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MoneyMarketing 19 November 2009

Retirement planning

Splash landing

Why making the right choices now will determine whether you sink or swim in retirement


in control
In our view, a SIPP should give you the flexibility to steer your clients along the route that's right for them.
That's why if HMRC allow it, so do we - putting you in the driving seat and your clients in control of their future.
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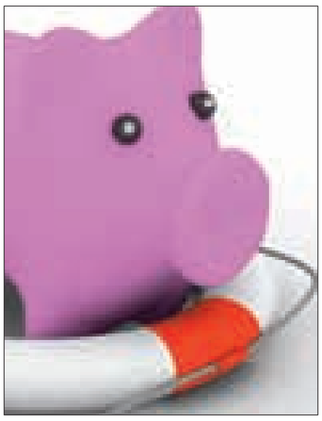

Sense of expectancy

Life expectancy in Britain has hit its highest-ever level. Figures from the Office of National Statistics show that with no further improvements in life expectancy, a boy born today can expect to live to age 77. A girl born today can, on average, expect to live to 81. If you manage to make it to 65 years old, the news is even better. Again, with no further increases in life expectancy, a male 65-year-old in good health today can expect to live to just over 82 while a woman meeting the same criteria can expect to live to 85.

Of course these figures are only averages and they are trying to predict what will happen anywhere from 15 to 80 years in the future. But the thing about averages is that there are very few people who are average. Some people will live shorter lives than the median figure while some will live longer, in some cases a lot longer.

In 1911, there were only 100 centenarians in the UK but by 2008 this number had grown by a factor of 95 to stand at 9,600. Several years back, scientists predicted that the first person to live to 150 years old had already been born and with advances in medicine, improvements in diet and a greater increase in disposable wealth you will be hard pressed to find many people betting on a reversal of the trend for longer and longer lives.

But greater longevity does bring with it a number of problems.

If mortality continues to improve, many people working today will spend almost as long in retirement as they do in employment and this raises real questions on how people pay for their retirement. With the decline of DB pensions and the continued erosion of state benefits people will need to ensure they have made adequate provision for a retirement that could be considerably longer than anticipated.

The cost of long-term care is a particularly thorny issue. Although many people will remain active throughout their retirement, for some, the cost of full-time or residential care can become very expensive very quickly for the elderly.

With proportionally fewer people of working age to pay for welfare costs, the issue of who pays for the cost of long-term care becomes more urgent. The issue of LTC has risen up the political agenda this year, with both the Government and the Conservatives outlining their plans.

With these concerns in mind, this issue of Retirement Planning takes a specific look at some of the problems that increasing life expectancy is causing as well as looking at what advisers need to take into account when planning for the future.

Gregor Watt
Deputy editor
Money Marketing

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PERSONAL ACCOUNTS

The means season

Cherry Reynard asks what happens to the people beyond the advice scope

Is it possible that the new system of personal accounts will create thousands of pensions lepers – people who will be beyond the scope of financial advice? It is being suggested that once auto-enrolment is introduced, there will be a group of untouchables who, having opted out of the occupational pension their employer is compelled to provide, could not be advised by advisers without accusations of misselling. This could apply to existing or potential clients. So how real is the threat?

Steve Bee, head of pensions strategy at the Royal London Group, believes this is a significant and under-recognised issue facing advisers.

He says: "In the old days, there were two types of employee – those that were members of an occupational scheme and those that weren't. Those that were in occupational schemes were off limits to advisers because no one could realistically be advised to opt out of their company scheme.

"Post-auto-enrolment, there will be two types of employee – those that are in company schemes and those that have opted out. Once someone has opted out, they will be a pension leper – how many caveats would you have to offer as an IFA to advise that person? It would be impossible. This issue should be concerning IFAs for their existing clients and those they will no longer meet."

The Government is concerned that employers will coerce people into opting out to save themselves money, as has happened with the working time directive and as a result there seems likely to be considerable bureaucracy around opting out. Employees will have to send a letter to the DWP rather than their company and will have to be advised that it may affect their income in retirement. The personal accounts legislation has also made it clear that employers will not be allowed to pay their contribution as anything other than a pension.

There are valid reasons for opting out of personal accounts, means-testing being probably the most important.

Evolve Financial Planning director Jason Witcombe says: "If you only get basic-rate tax relief and then the pension you get erodes your means-tested benefits, you are in trouble."

Aegon Scottish Equitable head of pensions development Rachel Vahey agrees. She says: "For most people opting out, the biggest driver will be because they can't afford it. Means-tested benefits is a particularly tricky area."

Another potential issue is inheritance tax, where lump-sum death benefits from personal accounts could potentially be liable for IHT. But Vahey believes this is less of an issue as many people with personal accounts would not be going near the limit anyway.

But does opting out automatically rule out advice? Witcombe believes it will be possible to advise opted out people as long as there is a clear reason for their decision.

He says: "It would probably be easier to do this than try and recommend one product over another based on investment flexibility or something, when the only real difference is high commission."

Vahey also believes that as long as advisers go through it step by step and are transparent and clear, they will still be able to give advice.

