Options and freedom: should seniors be able to decide themselves how to spend their retirement money?

Nigel Keohane

Social Market Foundation, London, UK

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Context: Pensions policy in the UK

- State pension:
  - A new ‘Single Tier’ state pension has been introduced in 2016.
  - The full state pension is £156 per week for a single person.
  - Low-income pensioners may be eligible for means-tested top-ups, including housing benefit to help pay rent, subsidies to help pay for their local council tax and top-ups to their pensions if they have an incomplete National Insurance record.

- Private pensions
  - There has been a dramatic reduction in membership of ‘Defined Benefit’ pensions in the private sector and a reduction in the generosity of those schemes that continue.
  - There has been a strong growth in ‘Defined Contribution’ pensions in the last three decades.
  - The Government introduced a scheme in 2012 compelling employers to automatically enrol all their workers into a workplace pension scheme. For new savers, these schemes are ‘Defined Contribution’ schemes.

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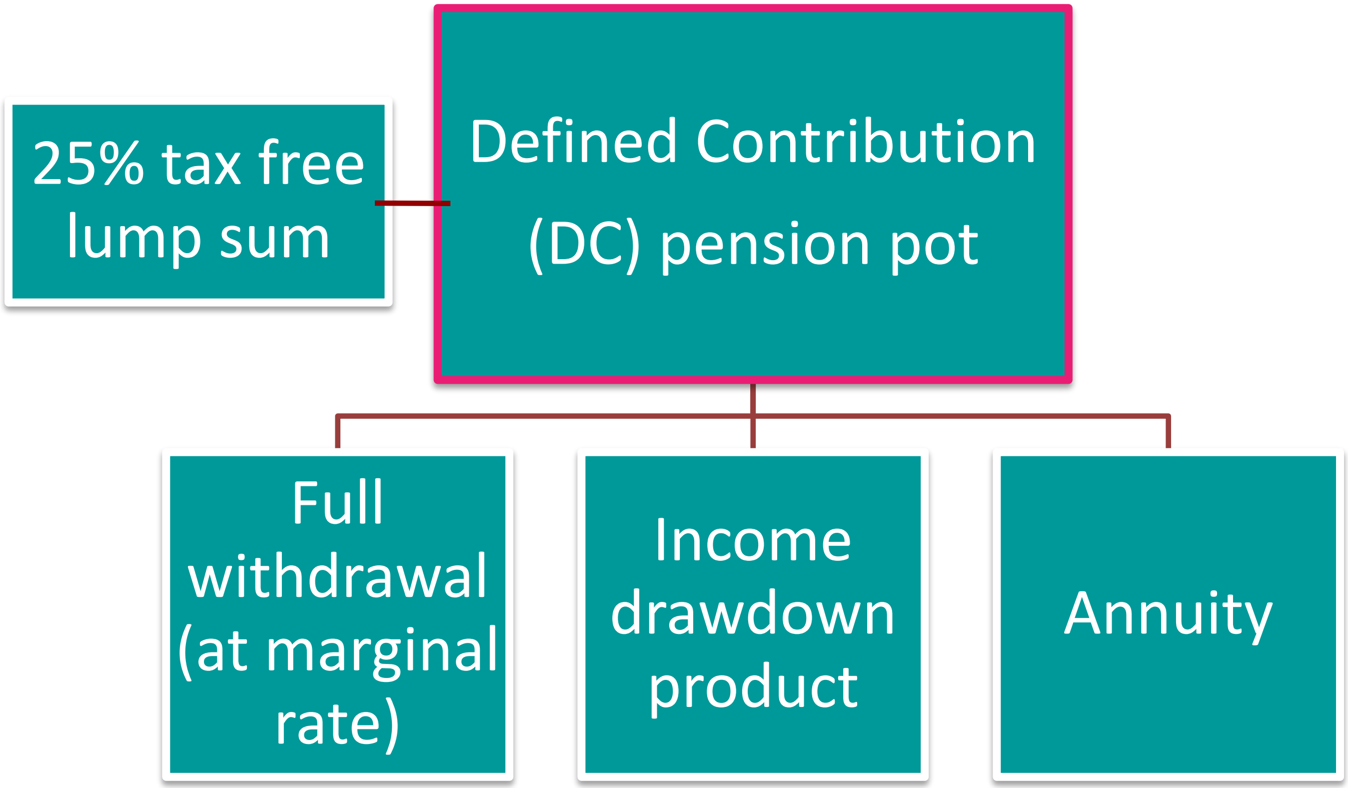
The ‘freedom and choice’ reforms

- Previously, almost all savers (except those with very small savings or very high retirement incomes) faced a punitive 55% tax on any pension savings that they withdrew unless they bought an annuity – in effect annuities were compulsory.
- In April 2014, the Chancellor of the Exchequer announced that from April 2015, all those aged over 55 would be able to spend their ‘Defined Contribution’ pension savings in any way they wanted.
- Any money withdrawn is taxed at the standard income tax rate (0% up to £11,000 income; 20% £11,001 to £43,000; 40% £43,001 and above)
- Background to the reforms:
  - Deteriorating annuity rates due to longer lives and low gilt rates.
  - A goal of making pension saving more attractive (by making it more flexible)
  - Poor competition in the annuity market, partly in a consequence of little shopping around by consumers.
  - Greater diversity of retirement (health, wealth, consumption)
  - Desire to provide greater freedom to ‘prudent’ savers
- 2.2 million aged 55-70 with £175 billion of DC savings. Many of these have no other private pension income.

