

How complex are the decisions that pension savers need to make at retirement?

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Pensions Policy Institute

Thursday 27 November 2014

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How complex are the decisions that pension savers need to make at retirement?

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- What decisions do people face at retirement?
- How do people make decisions at and during retirement?
- How will decision-making change in future?
- Who is at greatest risk of making poor decisions about their DC savings?

What decisions do people face at retirement?

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The main pension and retirement transitions can be grouped under the following five headings:

- Work and retirement transitions
- Accessing state pension
- Accessing DB pension entitlement
- Accessing DC savings
- Accessing other income and assets

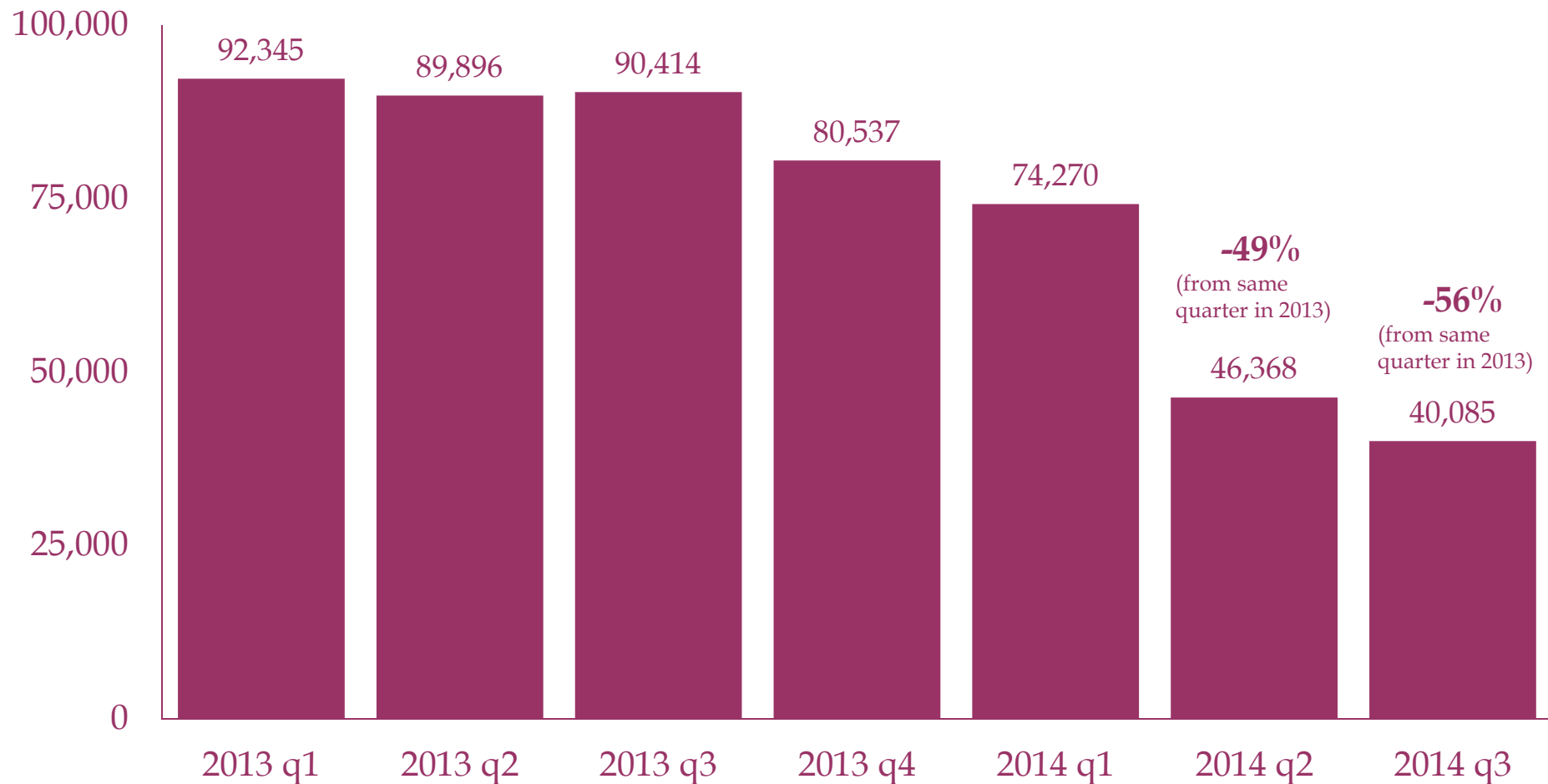
Decisions for those with DC pension savings will change after 2015



