



## Financial Services User Group (FSUG)

### FSUG draft response to the study on the performance and adequacy of pension decumulation practices in four EU countries (26-10-2016)

#### Background information

The ultimate objective of the study was to look at pension decumulation from the perspective of the customer through a qualitative assessment of which decumulation options result in the most adequate and safest old-age income as well as by identifying existing shortfalls and analysing their causes.

The study was limited to four of the seven countries selected by the FSUG, namely Germany, the Netherlands, Poland, and the United Kingdom. The choice of these four countries was explained by the research team as reflecting well the huge differences that exist today in terms of markets, decumulation products's providers and consumers' situations across the EU.

The research team was asked to answer a series of questions from the perspective of the consumer, using two profiles:

- a pensioner with average accumulated assets typical for the analyzed country and pension scheme
- a pensioner with a small pension pot to decumulate (less than half the average accumulated pension pot).

#### General remarks

- The outcomes of the study were affected by the lack of publicly available and reliable data regarding pension decumulation products and market performance at national level.

FSUG recommendation: Given the growing diversity and complexity among pension decumulation products and the role these products are expected to play in the future adequacy of old age income, the EU should propose some concrete initiative to improve access to a publicly available and comprehensive set of data to support consumers' informed choice (national comparative tools).

- Within the scope of this study, the lack of comparable data did not allow accurate benchmarking between the four analyzed countries.

FSUG recommendation: If the EU wishes to support cross border mobility of workers and promote a single market for pension decumulation products, they should propose to develop a set of mandatory comparable data collection on pension products performance and safety to allow consumers' choice cross border.

## Comments on main findings

- The huge complexity of products offer does not benefit the average consumer

The study highlighted an issue that was raised by FSUG, i.e. the complexity and huge diversity of pension decumulation products as a result of the move from DB schemes to DC schemes and increased reliance on personal pensions to ensure an adequate income in old age. The huge complexity and diversity of the current offer does not seem to benefit the average customer but rather the wealthiest.

FSUG recommendation: With the growing trend to reindividualize the risk of old age income adequacy and the longevity risk, it is important to ensure that the current EU initiative to set a EU pillar of social rights will include measures to adequately protect consumers, including those with average and below average pension pots to ensure they will have access to suitable decumulation products for their profile.

- The size of the pension decumulation market depends heavily on the existing statutory pension schemes

The most developed of the four studied markets was found to be the UK, where the annuities market boomed as a result of the shift from DB to DC and, to 2015, a *de facto* requirement to annuitise accumulated pension savings (or incur severe tax penalties). While in Germany and in the Netherlands, the market is still relatively small because the social security schemes play the main role in pension provision and cover most of the pension needs. In Poland the market is too young to draw lessons yet.

FSUG recommendation: From the average and below average pot holder's perspective, mandatory statutory pension schemes should remain the main pension income sources. Policy makers should thus ensure that the mandatory statutory pension schemes guarantee an adequate income in old age including for the average and below average pension pot holder.

- Impact of regulation on consumers choice

The study gives a good overview of how regulation influence consumers choice through regulating information on fees, creating tax incentives and facilitating consumer access to comparative information on available decumulation products.

FSUG recommendation: Obviously regulation seems to deliver positive outcomes for consumers. Yet more is needed to ensure that consumers have easy access to comprehensive, reliable and comparable information to make an informed choice. Comparing fees of products which are of different nature such as annuities and drawdown products is not easy for an average consumer who may underestimate the costs of additional advice he will need to manage his drawdown portfolios over the lifetime of retirement, reducing the net return available from drawdown schemes.

The FSUG recommends more research to be done to develop methodologies that would allow more reliable comparison between pension decumulation products to support informed choice among consumers with average and low pension pots (wealthier consumers have the means to buy specialized financial advice).

- The pension decumulation market is opaque and not cost effective

The study shows that the pension decumulation market is opaque and does not seem to be cost effective from the perspective of the average consumer. For most consumers it is not possible to understand and compare the diverse and complex offer of annuities. For drawdown products, there is even no comparable data to analyse the pros and cons of each product and to benchmark products. It is even difficult for experts to find all information to make an informed choice. In all studied countries, the study confirmed that the annuitization of the pension pot is the most common option.

FSUG recommendation: Regulators should take action to ensure that simpler, more effective and sustainable annuity products are available and recommended in priority to consumers with average and below average pension pot to decumulate, while other types of decumulation products should be only open to those who already have enough income from annuities.

➤ It is very difficult to assess the impact of taxation and tax incentives

As highlighted by the study, *“taxes on pension benefits during the decumulation phase depend on taxes on contributions paid during the accumulation phase. {...} Hence, assessing the economic value of pension decumulation products by taking into account the taxation of decumulation products but not the taxation of contributions paid during the accumulation phase would bias the tax burden.”*<sup>1</sup>

Pension products are long-term products on which different taxation regimes may apply overtime both during the accumulation phase and the decumulation phase. For example, in France, annuities are discriminated tax wise compared to cash withdrawals.