What has changed? - Retirees now have much greater choice over what they do with their pension savings



2.2 million aged 55-70 with £175 billion of DC savings.

The big policy questions

- What is the early evidence about how UK retirees are spending their pension savings?
- What can we learn from other countries where pension freedoms have been in place for a longer period of time?
- What might be the long-term consequences of an individual spending their pension in a different way?
- What are the policy considerations?

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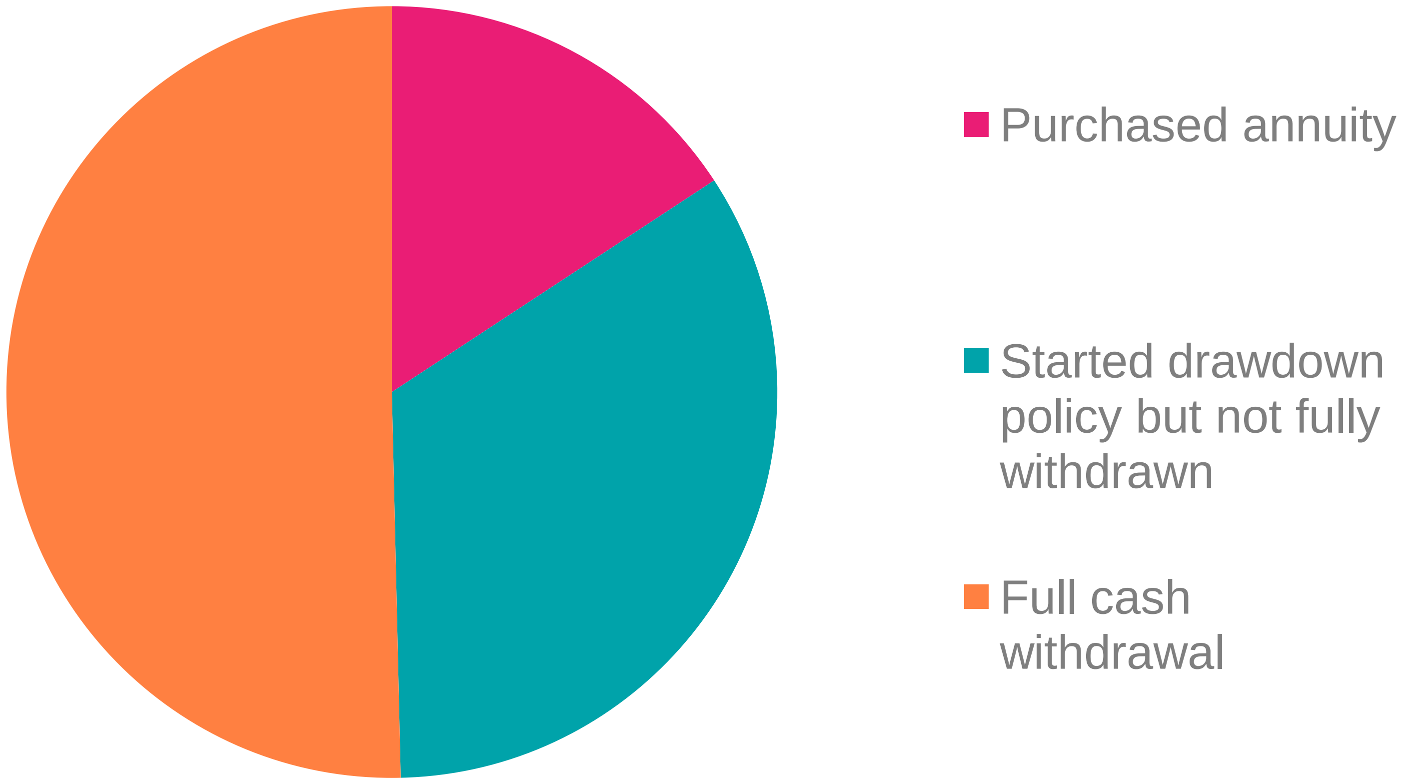
Some early data on what UK consumers are doing

Total number of pots accessed for the first time between October 2015 and March 2016 to take an income or fully withdraw their money as cash



BUT – we don't know who these people are, whether they have other retirement income and what they are doing with the money.