- Prior to April 2015 people over minimum pension age with DC savings above and below a certain level must purchase a product which will provide a secure retirement income in order to access DC savings
- After April 2015, all people over minimum pension age with DC savings can:
- Purchase – a lifetime annuity, flexible annuity, flexible drawdown, new products...
- Withdraw one or more lump sums from uncrystallised pension funds

Annuity sales were 56% less in the third quarter of 2014 than they were in the third quarter of 2013

Annuity sales by quarter 2013 - 2014 Q1-3

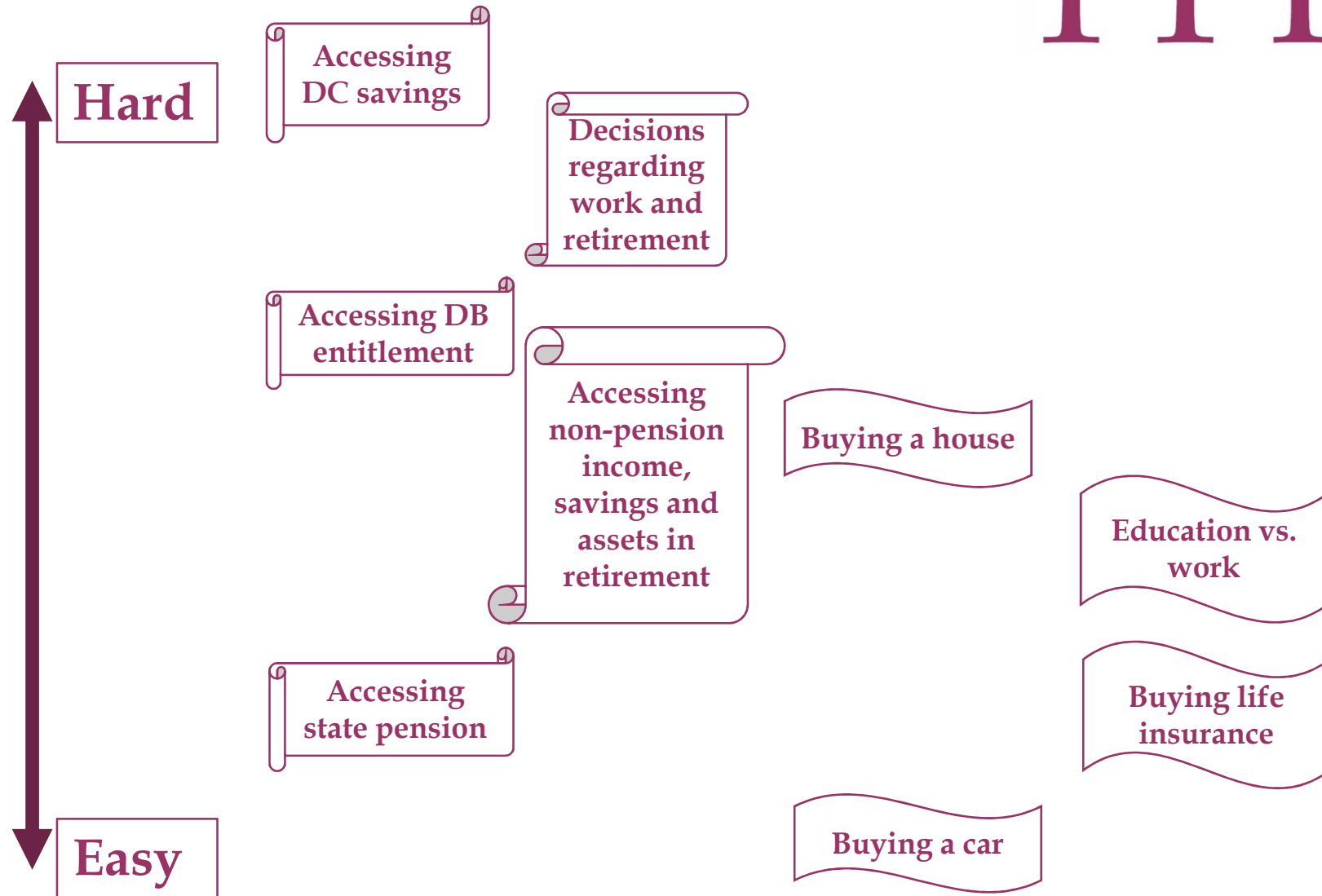


Decision making about DC pension will become more complex

Skills and knowledge necessary to make an informed decision about accessing DC savings

- What options are available
- Longevity risk
- Potential future needs incl health/social care
- Economic factors:
 - Inflation
 - Market risks and returns
 - Understanding of compound interest (and charges)

Difficulty of making informed financial decisions



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Internal and external factors influence work and retirement transitions

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- Transitions can be involuntary, particularly among people of lower socio-economic class (profession based)
- “Decisions” can be influenced by internal and external factors:
 - Cognitive factors
 - Affective (emotional/feeling) factors
 - Behavioural factors
 - Attitudes towards external stakeholders
 - Structural factors

Numeracy is correlated with the ability to make “good” decisions about accessing pension savings

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- Numeracy levels are low in the UK. Among UK adults:
- Around 4 in 5 adults have a low level of numeracy (below GCSE grade C level)
- Nearly one in five people cannot correctly identify the balance in a bank statement
- A third of adults do not understand the impact of inflation on purchasing power

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What will the next ten to fifteen years of retirees look like?

