PRESS RELEASE
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"For the vast majority of people, annuitising is likely to remain the safest and most appropriate option for converting defined contribution pension savings into a retirement income" says Pensions Policy Institute report

In 2010 the vast majority of people aged between 55 and 75 would not have had a large enough private pension pot to be able to bear the investment and longevity risks associated with Capped Drawdown and would not have been able to meet the Government's Minimum Income Requirement of having a secure pension income of £20,000 per year, according to new research published today by the Pensions Policy Institute (PPI).

The research is the fifth report in the PPI's retirement income and assets series, looking at the future of retirement income and assets in the UK. The report explores the implications of the Government's new legislation that ends the effective requirement to purchase an annuity by age 75.

Commenting on the report, Chris Curry, PPI Research Director, said

"The research shows that the vast majority of people aged between 55 and 75 in 2010 – and particularly lower earners with small pension pots - are likely to find that annuitising is still the safest and most appropriate option for converting their defined contribution pension savings into a retirement income."

"The PPI's broad estimates suggest that around 600,000 to 700,000 people in the UK between the age 55 and 75 in 2010 are either already using income drawdown or have enough saved in a defined contribution pension fund to have the potential to use the new Capped Drawdown arrangements from April 2011. This represents around 5% of all people aged between 55 and 75 in the UK and around a quarter of those aged 55 to 75 who have defined contribution pension pots and haven't yet purchased an annuity."

"In addition, the PPI estimates that around 200,000 people could meet the Government's new Minimum Income Requirement of a secure pension income of at least £20,000 per year, and have some defined contribution pensions saving left over to withdraw under the new Flexible Drawdown arrangements. This represents around 2% of all people aged between 55 and 75 in the UK and 7% of those aged 55 to 75 who have defined contribution pension pots and haven't yet purchased an annuity.

"The research suggests that initially a relatively small number of individuals will be able to make use of the Government's new flexibilities. However, in the future, a greater number of people may be able to take advantage of both Capped and Flexible Drawdown, as more individuals build up defined contribution pension funds and the market for annuities and drawdown products develops. This is likely to increase the need for advice as to which products are most appropriate for different individuals."

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Notes for editors

1. The Pensions Policy Institute is an educational research charity, which provides non-political, independent comment and analysis on policy on pensions and retirement income provision in the UK. Its aim is to improve the information and understanding about pensions policy and retirement income provision through research and analysis, discussion and publication.

2. The research is the fifth report in the PPI's retirement income and assets series looking at the future of retirement income and assets in the UK. This fifth report explores the implications of the Government's new legislation that ends the effective requirement to purchase an annuity by age 75.

3. Until June 2010, individuals with defined contribution pensions were effectively required to annuitise any remaining private pension savings (after taking an optional 25% tax-free lump sum) by age 75. As a response to calls for more flexibility, the Government has removed the effective requirement to use private pension savings to purchase an annuity by age 75.[1] The Government's stated policy objective is to make pension saving more attractive by giving individuals greater choice over how they provide a retirement income for themselves.

4. From April 2011, people will be allowed from the age of 55 to access their private pension savings through one, or a combination of the following methods:
   - Purchasing an annuity at any point,
   - Investing their pension savings in an income drawdown arrangement with no upper age limit and with a withdrawal cap of 100% of what they would have received from an equivalent annuity. The Government is calling this approach ***'Capped Drawdown'.***
   - Withdrawing unlimited amounts from their pension savings, provided that they can demonstrate that they can meet a Minimum Income Requirement of a secure income of £20,000 per year in 2011. The Government is calling this approach ***'Flexible Drawdown'***.

   A summary of conclusions from the report and a summary of the key results follows. The full report can be downloaded from www.pensionspolicyinstitute.org.uk

5. The other reports that the PPI has published in the retirement income and assets series are as follows:-

   - Retirement income and assets: do pensioners have sufficient income to meet their needs?

[1] www.hm-treasury.gov.uk/d/consult_age_75_annuity_responses.pdf

- Retirement income and assets: how can housing wealth support retirement?

- Retirement income and assets: how can pensions and financial assets support retirement?

- Retirement income and assets: outlook for the future?

6. All five reports can be downloaded from the PPI's website at www.pensionspolicyinstitute.org.uk.

For further information please contact -
Chris Curry, PPI Research Director on 020 7848 3731 or 07970 254 940
email: chris@pensionspolicyinstitute.org.uk

Martin Campbell, Beacon Strategic Communications: 07802 634695
email: martin@beaconstrategic.com

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Summary of Conclusions

The Coalition Government has removed the effective requirement to purchase an annuity by age 75 and, from April 2011, will allow people to access their pension savings in a more flexible way. From the age of 55, people will be allowed to access their private Defined Contribution (DC) pension savings through one, or a combination of the following, methods:

- Purchasing an annuity at any point.
- Investing their pension savings in an income drawdown arrangement with no upper age limit and with a withdrawal cap of 100% of what they would have received from an equivalent annuity. The Government is calling this approach ***'Capped Drawdown'.***
- Withdrawing unlimited amounts from their pension savings, provided that they can demonstrate that they have a secure income already in payment, guaranteed for life of £20,000 per year in 2011. The Government is calling this approach ***'Flexible Drawdown'***.