(Financial Conduct Authority, October 2016)

We really need to look abroad to get a fuller understanding of the long-term implications

	Retirees able to freely withdraw DC pension savings?	Retirees penalised for withdrawing savings?	Liberalised decumulation phase?
Australia	✓	✗	✓
United Kingdom	✓	✗	✓
United States	✓	✗	✓

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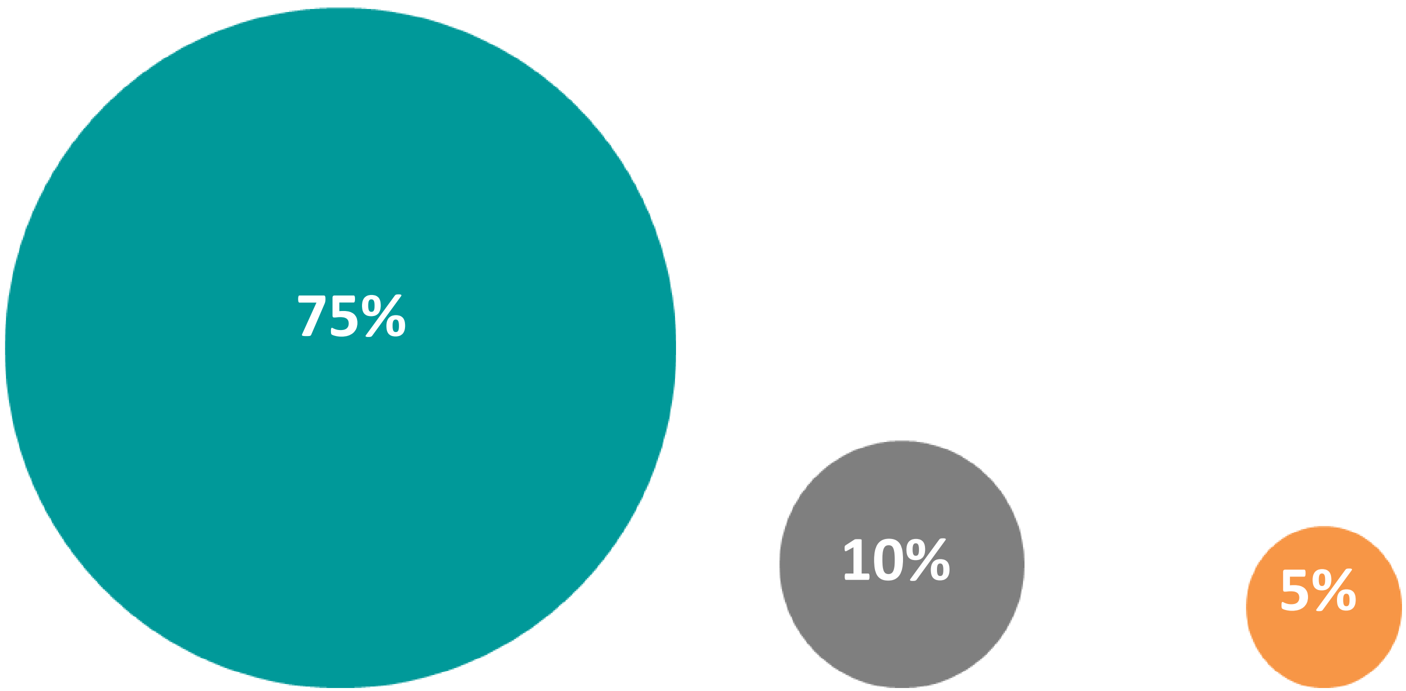
Only a small minority insure against longevity