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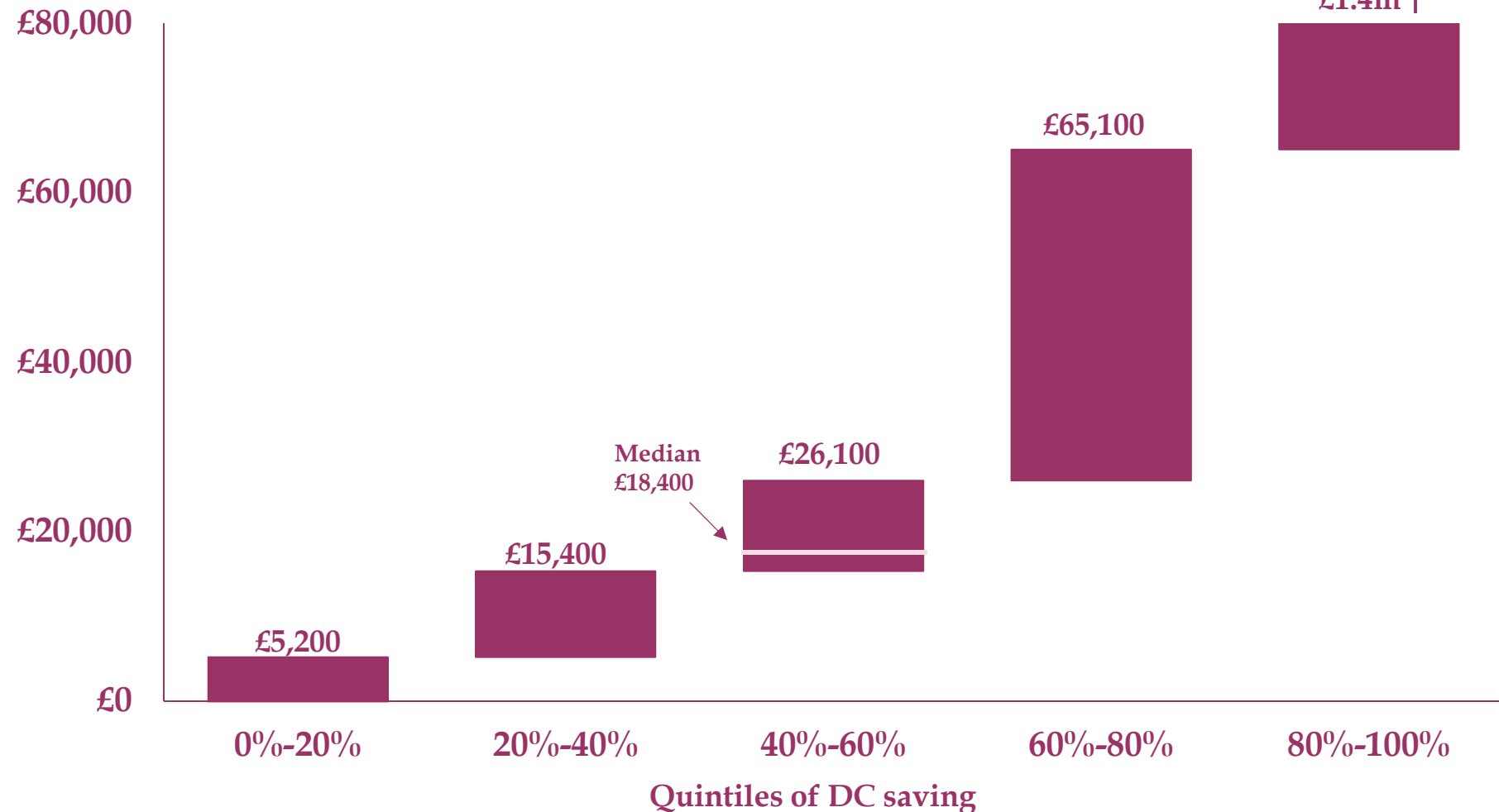
- This project uses data from the English Longitudinal Study of Ageing (ELSA) Wave 5 (2010/11)
- Looked at people aged 50 to SPA in 2014 with private pension savings; DB or DC
- Projects forward assumptions about continued earnings and savings
- Those eligible are auto-enrolled in 2014
- Assumptions regarding DB scheme closures – people already in DB schemes in 2014 remain until SPA

60% of people aged 50 to SPA in 2014 with DC savings, have pots of £26,100 or below

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Quintiles of DC savings for individuals aged 50 to SPA in 2014 (c. 560,000 per quintile) (2014 earnings terms)