Axa Winterthur head of pensions development Mike Morrison believes that many pensions savers will just take a "keep calm and carry on" approach rather than opt out.

He says: "They will probably opt in to their company scheme and then continue doing what they have always done on the side. You might be saving a bit more than you need but unless you happen to be losing it through means-testing, it's no bad thing."

> 'Savers will probably opt in to their company scheme and then continue doing what they have always done on the side. You might be saving a bit more than you need but unless you happen to be losing it through means-testing, it's no bad thing'

According to Morrison, the real problem comes in paying for advice. If people opt out because they cannot afford a personal account, they cannot afford a personal pension, so there is no potential commission. This option will be curtailed by RDR but there is always the option of charging fees. But Morrison says these people are unlikely to have the wherewithal to pay fees for financial advice either.

One solution would be for employers to pay for advice for their employees and this potentially represents a good opportunity for advisers.

Morrison says: "With the scheme as it is, it would make sense for IFAs to work for employers. There would be some incentive that could be passed from the employer to the IFA and given as a benefit in kind to the employee."

Witcombe says: "If there were some tax breaks or an obligation for companies to bring in financial advisers who could sit down with employees face to face, it could work." But he says this would need lighter-touch regulation to allow advisers to speak to big number of people. "We could not do a 30-page report for each of them."

If not, the current system needs to provide for some sort of decision tree or information campaign to enable people to make the correct decision on opting in or out.

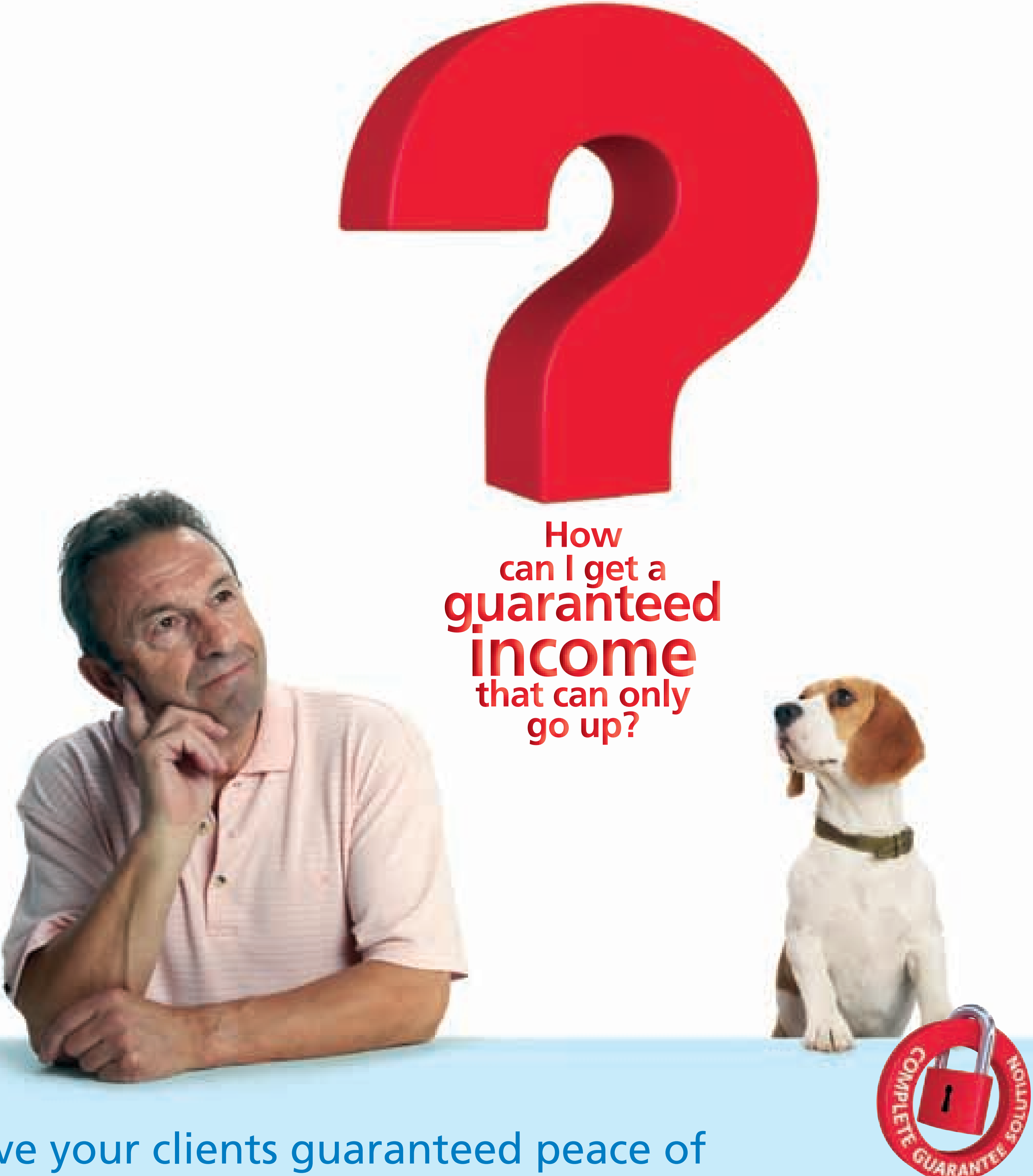
Certainly, any resolution to the issue for advisers is unlikely to be coming from politicians. The Conservatives will not change the auto-enrolment requirements, according to Bee, who has spoken with Teresa May on the issue.