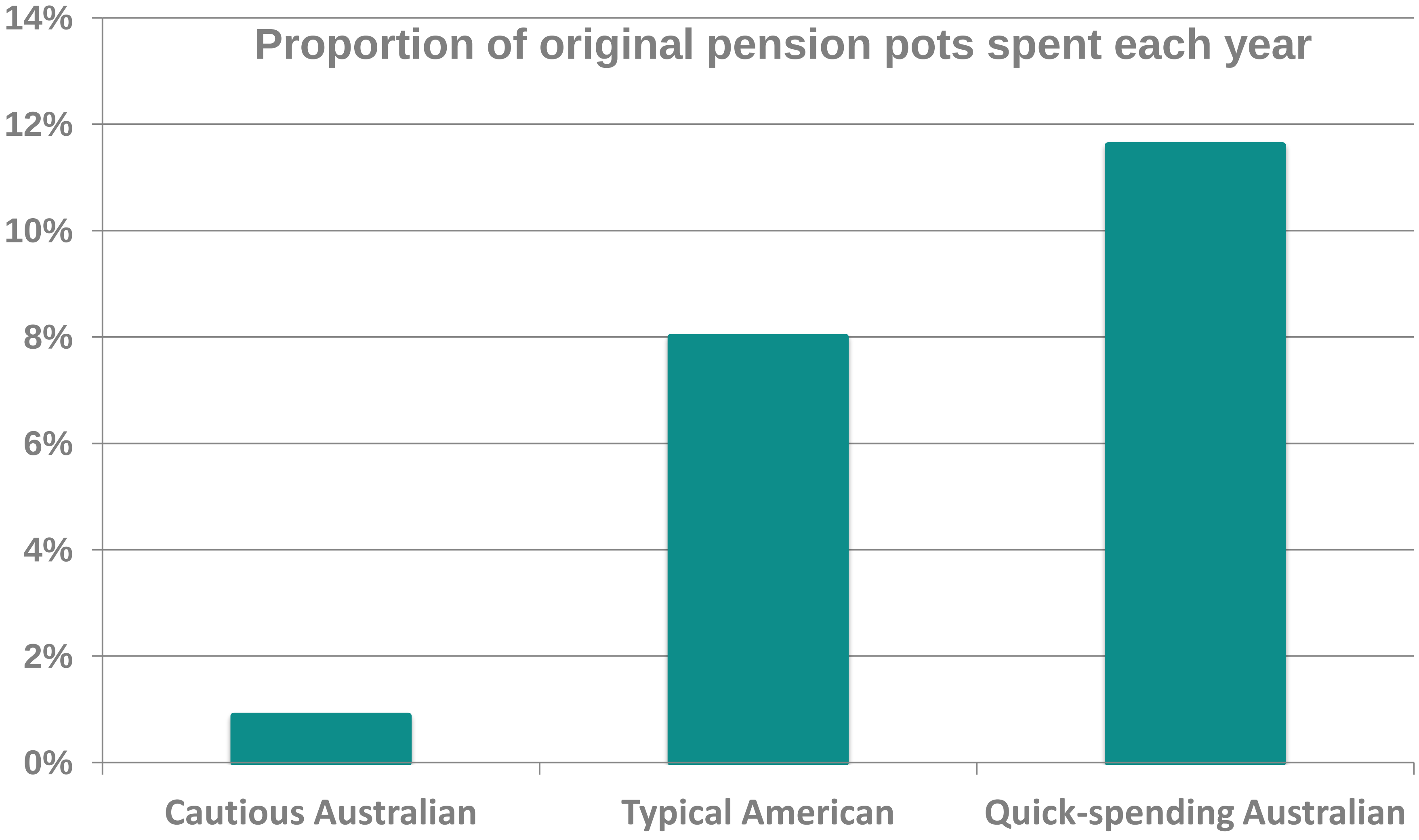
75% of UK retirees bought an annuity prior to the ‘freedom and choice’ reforms

10% of American retirees have an income from an annuity

5% of retirements products sold in Australia are term annuities

(House of Commons; Bateman; O’Meara)

Withdrawal patterns are diverse across these different countries but we've identified some paths to learn from