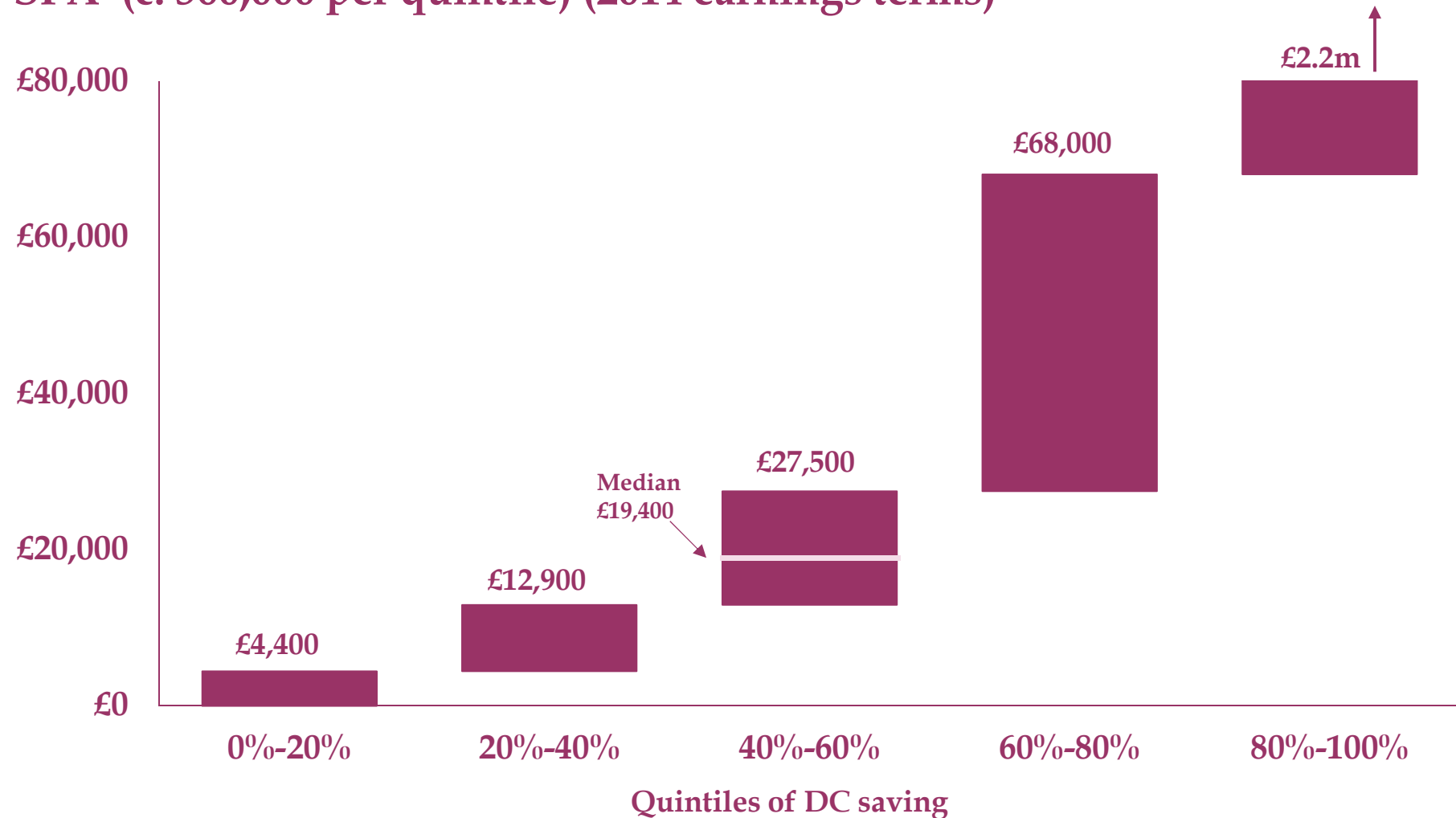


When today's 50-SPA year olds reach SPA, 60% of those with DC savings will have pots of £27,500 or less

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Quintiles of DC savings for individuals aged 50 to SPA in 2014 at their SPA (c. 560,000 per quintile) (2014 earnings terms)

