The Society of Actuaries in Ireland
Retirement Options and Approved Retirement Funds

Preamble

The Council of the Society of Actuaries in Ireland has approved the issue of this Position Statement. It is intended as a general expression of the views of the profession on an important topical issue. It is however neither formal guidance nor a definitive expression of the position of the profession as a whole. In particular, it is not intended as individual/specific advice to members of the public, who should take advice as appropriate in the light of their particular circumstances.

Introduction

The Finance Act 1999 introduced new retirement options for the self-employed and proprietary directors in exempt approved occupational pension schemes. These allow eligible retirees to cash in their accumulated retirement fund immediately or maintain it in retirement – in an Approved Retirement Fund (ARF) - rather than purchase an annuity. The Finance Act 2000 extended the new retirement options to employees' additional voluntary contribution funds. Further extension of the options may occur in the future.

The Society welcomes the flexibility that the new options afford retirees. It would appear that they are generally perceived to enhance the attractiveness of retirement provision and could therefore serve to widen retirement coverage. The Society is concerned, however, that the new regime should incorporate measures necessary to afford protection to the consumer.

Comparing Retirement Options

In order that an informed decision can be made at retirement, it is essential that a retiree who is eligible to exercise the new options should receive information about *each* of the available options, i.e.:

- a tax free lump sum and pension/purchase of an annuity. The full range of annuity options should be disclosed, i.e. traditional, with-profit, variable income annuities, etc.;
- part of the benefit as tax free lump sum and transfer of the balance, after satisfying the "set aside" requirement, to an ARF;
- part of the benefit as tax free lump sum and withdrawal of the balance, after satisfying the "set aside" requirement, as a taxable lump sum.

While an ARF can be used to provide a regular income in retirement, it is distinctly different from an annuity and direct comparisons between the two can be dangerously misleading. The insurance element of the annuity (i.e. insurance against the possibility of a longer than expected lifespan) is not present in the ARF option. The suitability of any one, or combination, of retirement options for an individual should involve assessment of :

- current and future income needs;
- current and future capital needs;
- provision for dependants on death;
- state of health;
- attitude to, and scope to withstand, risk.

Retirement Capital

The possibility of preserving capital for dependants might make the new retirement options attractive to some retirees. ¨ The full remaining capital from an ARF can be left to dependants and there are no restrictions as to which dependants can benefit from ARF funds on death. However, the retiree's dependants face the same risk as the retiree that the ARF funds could be run down substantially or even exhausted completely before the retiree dies.

Retirement Income

Whereas an annuity provides security in the form of a guaranteed income for the lifetime of the retiree, the ARF option is attractive from the point of view of control over the fund and flexibility to determine and vary the level of income taken in any year. There are, however, significant risks in using an ARF to provide a regular income in retirement. Projections carried out by a Society Working Party show that, if a retiree opts for an ARF and makes regular income withdrawals from the fund equal to the amount of income which could have been obtained with an annuity, there is a 50% to 60% chance that the fund will be exhausted before the retiree dies.

Consumer Protection

The Society is concerned that retirees should be empowered to make informed decisions as to the choices available to them. Full disclosure of information at retirement and preferably prior to retirement, should be required in relation to each of the available options.

There are no specific statutory controls on the sales and marketing of the new retirement options. A wide range of financial institutions subject to different regulatory regimes may offer ARFs. Specific controls would be appropriate in relation to ARFs, particularly where an ARF is used to provide a regular income in retirement.

Recommendations

The Society recommends that the £50,000 minimum investment in an Approved Minimum Retirement Fund be abolished in favour of the minimum guaranteed income test of £10,000 per annum, i.e. a retiree would only be able to invest his pension savings in an ARF or take them in cash if he or she already has a guaranteed income of at least £10,000 per annum. The minimum income test should be regularly reviewed to ensure that it maintains its value relative to earnings.

The Society further recommends that:

- where pension savings are going to be the only or main source of income in retirement, retirees should secure a minimum level of lifetime income by using some of their pension savings to purchase an annuity payable for life;
- pension fund trustees and personal pension providers should be required to provide retirees with information about each of the options available to them, including the option to buy an annuity, before any decision is made;
- there should be a statutory "cooling off period" during which a retiree could decide on a different course without financial penalty;
- where a retiree opts to make regular withdrawals from an ARF, it should be mandatory that the retiree receives standardised projections of the long term impact of such withdrawals on the capital invested;
- assumptions for the illustration of ARF withdrawals should be conservative and subject to regular review and revision to reflect changing investment conditions; and
- an information disclosure regime similar to that currently proposed for life assurance products should be mandatory for ARFs. This would include disclosure of commissions and expenses at the point of sale.

26 November 2000