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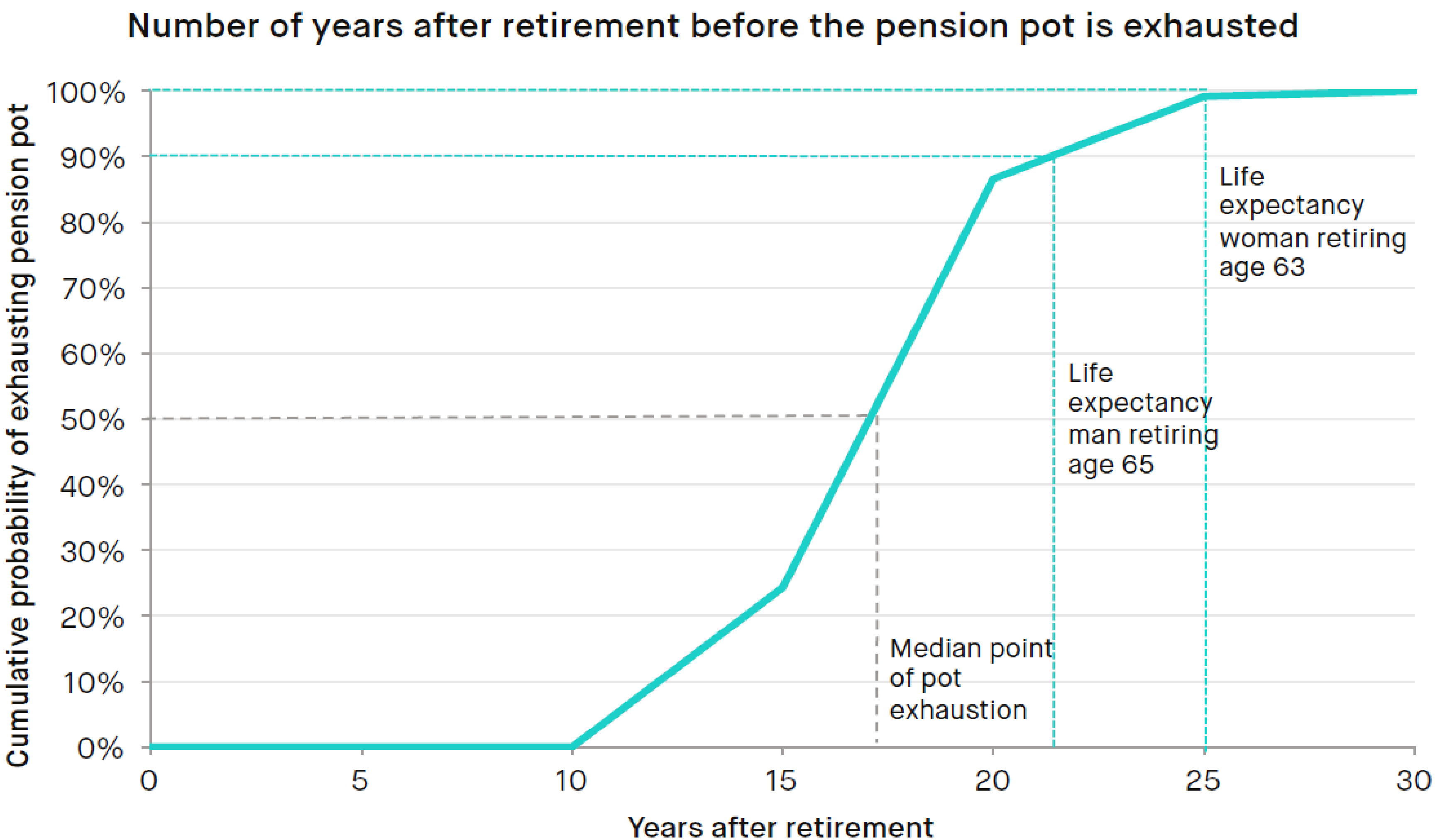
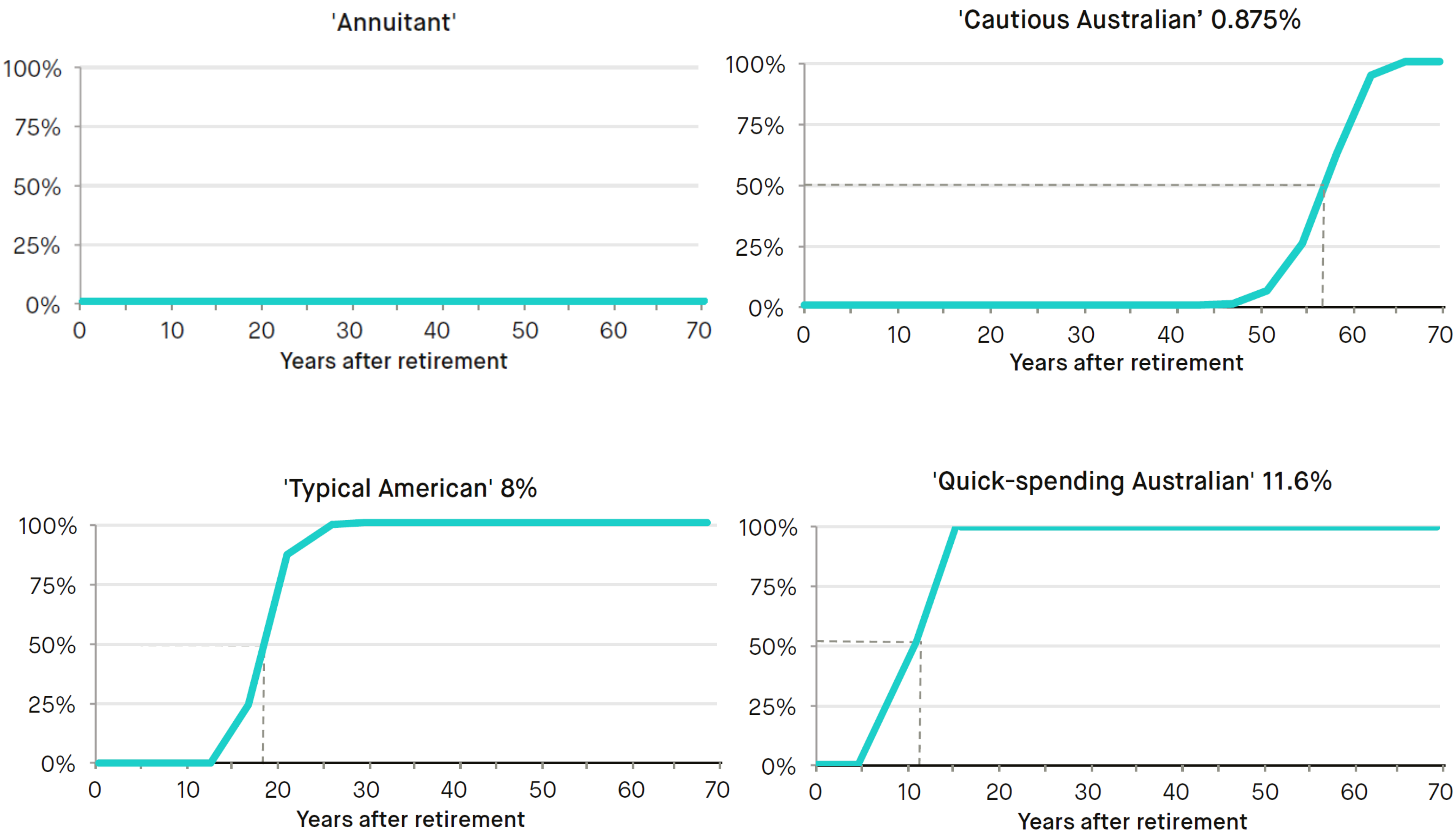
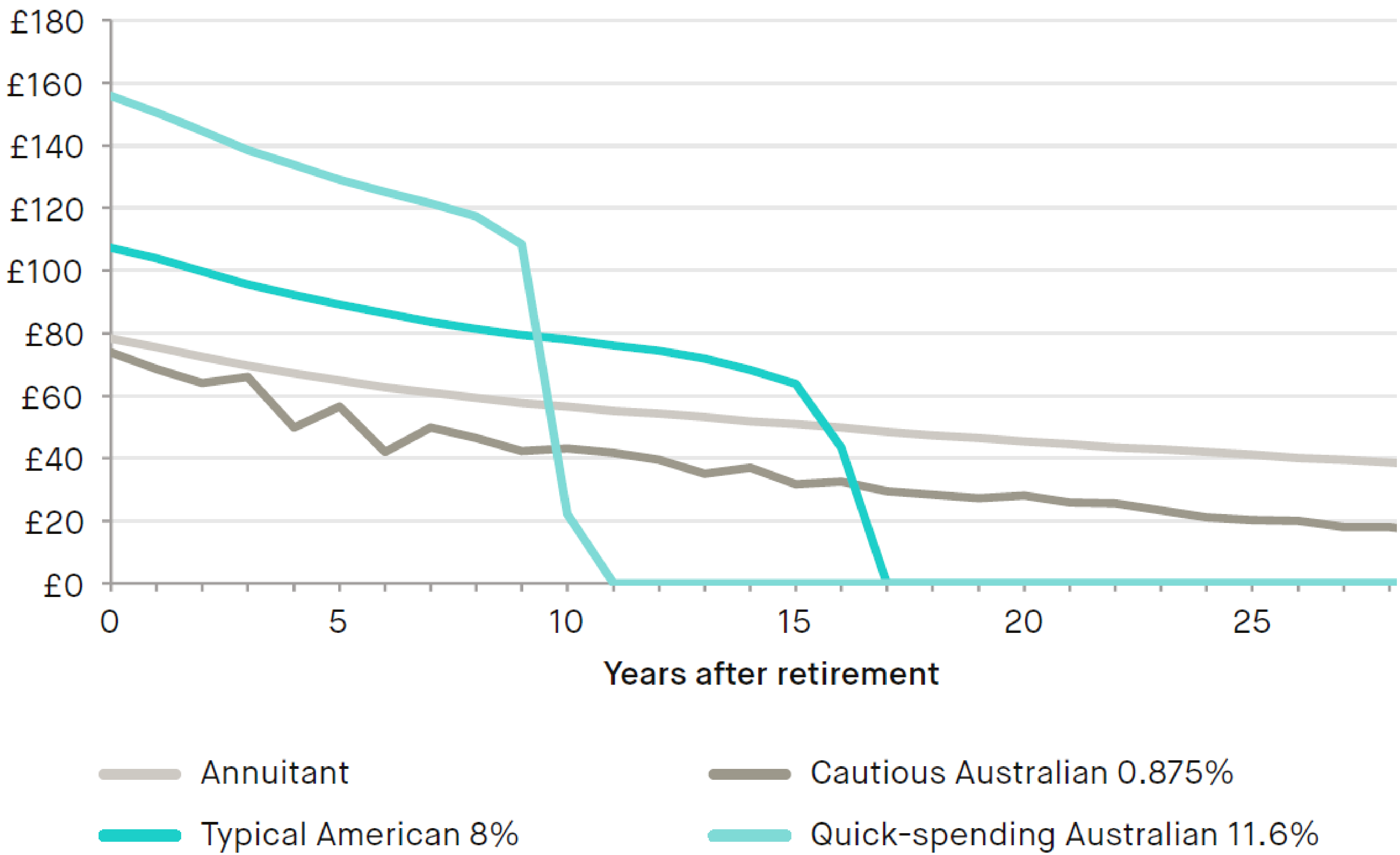
Following the 'Typical American' path means your pension savings are likely to last 17 years but investment risk introduces huge uncertainty.