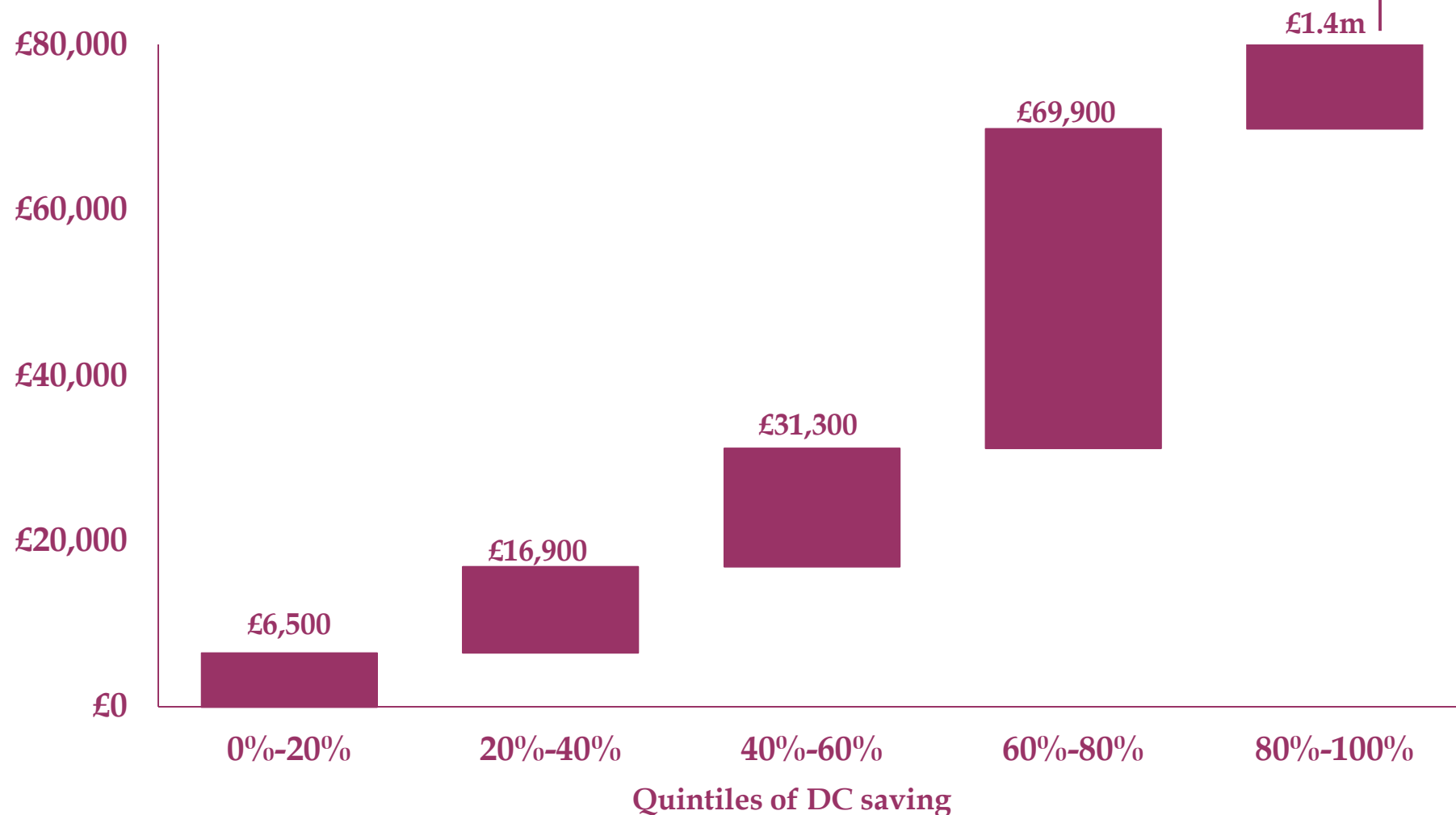


60% of households (1.4m out of 2.4m) with DC savings and a member aged 50 to SPA in 2014 have total savings of £31,100 or below

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Quintiles of DC savings for households where at least one member is aged 50 to SPA in 2014 (c. 478,000 households per quintile) (2014 earnings terms)

