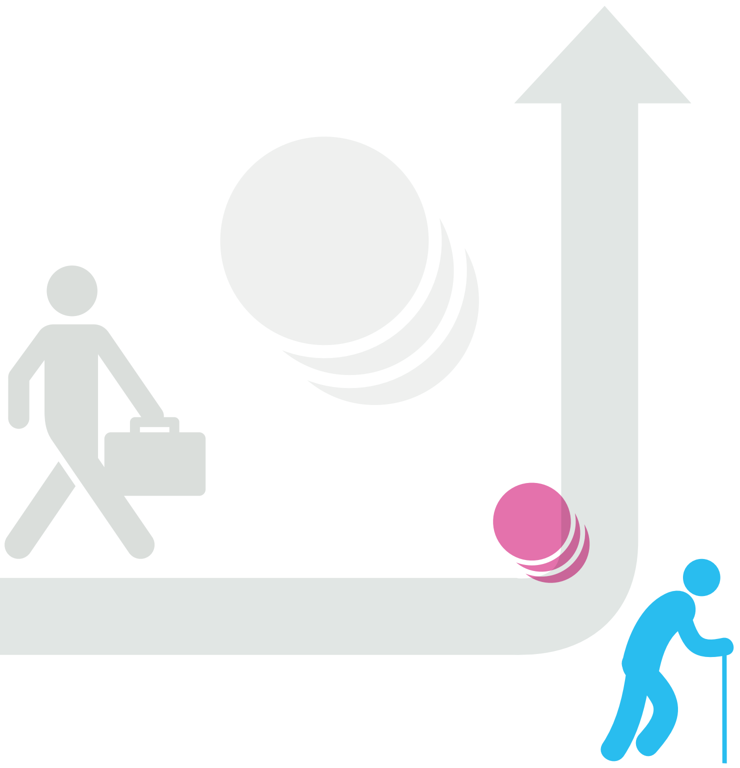
Government policy is increasing pension membership

Auto-enrolment (AE), which started in October 2012 and has a staged rollout based on company size until 2018, will improve pension provision for future generations. Workers are eligible for automatic enrolment if they are at least 22 years old and under State Pension Age, earning over £10,000 a year and work, or usually work, in the United Kingdom. Minimum contribution levels were introduced starting at 2% with minimum 1% from employer and 0.2% from tax relief. In April 2018, it increases to 5% (2% from employer and 0.6% from tax relief). From April 2019, the minimum increases to 8% (3% from employer and 1% from tax relief). 66% of all employees are now active members of a pension scheme, compared to 47% in 2012[15].

Auto-enrolment will work because you're "in" unless you opt out. Originally the Department for Work and Pensions was expecting an opt out rate of about 25% to 30%[16], but research by the Institute of Fiscal Studies found that "that automatic enrolment increased pension participation among those eligible by 37 percentage points, so that by April 2015, 88% of these private sector employees were members of a workplace pension scheme." Private sector employees who were members of a workplace pension increased from 5.4 million in 2012 to 10 million by 2015 and it is estimated that 4.4 million was as a result of auto-enrolment.[17]

Reduced Lifetime Allowance will affect increase usage of alternative investments

The Lifetime Allowance (LTA) was introduced in 2006/07 tax year at £1.5 million and was then increased every year until 2010/11 when it peaked at £1.8 million. In 2012/13 it was reduced to £1.5 million and then to £1.25 million in 2014/15 tax year and then reduced yet again to £1 million in 2016/17.



[15] The Pensions Regulator, Automatic Enrolment Commentary and analysis (July 2016), [16] Workplace Pension Reforms: Baseline Report (RR803), DWP (2012), [17] https://www.ifs.org.uk/publications/8735

Individuals with funds above the LTA are subject to different tax rates, depending upon how the funds are withdrawn:

- Any funds above the LTA that are taken as a lump sum are taxed at 55%
- Any funds above the LTA that are used to provide a pension are taxed at 25% with the pension income then being taxed at the individual's marginal tax rate

Given that the average pension pot at retirement is about £28,000 one could be forgiven for thinking that very few will be affected by the £1 million LTA, but with pension contribution often being made for many decades and buoyant stock markets it is likely to affect hundreds of thousands of people. Many may unknowingly sleep walk into this tax trap, but those that are aware that they are likely to exceed the LTA will be looking for alternatives to pensions investments and this represents a significant new business opportunity for established independent financial advisers and especially the burgeoning ranks of the robo-advisors who can target wider sections of the community.

Interest rates are low, so alternatives are sought

Some readers may recall the year prior to October 1990 when the Bank of England base rate was 14.875% which seems a far cry from its current 0.25% and indeed the 0.5% which prevailed for over 7 years from March 2009. Low interest rates feed through to low bond yields and low annuity rates as well as having significant impact on investment returns, foreign currency exchange rates and inflation. While annuity rates have risen recently, in this era of SIPPs and pension freedoms increasing numbers are tapping into the higher income available from dividends on offer from many equities and funds, although there is no certainty of continuity of dividend levels.