FSUG recommendation: First of all, the FSUG would like to stress that take up of personal pensions should not be encouraged by tax incentives. Indeed tax incentives do not encourage additional savings for retirement but have the effect of diverting one form of savings into another (tax advantaged) form of savings. Tax incentives favour better off consumers who can afford to save for a pension benefit at the expense of other tax payers.

Having said that, today it is very difficult to assess the impact of taxation on consumers' choice and whether the decumulation products they choose is the best option for them. The FUSG therefore recommends more research to be done on the impact of taxation and tax incentives during the accumulation and decumulation phase as well as the challenges that consumers willing to purchase decumulation products cross border might face if the taxation regime during the accumulation phase was different from the taxation regime in the country they wish to buy their decumulation products, to avoid cross-border double taxation issues or tax avoidance tourism.

➤ What impacts consumers choice

The study gives a good overview of availability of consumers choice in the four studied countries and looks at the factors that affect consumers choice. However they highlight the difficulty to assess in a reliable way what really affects the choice of consumers with an average or below average pension pot. According to the research team, *“the lack of information does not seem to prevent consumers making an appropriate choice. Thanks to disclosure requirements, publicly available information and online comparison tools, a great deal of information is available to consumers. However, even if information is available, the complexity of the information and the lack of financial literacy make consumer choices*

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<sup>1</sup> & 2.1.3 p. 23

*difficult. In addition, the comparison tools available are not always efficient (see **Error! Reference source not found.**).*

Although one may think that information disclosure is already quite regulated, the study showed that information is not available for all decumulation products (for ex. While comparative information is available in the UK for annuities, there is no similar information available for drawdown and in the other countries information is only partially available and not always in a comparable way).

FSUG recommendation: FSUG would like therefore to recommend that more is done at EU level to ensure that comparable, easy to understand information on pension decumulation products is available to allow consumer's informed choice including for those with average or below pension pots who cannot afford expensive financial advice. This would also support cross border purchase if consumers from other member states can access and compare information on pension decumulation offer in other countries.

➤ European Court of Justice ruling on the Test Achats case

The research team was asked to analyse whether the European Court of Justice, ruling on Case C-236/09 (Test Achats), which put an end to the exception clause included in Article 5.2 of the Gender Equality Directive 2004/113/EC<sup>2</sup>, with effect from 21 December 2012, had an impact on consumers.

Data collected by the study seem to demonstrate that the Directive has had a positive impact on women in UK. In Germany unisex premiums were already mandatory since 2005 given a longer period to assess impact. Yet according to the study consumers seem not to react to they should (*i.e. consumers should buy more guarantees when it gets cheaper for them and less if it becomes more expensive*)<sup>3</sup>. However results show an overall decrease in the demand. A possible explanation for such behaviour given by authors is the negative perception of unisex tariffs that consumers may have due to media highlighting only the detrimental effects of such regulation.

FSUG recommendation: An analysis of the impact of the Test Achats ruling should be done to better assess how the market has coped with the introduction of mandatory unisex premiums and if consumers are benefiting from this change.

➤ State of play of current debate on pension decumulation

The research study also took a forward looking approach, giving an overview of the state-of-play of the debate at EU and national level.

At EU level several proposals currently on the table are welcome by the FSUG:

- The KID for PRIIPS which seeks to help consumers better understand and compare key features of insurance-based investment products;
- The Product Oversight and Governance (POG) laid down by the Insurance Distribution Directive (IDD) which will take effect in February 2018 and will influence product design, requiring that the insurance undertakings consider the level of information available and the degree of financial capability and literacy of customers;
- The on-going debate on harmonization of personal pension products (PPP) and Pan-European Pension (PEP) and EC consultations to which FSUG has responded;

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<sup>2</sup> <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2004:373:0037:0043:en:PDF>

<sup>3</sup> Jaspersen, Johannes, Andreas Richter, and Sebastian Soika (2015)

At national level, reforms are going on which will change the decumulation market in the future. The question is whether these reforms will benefit also consumers with average and below average pension pots.

FSUG recommendations: Extend the KID for PRIIPs principles to pension decumulation products; Establish EU-wide transparent, competitive and standardised annuity markets and grant more freedom to pension savers to choose between annuities and withdrawals (but after enforcing a minimum threshold for a guaranteed life time retirement income)<sup>4</sup>.

## Conclusion

The on-going reforms to improve the long-term sustainability of mandatory pension schemes result in shifting the longevity and inflation risk to the consumer.

More and more pensioners will retire with an average and below average pension pot and will need to decide themselves how to decumulate it.

Yet personal pensions are designed for consumer profiles with an above average pension pot and are not always suitable for average and below average pension pots.

Information currently available is not easy to access, nor easy to understand for consumers with an average or below average pension pot.

Too little is known about the needs of these consumers' profiles.

Regulation is needed to ensure that decumulation products are developed and designed for these profiles, i.e. simple, safe, transparent and cost-efficient products.

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<sup>4</sup> Better Finance, Pension Savings The Real Return 2016 Edition