It looks like within the current personal account structure, the main opportunities for advisers will be on the corporate rather than the individual side. Advising people for £50 a month pension contributions was unlikely to be profitable for advisers in a post-RDR world anyway.

Aviva head of pensions marketing Paul Goodwin says: "Advisers hold a lot of the relationships with small businessowners and others who need to know what is going on. These people will turn to those they know and trust as to whether the personal account scheme or an alternative scheme is appropriate."

There are undoubtedly a group of people for whom it will be very difficult to provide cost-effective advice post-auto-enrolment and the impact of pensions on means-testing is a real issue for the Personal Account Delivery Authority.

The extent to which these would have been important clients for advisers in a post-RDR world is debatable but this is yet another issue on which advisers will need clarity in the run-up to 2012.



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SAVING STRATEGY

Life saving lessons

John Greenwood considers the effects of increasing longevity

Advisers are well aware of the huge void between the public's expectation of what their retirement will be like and the stark reality. Many people expect a retirement that could extend well into three decades but the amounts they are saving point to retiring considerably older than they expect or a hand-to-mouth existence when they stop earning.

Pension professionals say the retirement saving structure has not adapted to changing demographics. In 1950, a 65-year-old male could expect to live a further 12 years. By 2008, that figure had risen to more than 21 years and by 2050 is expected to reach 25 years. These figures are averages, meaning around half of people will live longer, some considerably more so.

Factors such as low gilt yields and increased longevity may be beyond the control of Government, regulators and providers. Yet, while the need for retirement saving has increased, take-up of pensions has fallen.

Pension experts say radical changes are needed, beyond the pension reforms already in the pipeline, both to the way that pensions are drawn and in how consumers understand what retirement planning means for them. They also say the process of distributing products to individuals must be made more straightforward if private sector solutions are to succeed at all income levels.

One area where there is broad consensus for change across the pension industry is on the abolition of the requirement to go into alternatively secured pension at age 75. Most pension experts agree this should be coupled with a facility to allow any funds remaining in schemes on death to be passed down to dependants within a pension wrapper. With the state pension age rising to 68, experts argue that a raising or removal of the requirement to go into alternatively secured pension just seven years later at age 75 is long overdue.

Hargreaves Lansdown head of pensions policy Tom McPhail says: "I am comfortable with abolishing compulsory annuitisation altogether. If you have only got £25,000, you are probably only going to buy an annuity anyway. For anyone else, they can manage their assets more effectively if the age 75 rule goes. I would like to see surplus funds on death cascade down to children within a pension. This would make pensions considerably more attractive to the public."

Richard Jacobs Pension & Trustee Services director Richard Jacobs believes this would not cost the Government anything in terms of income and could, in fact, boost Treasury revenues. He says: "At the moment, people will buy an annuity to avoid the 82 per cent tax. The Government would get a smaller bite of a bigger cherry if they allowed people to remain in unsecured pension after 75 and then get 35 per cent on death."

Axa head of pension development Mike Morrison says: "Mortality drag means buying an annuity becomes increasingly attractive as people get into their 70s. But giving us the freedom to design products with a clear run from age 55 to death would make it easier for providers to address the problems that retirees are facing."

Even when the planned reforms to the pension system are implemented, more radical changes will be required if advisers are to be allowed to give people any chance of meeting their retirement objectives.

Standard Life senior pensions policy manager Andy Tully considers that real retirement ages will increase to between 74 and 86 for median-earners. He says it will be decades before auto-enrolment has done anything to redress the fall in pension incomes that will result from the flattening of state second pension. Someone earning £43,000 and reaching state pension age in 2030 will be £3,000 a year worse off than those retiring today, points out Tully, requiring a £78,000 pension pot to make up that shortfall.

Tully believes that product providers and regulators need to do more to make it easier for people to save. He says: "People have talked for some time about initiatives that encourage staff to pay more in, such as Save More Tomorrow, but it has not really taken off yet. More work in this area would help. No one is talking about getting rid of regulations altogether but the rules surrounding financial promotions could be simplified to make it easier to ask pension savers if they want to increase their contributions."

Tully believes annuities are not necessarily the best product for people who are looking to work through their retirement.

> 'Most people have no idea how long they are going to live and they generally underestimate it but they certainly do not invest in the way that their time horizon should suggest they do. People need to accept their assets are going to be around for a long time and if they put their money on deposit they are going to lose the bet'

He says: "The at-retirement phase needs to be made simpler and more flexible. Annuities do not really fit with flexible retirement because they are a once and for all decision. There has to be some way of getting a mid-market product that gives some growth with an income floor but it has to be at a price that people are willing to pay, and it is fair to say that now is not the best point in the economic cycle to introduce something like that."

Jacobs is sceptical of the role of downsizing and equity release to solve the pension crisis and says people need to be encouraged to change their mindset if they are to make their money work over several decades of retirement.