Dividend yields and total annual returns in recent years have been[18]:

DATE	FTSE 100 yield	FTSE 100 annual total return	FTSE 250 yield	FTSE 250 annual total return	FTSE All Share yield	FTSE All Share annual total return
30/11/16	3.83%	11.07%	2.80%	3.53%	3.64%	9.77%
31/12/15	3.98%	-1.32%	2.58%	11.15%	3.70%	1.10%
31/12/14	3.54%	0.73%	2.65%	3.70%	3.39%	1.18%
31/12/13	3.46%	18.70%	2.46%	32.28%	3.51%	20.78%
31/12/12	3.72%	10.00%	2.79%	27.01%	3.77%	12.32%
31/12/11	3.59%	-2.20%	3.11%	-10.09%	3.46%	-3.46%
31/12/10	3.00%	12.60%	2.21%	27.37%	3.22%	14.51%
31/12/09	3.31%	27.30%	2.49%	50.59%	4.11%	30.09%

People living longer and state pension age is increasing

Life expectancy has increased significantly in recent decades: a man aged 65 in 1982 could expect to live another 13 years, whereas his counterpart aged 65 in 2014 could expect to live another 18.4 years. For a 65-year old woman the corresponding life expectancies were 16.9 and 20.9 years[19]. The most common age at death is 86 for men and 89 for women.

This has significant implications on all pension stakeholders as it vastly increases retirement income requirements. Ever advancing ages also result in a rise in the likelihood of morbidity with its attendant care needs. Increasing life expectancy is also likely to feed through to a significant increase in equity release sales as retirees seek additional income.

The first state pensions were paid in 1909 to those aged 70 or higher who had an annual income of less than £31. Contribution based non-means-tested pensions were introduced in 1925 for those aged 65 plus. In 1940 women's pension entitlement age was lowered to age 60 but this is being gradually increased back to age 65 between 2010 and 2018. This equalisation of state pension age has met considerable opposition because of the speed with which it takes effect and concern over ineffective communication about the change, which has left many women with insufficient time to make alternative arrangements. The SNP MP, Mhairi Black, led a House of Commons debate on the issue and told MPs that women are being "shafted and short-changed." Men and women's state pension ages are rising to 66 by October 2020. The age is increasing to 67 between April 2026 to April 2028 and to 68 between April 2044 and April 2046. Further revisions are likely.

State pension under threat?

According to the Centre for Policy Studies (CPS) report '*The State Pension: No longer fit for purpose*'[20] in 2015/16 the "National Insurance Fund, which funds the state pension, received £86 billion in National Insurance Contributions (NICs) and paid out £95 billion in benefits (including £89 billion as the state pension): it required bailing out by a £9.6 billion Treasury grant."

The CPS says the current state pension is unaffordable and that from 2020 no further entitlements should be created. It suggests that past entitlements should be honoured as a 'legacy state pension' but it, along with all other pensioner benefits should be means tested.

It further suggests that a senior citizens' pension, payable to people aged 80+, should be started from 2034, and the CPS wants to see the introduction of a Workplace ISA, with employee, employer and government contributions. It says its proposals "could be funded by ending all Income Tax and NICs reliefs on pension contributions, assisted, over time, by the diminishing cost of the legacy state pension."

Regardless of how much credence can be placed on the CPS proposals – critics suggest it would act as a disincentive to save – it seems inevitable that the government will continue to make changes to pensions.

[18] Siblis Research, [19] http://www.ons.gov.uk/peoplepopulationandcommunity/birthsdeathsandmarriages/lifeexpectancies/bulletins/nationallifetablesunitedkingdom/2015-09-23, [20] http://www.cps.org.uk/files/reports/original/161102105025-TheStatePension.pdf

FINAL THOUGHTS

Flexible mindset needed

People face a bewildering array of options in building up their assets to provide income for their retirement. Auto enrolment will help future generations although it is likely that contribution levels will need to be ramped up considerably to cope with ever increasing life expectancy despite the planned increases in state retirement age.

Regardless of the scheduled increases in state pension age, together with their likely future upward revisions, it seems likely that future generations face far less certainty about their actual retirement ages and will need to be much more flexible than their predecessors.

Gone are the days when most can confidently predict their future retirement date – time was when most knew that they would retire at age 60 or 65 - but it's a different environment now.

Retirement planning remains vital but it's fraught with uncertainty over many aspects: investment returns, inflation, life expectancy, changing future personal circumstances, likely retirement income gap, pension freedom opportunities, alternative investment vehicles and the seemingly ever changing tax rules that frequently move the goalposts. The lack of certainty means that many see retirement as a process that can take place over a lengthy period often dictated by the individual's available financial resources. This can mean delaying retirement, gradually reducing working hours, switching to part time job(s) or seeking other additional income streams.

Although this does present challenges for governments, regulators and providers alike to introduce measures to help individuals plan for future income, it also presents significant opportunities for providers to differentiate themselves by offering alternative solutions, guidance and building deeper relationships through both the intermediary and direct channel.

About the author

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Alexa heads up the financial services division at Opinium and has extensive experience working in market and consumer research delivering insight across consumer and business audiences for challengers through to iconic global brands. Alexa's experience comes from across the financial services categories dealing with many facets of marketing information such as: communication evaluation, concept testing, brand planning & strategy development, and customer satisfaction.

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About Opinium

Opinium is an award winning strategic insight agency built on the belief that in a world of uncertainty and complexity, success depends on the ability to stay on the pulse of what people think, feel and do. We help financial organisations get to grips with the world in which their brand operates by ensuring we develop the right approach, methodology and questions to deliver robust insight, targeted recommendations and address specific business challenges.

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