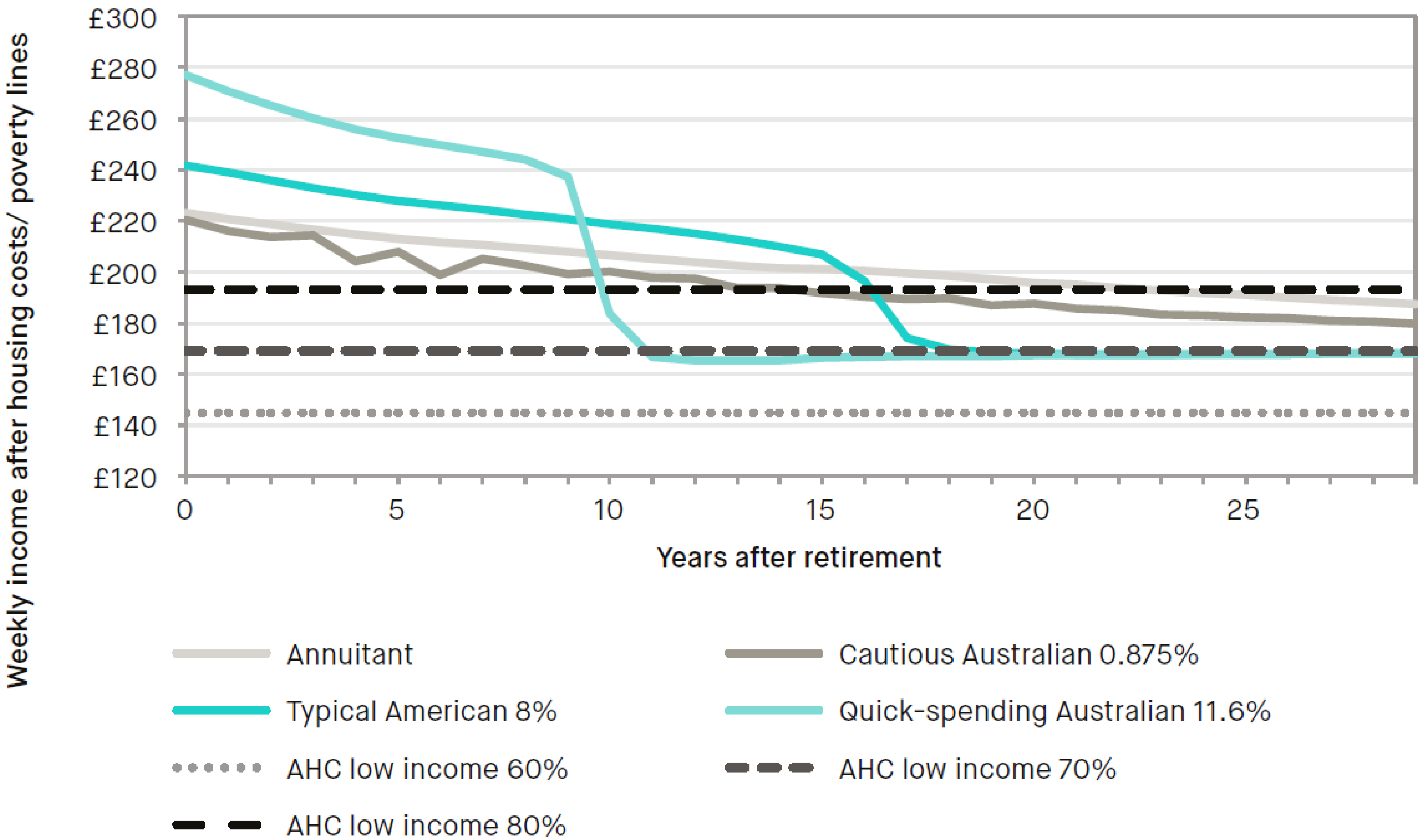
Following the different paths leads to very different outcomes – for when you run out of money…