He says: "Most people have no idea how long they are going to live and they generally underestimate it but they certainly do not invest in the way that their time horizon should suggest they do. People need to accept their assets are going to be around for a long time and if they put their money on deposit they are going to lose the bet."

This is not an easy argument to get across to people. Jacobs says the role of advice is crucial to increasing understanding of pension saving rates but he is concerned that the effects of the retail distribution review will only make that harder.

"More education in relation to risk is vital if people are to make their retirement pots work for them over several decades. The problem is that face-to-face advice is the only way to achieve this level of understanding and you can only deliver this to the people that really need it through a commission-based model," he says.

LONG-TERM CARE

Parties battle for LTC vote

Do the main parties have genuine solutions to restore the crumbling long-term care system or is it all just electioneering? **Lee Jones** reports

The consultation process following publication of the Government's green paper on the future of UK long-term healthcare ended last week and industry experts will gather their thoughts to form a white paper in 2010. Since the publication of the green paper in July, the issue of long-term care has moved up the agenda and the Conservatives announced their own ideas to solve the UK's impending care crisis at their party conference.

But are the main parties on the right track to solve the huge problems facing an indebted country with an aging population or is this a case of electioneering?

Age Concern and Help the Aged head of policy Andrew Harrop welcomes any political "bidding war" between the parties on how to fix the crumbling care system. He says: "I hope this signals that care will be central to the political debate in the run-up to the next general election.

"If these proposals can be made to work at this cost, they could provide huge relief for many older people and their families."

Labour has came up with three options:

- A partnership approach where everyone is entitled to a set level of care contribution regardless of means, allowing individuals to top up their funds through private products.
- A voluntary pre-funded insurance scheme with a level of state backing.
- A compulsory pre-funded scheme whereby everyone is forced to pay a tax at a certain point in their lives.

After the announcement, health minister Andy Burnham admitted that all the proposals may be subject to a sliding scale to determine who pays what.

Opinion is divided over which proposal will be the most suitable and most effective way to pay for long-term care.

Partnership managing director Chris Horlick says the shared approach is best as it combines state aid with private investment. He says: "This would offer something for everybody. But the state cannot pick up the whole tab so it is fair that people are able to find their own solutions to make up the difference."

Horlick says any insurance scheme, either voluntary or mandatory, will not catch on. "There is always a significant risk that you will never need to spend the money, so people will see a pre-funded scheme as a waste of money," he says.

But Bupa head of policy Matthew Flinton says: "The care system is underfunded and is only going to get worse, so the comprehensive model must be enforced whereby a mandatory contribution is made by everyone. People underestimate the likelihood of needing care and they still seem to think that the state will pay for them."

Bupa estimates that if a 40-year-old person contributes as little as £40 a month into a mandatory, pre-funded insurance scheme, they would be able to afford any taxes on them by the time they reach 65.

Flinton says: "If people know that they will have to make a contribution at a certain date, they will make provisions to be able to do that. Depending on how early

'The care system is underfunded and is only going to get worse, so the comprehensive model must be enforced whereby a mandatory contribution is made by everyone. People underestimate the likelihood of needing care and they still seem to think that the state will pay for them'

they begin those provisions, this need not be expensive."

While opinion is divided on the three main proposals, all agree that the green paper has a gaping hole as the proposals will only pay for care rather than the "room and board" aspects of living in a residential home.

Flinton says: "Half of the cost of care is living costs and those who suffer worst are those who are in care for a long time and it adds up to quite a lot of money for a lot of people. It undermines the green paper as a solution as half of people's costs are not covered. Omitting such a large cost is not the right approach and it is surprising that it is not in the scheme."

The green paper also proposed a "National Service" that combined aspects of long-term care with the NHS. At the Labour Party conference in September, Prime Minister Gordon Brown pledged that it would help 350,000 of the "most needy" people in their own homes.

Horlick says this "bizarre" announcement could result in a multi-millionaire receiving state aid but someone just above the means test threshold receiving nothing. He says: "What does that mean? Who are the most needy? The Government says it will spend around £650m to do this but that equates to £6 a day per person. That is barely enough to cover a domiciliary getting to someone's home - it just does not stack up."

The Conservative Party has proposed a different model for the funding of elderly care. It says a voluntary payment of £8,000 at retirement would pay for all those who

need care, without anyone having to sell their home to pay for the privilege.

Key Retirement Solutions group director Dean Mirfin says any voluntary proposals will fail. "Politicians have forgotten that there was a pre-funded market and it died. The problem is that no one wants to admit they will ever need care regardless of the statistics."

The Tories surmise that a fifth of retirees need care but Mirfin says those who are the most likely to pay the money are the ones who are already ill or those who have a history of illness in the family.

He says: "As a result, the percentage of those who pay for care compared with those who need it increases. You would end up with one in three instead of one in five using the proceeds and then it all falls down. The numbers would not work, so the state would have to pick up the pieces."

Symponia managing director Janet Davies says both sides are merely trying to spin the proposals as "vote winners" to appease middle-income people who miss out on state aid thanks to means testing and end up having to sell their home to pay for care. Both parties have made sure to pledge that any long-term care proposals mean people do not need to sell their home.