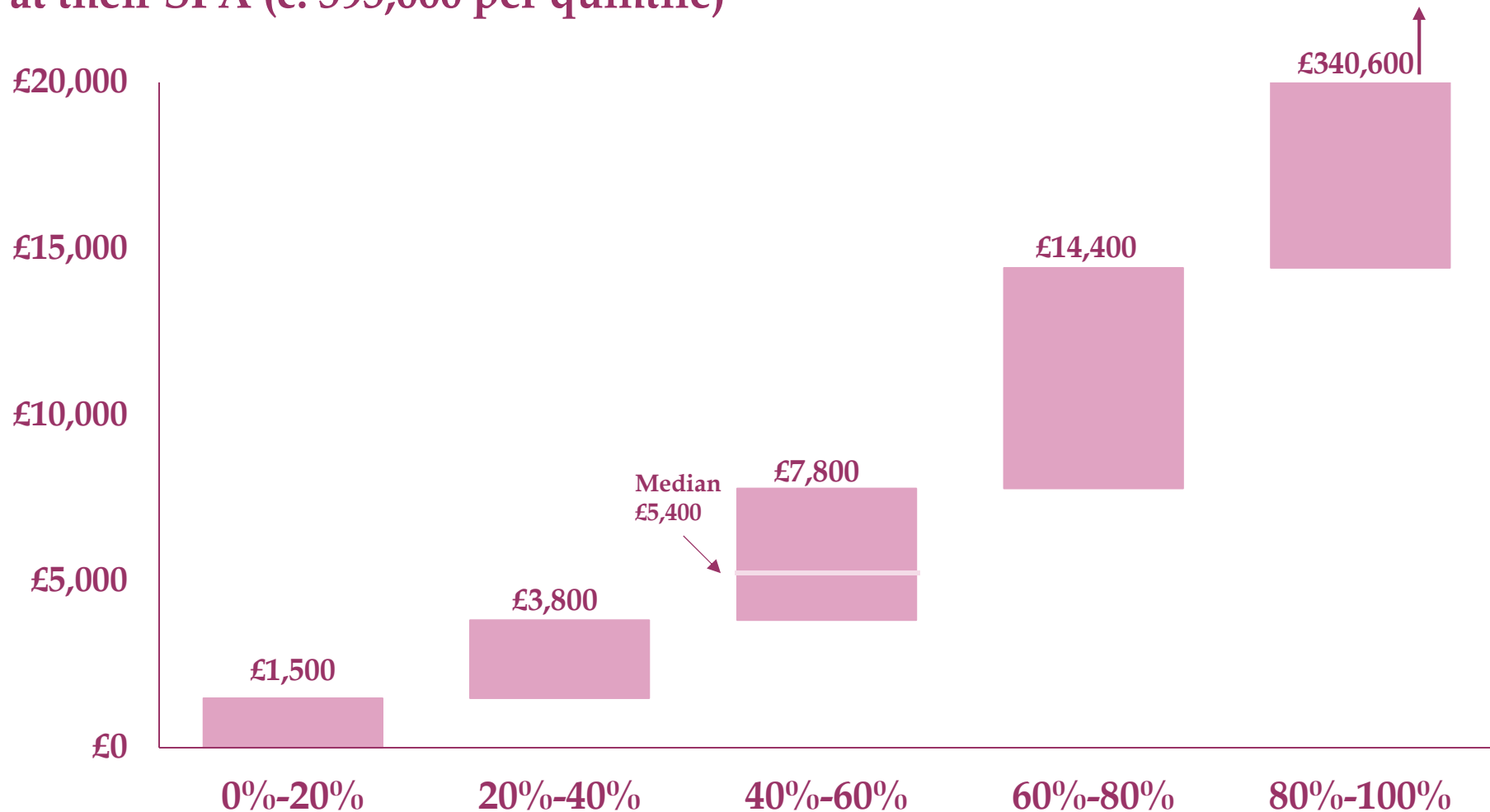


When today's 50-SPA year olds reach SPA, 80% (2.4m out of 3m) with DB savings will have annual entitlement of **£14,400 or less**

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Quintiles of yearly DB entitlement for individuals aged 50 to SPA in 2014, at their SPA (c. 595,000 per quintile)