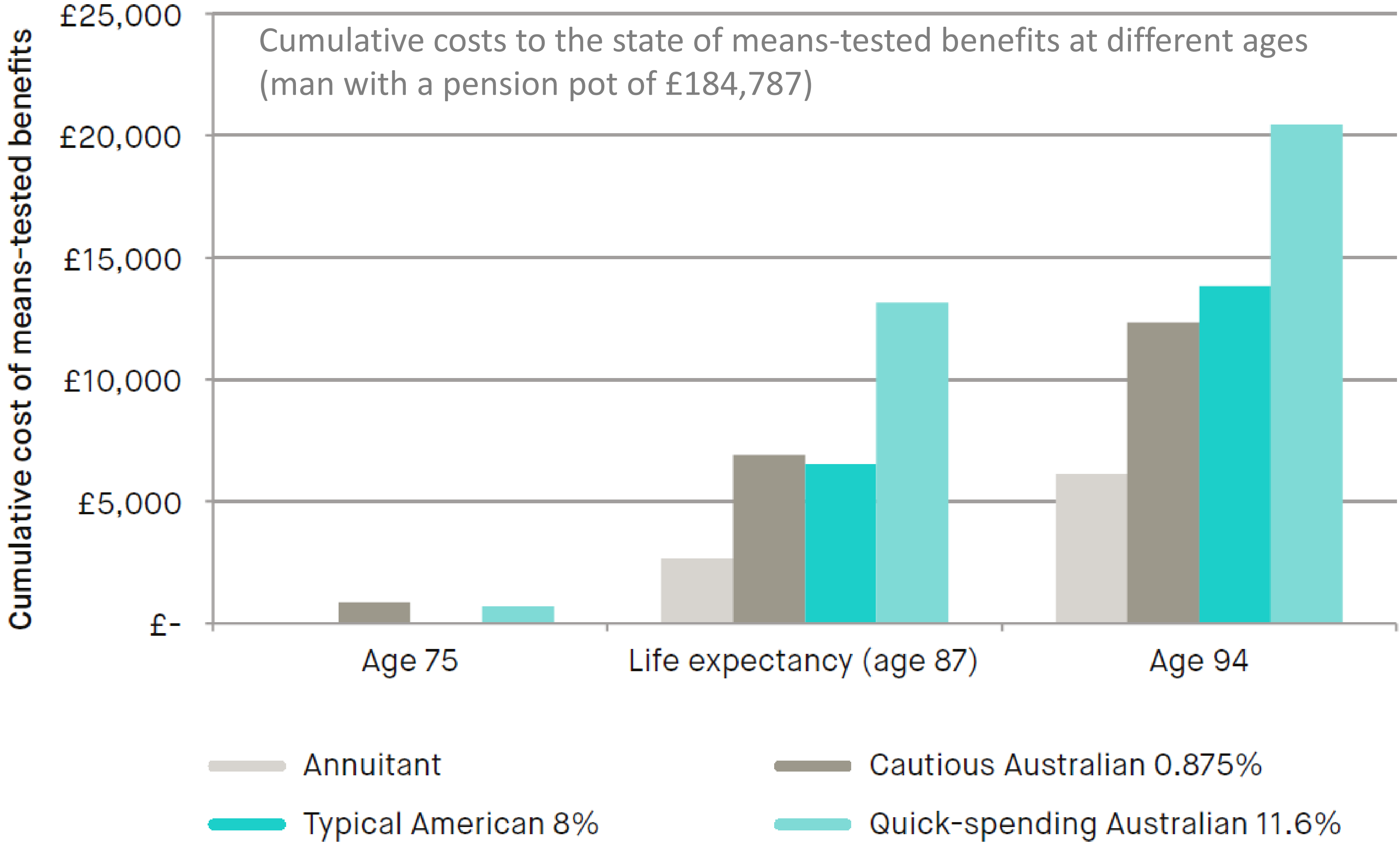
…and for private incomes in retirement…



Retirees may be taken closer to ‘low income’ indicators



… and potentially for the costs to the state of means-tested benefits



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Drawdown paths affect the risks to which the individual and the state are exposed

Individuals	State
Pot exhaustion	Higher benefit bills
Low incomes	Heavier reliance on the state pension
Low replacement rates	
Proximity to poverty	

And specific groups are particularly at risk

Gender	Women	
Pension type	Only DC savings	DC + small DB
Pension access	Early retirement	Early access
Other assets	Non-homeowners	Low liquid wealth

Decision-making context

- Low financial literacy
- Lack of preparation for retirement
- Behavioural biases affecting decumulation strategies
- Behavioural biases affecting market outcomes

What policy is in place already:

- UK Government has introduced Pensionwise – a free guidance service for people making decisions on their savings.
- Pension firms must provide risk warnings to consumers about the risks attached to products.

Policy interventions

What we proposed:

- The need for an 'Early Warning System' to assess how consumers are acting and intervene to prevent them exposing themselves to long-term risks.
- Engaging consumers before they make decisions (when they leave employment or sign on for state pension)
- Make people think twice before withdrawing all their money – for instance, requiring them to use the guidance service or advice.
- Introduce prompts to encourage people to test out the products across the market rather than simply stick with their current provider.
- A 'Mid-retirement financial healthcheck'

Some broader questions?

- How should we deal with people who don't act?
- Can we encourage individuals to commit part of the money they save to an annuity account?
- Should other countries like Estonia follow the UK's example?