She says: "Both Labour and the Tories are trying to make the state the good guy and to put the decision of selling the home on the homeowner. Accommodation and food will cost more than the care but by saying people do not have to sell their home to afford 'care' takes a lot of the negative emotion from what needs to be done. We live in a country where our home is our castle and no one wants to sell that home."

Davies says the small weekly allowances from all proposals on the table will mean that anyone who wants better quality care will still have to pay and as a result will probably have to sell their home anyway. "These proposals are presented as a totally different approach to funding long-term healthcare but in reality it is the same. It is just spin," she says.

Horlick says the green paper should have addressed these "middle" people more affectively. He says: "The local authority means tester should point any person who does not qualify for state aid towards an appropriately qualified financial adviser.

"No one has picked up this need for independent financial advice in any of these proposal. If they made it law that those who don't qualify are advised to seek advice, then many more people would be helped to properly plan their long-term healthcare finances."

The Government will publish its white paper in 2010 and experts hope that a little more can be gleaned as to the future of long-term healthcare funding in the UK before the election.

Horlick says: "If politicians were a little more honest about the fact that the vast majority of people will have to pay for the majority for their own care, then people could begin saving for it properly."

Industry must show it can offer solutions

The need for a real shake-up in long-term care has never been more apparent. Britain is undergoing a demographic transformation that will see a dramatic ageing of the population.

For the first time, over-65s outnumber under-16s and by 2030 there will only be two people of working age for each person in retirement. This compares with a ratio of four workers per pensioner today.

Working out how we fund support for our ageing population is of paramount importance to individuals and their families but also to local authorities, the health service and the taxpayer, who are ultimately responsible for looking after those who cannot afford to pay themselves.

The issue of how the UK pays for the care of our elderly has burst to the forefront of the political debate in the last six months and is set to remain there long after next year's general election. Current funding arrangements are not working and all the major political parties agree that major reform is necessary.

A range of providers have expertise which can help shape the debate and it is vital that they all participate fully in the policymaking process.

The shifts in the UK's demographics provide a number of opportunities for insurance brokers and IFAs.

Providers and advisers, along with care homes and local authorities, have a real duty to raise public awareness of available products which ensure that elderly people do not use up all their assets to pay for long-term care. These products exist now and yet we still see hundreds of self-funders a year run out of money and fall back on the state.

Tackling this will benefit individuals who face difficult decisions at a vulnerable stage of their life, relieve pressure on the public purse and demonstrate that the financial services sector can offer solutions to some of the biggest challenges facing this country.

Chris Horlick is managing director of care at Partnership Assurance

SIPPS

Property principles

Philip Scott considers the future of property investments for Sipps

Sipps and residential property have a poor history. Ever since Gordon Brown's last-minute U-turn on residential property, Sipps investing in anything other than an authorised, listed commercial property fund or a straightforward bricks and mortar purchase seem to have been riddled with problems.

In the run-up to A-Day, advisers and providers were expecting a residential property bonanza as the British public seemed sure to further indulge in their favourite investment, this time with the benefit of tax-efficiency by funding the purchase through pension contributions.

Brown's actions as Chancellor, although unpopular at the time, may well have saved many investors some money, at least on current property valuations. But his last-minute decision to exclude residential property left a lot of pent-up demand.

Since then, several companies have attempted to fill the void by offering property investments that fall somewhere between commercial and residential property but several have not lasted that long.

One of the first companies to try and fill the gap was Guestinvest. The company offered investors the chance to buy individual hotel rooms and get an income based on the room rental and a number of free nights accommodation. With promised annual returns of at least 6 per cent a year, the option attracted a lot of interest but the company went into administration in October 2008.

Another specialist approach to property investment was closed down last month when Freedom Sipp was placed in administration. Among the other mainstream investment options available to members, Freedom Sipp offered investors the chance to buy French and Canadian sale and leaseback holiday property through their pensions, again with guaranteed rates of return.

Although the problems that led to the winding-up of Freedom related to outstanding tax bills, there has been some reluctance among other Sipp providers to accept a transfer of the overseas property investments due to concerns that they do not comply with HMRC's rules on allowable investments.

So is this the end of unusual property investments for Sipps?

Today, most investors will be limited to a choice of commercial property, UK real estate investment trusts and "genuinely diverse commercial vehicles".

For many IFAs and their clients, commercial property funds are the most appealing option due to the diversification, liquidity and lower purchasing costs they offer over a direct purchase.

Baigrie Davis director Amanda Davidson says "The point here is diversification, which is important for investors. Sipp investors can invest directly into a commercial property if they wish but doing so will involve them in lots of transaction and costs."

But there are still one or two unusual investment opportunities available for investors determined to find something different.

The definition of commercial property can include farmland or commercially managed woodland and, although purchases of commercial property directly tend to focus on Sipp members own business premises, a Sipp can in theory buy any commercial property such as pubs, shops or car parks.

The last few years have seen the emergence of several student accommodation funds, with investment funds now available from specialist investment companies such as Unite, Brandeaux and Braemar.