For the vast majority of people, annuitising is likely to remain the safest and most appropriate option for accessing private DC pension savings
In 2010 the vast majority of people aged between 55 and 75 would not have had a large enough private pension pot to be able to bear the investment and longevity risks associated with Capped Drawdown and would not have been able to meet the Minimum Income Requirement (MIR). For the majority of people, annuitising will still be the safest and most appropriate way of accessing their private DC pension savings.

A small proportion of people might be able to use Capped or Flexible Drawdown
From April 2011, people will be permitted, from age 55, to remain in income drawdown, 'Capped Drawdown,' with no upper age limit. The Government has placed a cap on the amount of income that people can withdraw, at 100% of an equivalent annuity. There is no regulatory restriction on the size of pension pot a person needs to enter income drawdown, however many IFAs recommend people need a pension pot of a minimum of between £100,000 and £250,000 as well as other income and assets in order to ensure people can bear the investment risk and longevity risk associated with drawdown.

- If it is assumed, for illustrative purposes, that people with pots of £100,000 or more might be in a position to purchase an income drawdown product, then, based on existing market data and analysis, around 600,000 to 700,000 people aged between 55 and 75 in 2010 could potentially make use of Capped Drawdown because they are either already in income drawdown or have enough DC pension savings (which have not yet been used to purchase an annuity) to enter Capped Drawdown. This includes those already in income drawdown arrangements as well as those individuals who have more than £100,000 in uncrystallised DC pension savings, some of these people will still be working and contributing to their pensions.

- This represents around 5% of all people aged between 55 and 75 in 2010 and around 22% to 26% of people aged between 55 and 75 with uncrystallised DC pension savings.

A small proportion of people might have enough income and savings to meet the Minimum Income Requirement (MIR) but relatively few will be able to use Flexible Drawdown

The Government has legislated to allow people over age 55 to access their private pension savings in a more flexible way, provided that they can demonstrate that they have a secure source of pension income in payment and guaranteed for life, the Minimum Income Requirement (MIR) at a level high enough to prevent them from 'falling back on the state' through means-tested benefits. The Government has set the MIR at £20,000pa in 2011, and intends to periodically review this amount. Income from state pensions, Occupational Pensions, and annuities can all count towards the MIR.

- Around 700,000 to 1m people between age 55 and 75 in 2010 could have enough pension income in payment to meet an MIR of £20,000pa using income from: state pensions, occupational scheme pensions, existing annuities, or uncrystallised DC savings which could be annuitised. This represents between 5% to 8% of people between age 55 and 75 in 2010.

However, the majority of people who could meet the MIR are unlikely to be able to take advantage of Flexible Drawdown, which is where an individual can withdraw unlimited amounts from their DC savings, provided that they can demonstrate that they have a secure income of at least £20,000pa. Many of the people who can meet the MIR in 2010 will have mainly state and Defined Benefit (DB) pension income which cannot be withdrawn. Those already in receipt of DB pension income cannot transfer out of their schemes and convert their savings into DC savings. However, people who are still accruing DB entitlement could transfer out of their schemes into DC pension saving funds in order to meet the MIR in future and use Flexible Drawdown for the remainder of their DC pension savings

- Around 200,000, of the 700,000 to 1 million people who could meet the MIR, could have sufficient pension income and DC pension savings to meet the MIR and have some DC savings left over to access flexibly. This is around 2% of people between age 55 and 75 in 2010 and around 7% of people between age 55 and 75 in 2010 with uncrystallised DC pension savings.

More people might be able to use Capped or Flexible Drawdown in future

Part of the reason why such low numbers of people between the ages of 55 and 75 in 2010 might be able to access Capped or Flexible Drawdown is the historically low levels of DC saving. However, the decline in DB pension provision has led to an increase in people saving in DC schemes, which is likely to be compounded when auto-enrolment into pension savings begins in 2012. It is likely that over the next few decades, the number of people reaching retirement with DC savings will increase and that in the future more people will have an opportunity to access Capped or Flexible Drawdown.

The impact on low earners
On the whole, the new policies are unlikely to impact directly on people who earned at low earnings and have small private pension pots in retirement. Some people with small pots might try to delay or avoid buying an annuity as a result of the new policy, however annuities will still provide the safest and most appropriate way for the majority of low earners to access their private pension savings. The new policies could have the potential to either increase or decrease annuity rates depending on the behaviour of people accessing pension savings and the way providers decide to respond.

The impact on median earners
Median earners are unlikely to have large pension pots and high levels of other income and assets, and it is likely that for many people who earn at or around median levels during working life, purchasing an annuity will still be the safest and most appropriate way to access their private pension savings. However there are likely to be greater numbers of people reaching retirement with DC pension savings in future. These changes, coupled with the removal of the requirement to annuitise, could encourage people to take a more flexible approach to using existing annuity products.

