NAPF Securing the future of pensions | Pensions Institute | Cass Business School CITY UNIVERSITY LONDON

Press Release

Embargoed to 00h01 Saturday 4 February 2012

SAVERS LEFT SHORT-CHANGED AND BEWILDERED BY UNFAIR ANNUITIES SYSTEM

Millions of private sector workers saving for their retirement are stuck with a hugely unfair and opaque annuity system which lops up to £1bn off pension incomes every year, pensions experts warned today.

A joint report by the National Association of Pension Funds (NAPF) and the Pensions Institute (PI) at Cass Business School found that around half a million people retiring each year are being short-changed by up to £1bn from their total future pension income, because overwhelming obstacles stop them getting the best deal.

The report also uncovered evidence of sharp practice and murky pricing in the annuity market, putting unsuspecting consumers at a huge disadvantage.

The £1bn loss could treble in size to £3bn over the next decade as the annuity market matures and as up to 8m people start being automatically enrolled into workplace pensions from 2012. And around 20% of these losses are passed on to the public in the form of lost taxes and higher means-tested retirement benefits.

When they retire, people in the private sector saving in a 'defined contribution' pension – now the most common form of company pension scheme – use their pension pot to buy a product called an annuity from an insurer. This gives them a regular income and is a one-off, irreversible decision that sets the size of their pension for the rest of their life.

The process for choosing an annuity is a complex one and the majority still go for the 'default' option by sticking with their pension scheme provider. This failure to shop around for a better deal can wipe 30% off their annual pension income, and in some cases up to 50%.

The NAPF/PI report found that it is too difficult for savers to get the best deal:

- 80% of savers have pots of less than £50,000, and most annuity advisers will not find it profitable enough to advise on pots of this size. So the ‘open market option’ (OMO) shops where they can find the best products and rates are effectively shut. This will have a real impact on the millions of low to median earners auto-enrolled into a pension.

- Fewer than one in five people have the financial know-how needed to pick the right annuity at the best price. The rest lack sufficient understanding of factors like interest rates, inflation and longevity, and need some form of advice.

- Those savvy enough to ‘shop around’ for the best rate struggle to do so because the best shops are not signposted. It is virtually impossible to find a specialist adviser who covers the whole market and who is willing to help those with smaller funds.

- People get too little support from employers or providers when making a decision about their annuity – often they get nothing more than a leaflet pointing them to a website with a postcode-based search engine.

The report, partly based on extensive interviews with companies that cover 80% of the annuity market, also discovered that annuity prices are heavily manipulated:

- There is a severe lack of transparency and understanding about how annuities are priced, especially for those with medical conditions who could qualify for a much higher level of pension income.

- Annuity advisers say some insurers push rates downwards at certain pot sizes when they see a group of people approaching retirement, as they expect many will not look for a better deal and will accept the insurer’s first quote.

- Annuity rate bands can have ‘cliff-edges’ which mean that rates outside of the commonly quoted £50,000 and £100,000 benchmarks suddenly drop off and become much worse, penalising customers who could get a better rate by having as little as £1 more in their pot.

- Most savers pay commission when they annuitise. It is factored into the annuity rates of most providers whether the saver gets advice on annuity choice or not.

Joanne Segars, Chief Executive of the National Association of Pension Funds, said:

“The annuity market desperately needs to be straightened out if the UK is to pay for its old age. People are saving through their working lives only to end up short-changed by a toxic system. Every year a billion pounds that could have been paid out in pensions instead disappears down the plughole of a murky annuity market. Lower and middle income workers are especially vulnerable.

“There is no point in encouraging people to save if we do not help them get the most out of their savings. Too many end up stuck with the wrong annuity at a bad price. Those about to retire need to shop around for a good deal, but how can they do that if the shops are either shut or impossible to find?

“The way the market is priced and structured must become more transparent, and people need stronger support in picking the right annuity. The Government and the industry must work harder to create a clearer, fairer system that delivers better value for money.”