Several of the funds have shown consistent investment returns in the last 18 months when most other investments have suffered some downturn. But the lack or regulation of some funds coupled with an offshore domicile means giving up some elements of investor protection and liquidity of some funds can also be an issue for investors.

For those determined to got some exposure to residential property, a new fund launch may be of interest. Dualinvest is distributed by Smith and Williamson and available through several Sipp providers, including, AJ Bell, Alliance Trust, Rowanmoor, Sipp Choice, Standard Life and Suffolk Life.

The close-ended fund is open for a minimum investment of £10,000 and is aiming to raise £25m to invest in empty new build residential property. The fund aims to by 65 per cent stakes in the properties from the housebuilders, with the builders then paying rent back to the fund.

The rent is paid up front for two years and after this period the property would then be re-sold. The fund aims to pay investors an annual return of at least 7 per cent and investors can also get 15 per cent of any upside profit but capital is protected if the portfolio's value does not drop by more than 30 per cent during the two years.

> 'The point here is diversification, which is important for investors. Sipp investors can invest directly into a commercial property if they wish but doing so will involve them in lots of transaction and costs'

Derek Uittenbroek of Smith & Williamson says: "Investors get their income upfront rather than having to worry about rent collection or occupancy rates. Meanwhile, the downside safeguard shields them from fluctuations in the market while still allowing them to enjoy a share of any potential gain."

Davidson, does not think she would necessarily jump on recommending this product but adds: "I don't think that granting investors only 15 per cent of any upside is that attractive but I do think that investors will be attracted to residential property as an investment in their Sipp. We are obsessed with property in this country. Even when it goes down we love it."

Regardless of whether the property investment in question is a single commercial unit, a diversified commercial property fund or a listed residential property fund, many advisers say investors need to be wary of having too high an exposure the asset.

Informed Choice managing director Martin Bamford says that most homeowners should be wary of residential property funds. He says: "Individuals need to avoid over- exposure to a single investment asset class. If you already own a property, you arguably have enough of your own wealth invested."

Hargreaves Lansdown pension analyst Laith Khalaf says the firm is starting to see some value in commercial property after two torrid years of investment performance.

Khalaf says: "We have been bearish on commercial property for some time but are beginning to see some value in the sector."

But despite the optimism, he says investors in commercial property should limit their exposure who recommends a typical maximum of 5 per cent exposure.

INTERVIEW

Default dynamics

Pension Income Choice Association chairman Tom McPhail talks to **Gregor Watt** about the aims and ambitions of the new body

What is the reason for the formation of the Pension Income Choice Association?
The system does not work – or the system does work but very imperfectly. There has been a lot of good work from the ABI, the NAPF, the FSA, the Pensions Regulator and TPAS, everybody has had a look at it and given it a bit of a kick, with mixed fortunes and success. There has been some progress but not nearly enough.

The other reason we are doing this now is because of the particular timing. The baby boom demographic bulge is about to move through into retirement so a lot of people need a better solution than is currently available. We have the launch of personal accounts, which is another reason to get the defined contribution system right now. We have got the decline of defined benefits, which is another reason to get the money purchase system right. And look at the political calendar. We are moving towards an election and there was an opportunity to talk in specific detail to policymakers and that is not there all the time.

There is also the changing nature of the annuity market, the move away from standard rates towards bespoke underwriting, postcodes, enhanced, personal underwriting. There is no default solution you can put in front of someone and know it will be right for them. Whatever the default solution, it will almost certainly be the wrong answer so it is imperative that we get people shopping around.

Has the ABI's Options initiative done a good job so far?
Options is great. It simplifies the process of moving money through the system. Once you are in the shopping around process and you have identified that you want to move from company A to company B, Options will help that happen faster and more easily. If I had my way, every defined-contribution pension provider, every Sipp, every DC scheme, every insurance company would sign up to Options and I hope the process will come to work faster than at present.

Pica's position is that the open market option has to become the default option for pensioners at retirement. Is this the association's most important goal?
That is the core proposal, yes. That is the central recommendation and the one we are focusing on when we are talking to policymakers and regulators because until we do that, we don't believe that we will be doing anything more than chipping away at the margins of the problem. Whereas if we can nudge investors' behaviour towards seeing the shopping around process as the default, as what everybody does, then we will see meaningful increases in the use of the open market option.

'The baby boom demographic bulge is about to move through into retirement So a lot of people need a better solution than is currently available'

Supporting that one fundamental change, there are a number of other recommendations that we have got such as the use of a one-page universal form to assist with the shopping around process, to get the NAPF to adopt the shopping around process as one of its quality mark tests for DC schemes, to introduce the register of IFAs who will deal with small pots of money. But the key message is make shopping around the default.

The Pica manifesto also mentions the role of occupational pension schemes and pension scheme trustees in making sure people consider their options. What else should DC schemes be doing to promote the open market option?
The Pensions Regulator has been doing some good work here. It has been reviewing trustees progress, highlighting good practice, so we are not looking to tread on their toes. We would like to see trustees adopting the same approach as we are recommending for insurance companies, which is that every single scheme member is pre-

sented with the shopping around process as the default. In principle, that should happen already but the Pensions Regulator's latest report highlights the fact that that is not the case universally. We would like to see that adopted as best practice.