However there are risks involved with using annuities that are more flexible than conventional annuities, such as fixed term or flexible annuities. These types of annuities could expose people to greater levels of investment risk (flexible annuities) or the risk that annuity rates are lower when the fixed period comes to an end than they were at the time of the initial annuity purchase (fixed term annuities).

The impact on high earners
People who earned at high or very high earnings during working life are more likely to reach retirement with a pension pot large enough to use Capped Drawdown or, in some cases, meet the MIR and flexibly withdraw their remaining pension savings.

Capped Drawdown allows individuals the flexibility to potentially grow their fund, vary their level of withdrawals within the limits set by Government and leave some capital as inheritance, while purchasing an annuity does not. However there is a trade-off as people in Capped Drawdown run more risk of depleting funds and may need to withdraw from their accounts at lower levels than they would receive from an annuity in order to preserve their funds. For people with high levels of income and assets, high appetite for risk and for whom conserving a portion of their fund as an inheritance is important, Capped Drawdown could be an attractive, and potentially profitable way to access private pension savings. Frequent investment reviews in Capped Drawdown should help people to mitigate risks by changing investment strategy or lowering withdrawal rates if their investments are not faring well.

Some high earners may be able to meet the MIR and withdraw their remaining DC savings flexibly. People who have met the MIR may not face the same levels of risk to their pension savings as those solely using Capped Drawdown, as they will have a secure income for life of at least £20,000pa.

Summary of Key Results

How many people may be able to make use of Capped or Flexible Drawdown?

Tables 1 to 3 summarise the PPI's estimates of the numbers of people aged between 55 and 75 in 2010 in the UK who could use Capped Drawdown, could meet the Minimum Income Requirement or could meet the Minimum Income Requirement with some DC savings left over which could be withdrawn using Flexible Drawdown either in 2010, or at some point in the future before their SPA.

The figures are based on the PPI's analysis of the English Longitudinal Study of Ageing grossed up to the UK population in 2010. For illustrative purposes the analysis assumes that a pension pot of £100,000 is needed to enter Capped Drawdown. The projections are subject to some uncertainty, particularly the projections of those who might be able to use the new requirements by their State Pension Age (SPA). These projections assume that people continue their current patterns of working and continue to contribute to their pensions from now until their SPA. This is a fairly strong assumption, these estimates represent an upper estimate of the numbers of people who may be able to make use of the new flexibilities provided by the Government's policy in the future and should be used with caution.

In 2010 there were 13 million people aged between 55 and 75 in the UK, of whom 2.7 million had uncrystallised DC pension savings (i.e. pension pots that have not yet been converted into an annuity). Table 1 shows that around 600,000 – 700,000 people aged between 55 and 75 in 2010 may be able to make use of Capped Drawdown in 2010. Around a further 300,000 may be able to use Capped Drawdown by their SPA.

Table 1: PPI Estimates of the numbers of people who might be able to use Capped Drawdown in 2010 or by their SPA, assuming a DC pension pot of at least £100,000 is required to use Capped Drawdown

	Could use Capped Drawdown in 2010	Could use Capped Drawdown by SPA (but not in 2010)	Total who could use Capped Drawdown in 2010 or by their SPA
Numbers of people aged between 55 and 75 who could use Capped Drawdown	600,000 to 700,000	300,000	900,000 to 1 million
Percentage of all people aged 55 to 75 in UK	5%	2%	7%
Percentage of people aged 55 to 75 in the UK with uncrystallised DC pension savings	22% to 26%	11%	33% to 37%

Table 2 shows that around 700,000 to 1 million people aged between 55 and 75 could meet the Government's Minimum Income Requirement of having a secure pension income of at least £20,000pa in 2010. Around a further 900,000 to 1.1 million could not meet the MIR in 2010, but could meet it at some point in the future by their SPA.

Table 2: PPI Estimates of the numbers of people who might be able to meet the Minimum Income Requirement (MIR) of £20,000pa in 2010, or by their SPA

	Could meet MIR in 2010	Could meet MIR by SPA (but not in 2010)	Total who could meet MIR in 2010 or by their SPA
Number of people aged between 55 and 75 who could meet MIR	700,000 to 1 million	900,000 to 1.1 million	1.6 million to 2.1 million
Percentage of all people aged 55 to 75 in UK	5% to 8%	7% to 8%	12% to 16%

Table 3 shows that of the 700,000 to 1 million people who could meet the Government's MIR in 2010, only around 200,000 could meet the MIR and have some DC savings left over to withdraw flexibly in 2010. Around a further 500,000 people might meet the MIR and have some DC saving left over to withdraw flexibly by their SPA.

Table 3: PPI Estimates of the numbers of people who might be able to meet the MIR and who would have some DC pensions saving left over which could be withdrawn flexibly

	Could use Flexible Drawdown in 2010	Could use Flexible Drawdown by SPA (but not in 2010)	Total who could use Flexible Drawdown in 2010 or by their SPA
Number of people aged between 55 and 75 who could use Flexible Drawdown	200,000	500,000	700,000
Percentage of all people aged 55 to 75 in UK	2%	4%	5%
Percentage of people aged 55 to 75 in the UK with uncrystallised DC pension savings	7%	19%	26%