Professor David Blake, Director of the Pensions Institute at Cass Business School, said:

“This report is a wake-up call to the pensions industry, the government and the regulators. If the annuity system is not radically overhauled, employees in defined contribution schemes in the private sector will continue to suffer massive detriment and the government’s new auto-enrolment regime will fail the very people it aims to help secure financial independence in retirement.”

The report coincides with the deadline for consultation by the Association of British Insurers on an industry code around annuities which aims to encourage shopping around through promoting the ‘open market option’ (OMO).

The NAPF/PI report recommends:

- People should automatically shop around for the best annuity when they retire. They should be helped to access the whole of the market, instead of only getting quotes from the insurer. A new OMO process, built into all pension schemes, would ensure that people get the best deal.

- The Government should set clear baseline measures and monitor the evidence on ‘shopping around’ and the working of the annuity market more closely. If there is no improvement it should consider a national annuity support and brokerage service.

- Greater transparency is needed to increase competition and trust levels. The Government, the Financial Services Authority, and the ABI should drive transparency in annuity pricing, commission and retention business through greater disclosure.

- Employers and trustees should be able to support staff with retirement decisions without fearing legal comeback. Clearer and simpler rules need to be set for workplace advice, which could help create ‘safe harbours’ for employers to discuss pension matters with staff.

Notes to editors:

1. The NAPF and Pensions Institute report ‘Treating DC scheme members fairly in retirement?’ investigates the operation of the annuity market for members of contract- and trust-based Defined Contribution schemes in the private sector workplace. The UK has the largest annuity market in Europe. Currently this is worth about £12bn per annum and is expected to increase to about £23bn by 2014-15. The report is available here: http://pensions-institute.org/reports/TreatingDCMembersFairly.pdf

2. The report’s author, Dr Debbie Harrison, is a Senior Visiting Fellow of the Pensions Institute, Cass Business School, a pension consultant to the NAPF and the Organisation of Economic Cooperation and Development, a regular contributor to the Financial Times, and a trustee of the Financial Inclusion Centre.

3. The NAPF is the leading voice of workplace pensions in the UK. We speak for 1,200 pension schemes with some 15 million members and assets of around £800 billion. NAPF members also include over 400 businesses providing essential services to the pensions sector.

4. The Pensions Institute at Cass Business School was founded by Professor David Blake in 1996. As the first and only UK academic research centre focused entirely on pensions, the Institute brings together a broad range of disciplines from economics, finance, insurance, and actuarial science through to accounting, corporate governance, law, and regulation.
The objectives of the Pensions Institute are to undertake high quality research in all fields related to pensions, to communicate the results of that research to the academic and practitioner community, and to employers and trustees.

5. Cass Business School, which is part of City University London, delivers innovative, relevant and forward-looking education, training, consultancy and research. Located in the heart of one of the world’s leading financial centres, Cass is the business school for the City of London.
Our MBA, specialist Masters and undergraduate degrees have a global reputation for excellence, and the School supports nearly 100 PhD students. Cass offers the widest portfolio of specialist Masters programmes in Europe and our Executive MBA is ranked tenth in the world by the *Financial Times.*
Cass has the largest faculties of Finance and Actuarial Science and Insurance in Europe. It is ranked in the top 10 UK business schools for business, management and finance research and 90% of the research output is internationally significant.
Cass is a place where students, academics, industry experts, business leaders and policy makers can enrich each other's thinking. For further information visit: www.cass.city.ac.uk.

Contacts:

Paul Platt, Head of Media and PR, NAPF, 020 7601 1717 or 07917 506 683, paul.platt@napf.co.uk
Christian Zarro, Press Officer, NAPF, 020 7601 1718 or 07825 171 446, christian.zarro@napf.co.uk
Miranda Thomas, PR Manager, Cass Business School, 020 7040 5274, Miranda.thomas@city.ac.uk