You've called for the establishment of a register of IFAs willing to advise on pension funds of less than £50,000 but many IFAs say this is uneconomic for them, particularly if they are charging a fee. What is the solution for this – better technology?

There is not one answer to the question. First of all, if we make the shopping around process the default, that should significantly expand the demand and that should hopefully mean that there are greater rewards available to intermediaries and annuity providers. I think technology will to some extent will come to our aid here and the likes of TPAS have been looking at online decision-making tools to help people. We do not have all the answers on that score. Some intermediary businesses such as Hargreaves Lansdown, Kerr Henderson, Rockingham and others have come up with models that either partly or wholly address this problem. A lot of the answers are already there within the industry.

You have called for a number of consumer education initiatives such as better FSA comparison tables, better money guidance and direct to consumer propositions. Is there a chance that consumers will end up with a little bit of knowledge and end up with the wrong products?

In a perfect world, every investor would get regulated advice at retirement but I don't think anyone is pretending that is going to happen. Setting that aside, whatever we come up with has got to be better than what we have got now. The majority of the marketplace appears to be making decisions which appear not to be in their best interest. And that is about not just the rates that they are getting but about the shape of their retirement income. One of the issues we want to move on to next is the issue of death benefits. With the preponderance of pension rights held in men's names, what are we doing to ensure their spouses are well provided for because we know the majority of annuities are set up on a single life basis. How can it be worse than where we are at now? What we are trying to do is get people the engage with the buying process and make an informed decision about what is best for them. That looks to me life a good idea.

You have called for a review of the trivial commutation rules. What level do you think this should be set at?

I am not prescriptive about that. I would like to open the debate on it and I know there will be resistance from some quarters because as soon as you start tinkering with trivial commutation there is a risk that you will be seen to encourage individuals with small pots of money just to take all the money out and blow it. I recognise that that is a hazard and it will be a challenging conversation. Nevertheless, it is part of the overall picture. If we can find a way to take some of the very small pots of money out of the annuitisation system, thereby eliminating the potentially non-profitable business both for individuals and insurance companies, if we can do that in a way that does not act to the detriment of consumers' overall financial position, that also is a good thing.

'If we make the shopping around process the default, that should significantly expand the demand and that should hopefully mean that there are greater rewards available to intermediaries and annuity providers. I think technology will to some extent will come to our aid here'

What do you think should be the decumulation process for personal accounts?

We are in discussion with Pada. Pada have said they want to move to have a panel of providers – that in effect is limited Omo. But it comes back to the fact that there is no default annuity. Even for the most disinterested investor, you can't decumulate your fund without making at least one of two decisions. So the default position already is that everyone has to make a choice. What we are trying to do is to make that choice as easy and as effective as possible and to try and improve that decision-making process. Pada are interested in where we are going with this, with some of the systems around how we communicate with investors. I am speculating here but they may end up adopting some of the processes from the Pension Income Choice proposals, partly to work with their existing panel and partly as an option to step away from their exiting panel, particularly where members have larger pots of money.

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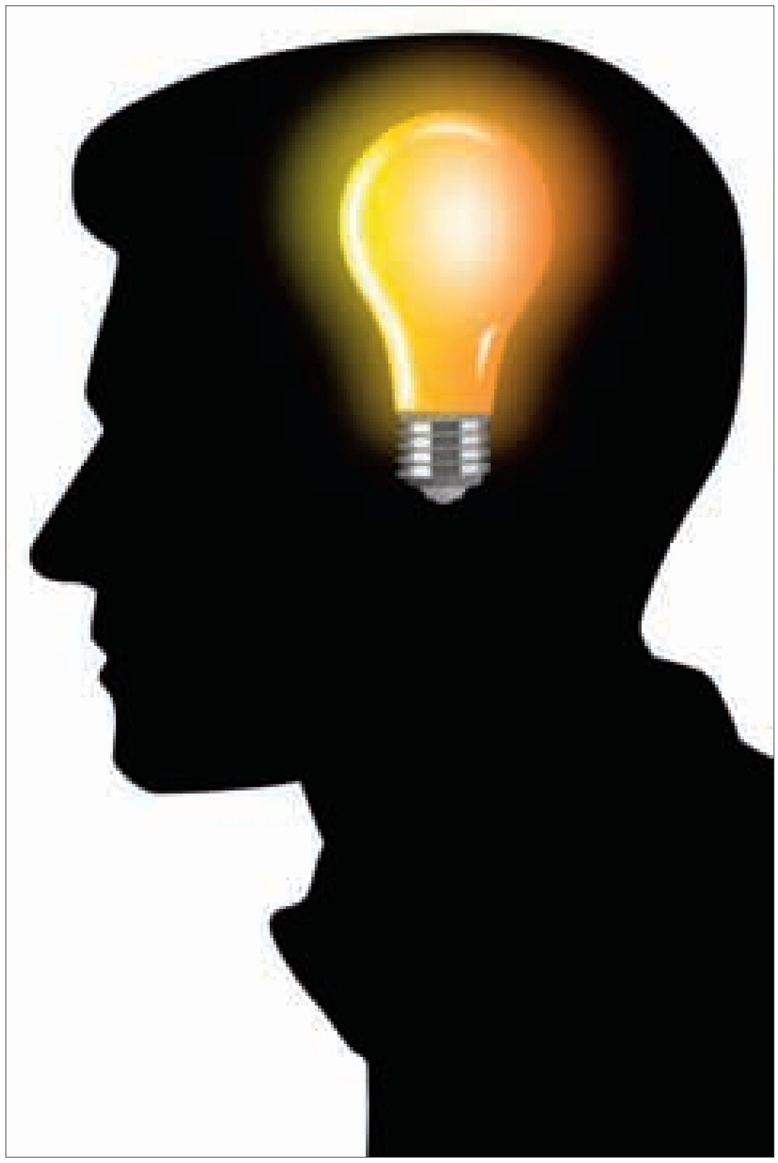

Quantitative easing, stretching longevity and low rates are adding to annuitants' woes but at least product providers are being innovative. Report by **John Greenwood**

For hundreds of thousands of pensioners, falling annuity rates have been one of the more serious effects of the economic downturn. But the extent of product development in the at-retirement market shows that the industry cannot be accused of overlooking the needs of retirees.

With Aviva, MGM Advantage and LV= looking at product innovations, advisers should soon be able to offer clients greater choice outside the traditional annuity market.

The Bank of England's quantitative easing policy and further stretches to longevity predictions have combined to pile the misery on annuitants, many of whom have been crystallising benefits at a time when their DC pots have already taken a hammering.

In September 2008, before Lehman Brothers filed for bankruptcy, a £100,000 pot would buy a non-smoking 60-year-old male a level income of £7,040.

Roll forward 14 months and the best available income has fallen to £6,300, a drop of 10.5 per cent, according to figures from Alexander Forbes Annuity Bureau.

As Government fiscal policy puts more pressure on gilts, the arguments for opting for an asset-backed annuity should be increasing but experts agree that the public's perceptions of what has happened over the last 18 months means that there has possibly never been a harder time to sell equity-linked products to annuitants. And with escalation proving so expensive now, advisers are still seeing the majority forgoing inflation protection despite warnings that the unravelling of quantitative easing could seriously erode the value of their income over time.

Alexander Forbes Financial Services proposition director Tim Whiting says: "The overwhelming majority of people still want the level option when it comes to annuities. Even though the figures may show that 71 or 72 is the break-even point for taking the inflation protection and Glaxo may invent a pill that keeps you alive until you are 200, people don't want to take the hit in the early years.

"With-profits or other asset-linked annuities are one way of dealing with the longevity problem, especially in light of the massive reductions in gilt yields. Quantitative easing is really hammering annuity rates and looking for some investment element makes an awful lot of sense. But that involves people taking risk, when their experience of markets over the last year has been terrifying. Going into the stockmarket at a time like this is counter-intuitive for a lot of people."

The Retirement Partnership director Billy Burrows agrees that investors have less stomach for the risk that equity-linked annuities entail. Burrows says: "I see a flight to quality. Forget what anyone tells you about interest in asset-backed annuities being on the increase. If people are in annuities, they are going for straightforward level products and many of those in drawdown are largely in cash."

Burrows concedes that Prudential's Income Choice product has gained some traction but believes interest has come from those taking a step away from drawdown rather than those previously likely to take a conventional annuities.

Prudential head of business development for pensions Vince Smith-Hughes says people can be attracted out of drawdown when they realise what mortality drag is doing to their retirement planning.

Smith-Hughes says: "Once you get over age 70, there is a 2 per cent difference between the return you need from drawdown and that required from an asset-linked annuity to generate the same income. But there are, of course, better death benefits and income flexibility with drawdown."

> 'We are coming across more and more 'distressed drawdown' cases who feel the rise in equity markets has given them some room for manoeuvre but who are adamant that they don't want to put themselves through the roller-coaster again'

Experts do see mileage in fixed-term products that allow an investor to draw an income and guarantee their principal sum while keeping their options open. Consumers can easily understand that they could enhance their annuity income if some form of ill-health takes hold before the age of 75 and advisers have welcomed the news that both Aviva and LV= are planning to launch fixed-term products to compete with current sole operator Living Time.

But MetLife has moved to counter reports that it intends to join Aviva and LV=, saying that while it has an ambition to launch in the sector, it remains no more than that at present.

Living Time managing director (sales & marketing) Dave Harris says the near 50 per cent rebound in share prices from last March's trough is offering traumatised investors an acceptable exit route into something more stable.

He says: "We are coming across more and more 'distressed drawdown' cases who feel the rise in equity markets has given them some room for manoeuvre but who are adamant that they don't want to put themselves through the rollercoaster again."

Another trend emerging as clients battle with the risk/reward dilemma is interest in taking more than one annuity. Burrows says: "Some people are buying several annuities and therefore spreading their risk around. It could be 50 per cent level and 50 per cent inflation-linked or with an element of with-profits in there such as Pru's Income Choice which seems to be gaining some traction."

Splitting your pot across several annuities becomes more attractive the more choices you have. Advisers and clients may not welcome the current rates on offer but at least they can look forward to some product innovation.

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