As more people reach retirement the average level of DC savings will increase

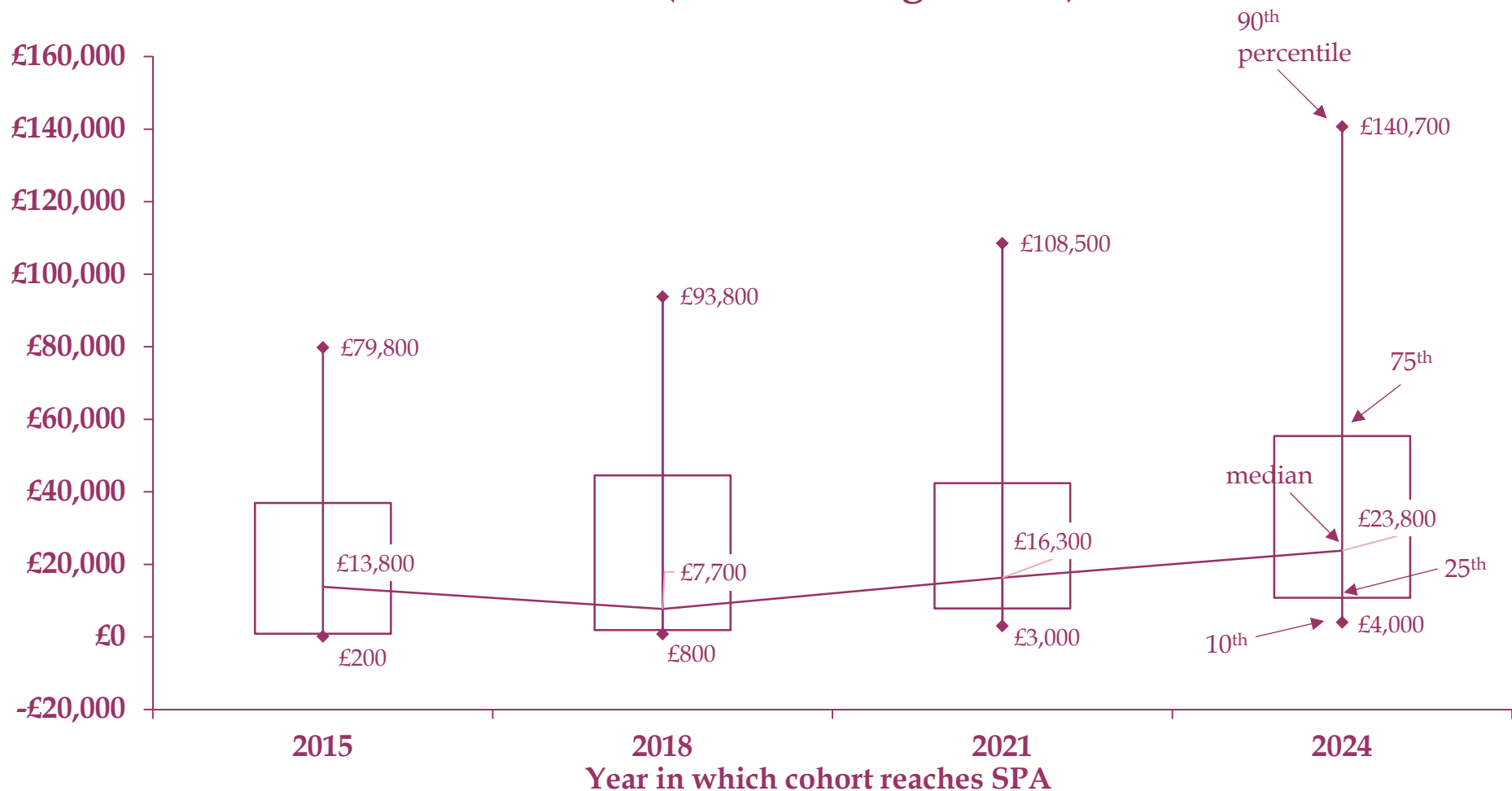
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- Between 2015 and 2024, the median level of DC savings for those reaching SPA with DC savings will rise from £13,800 to £23,800
- The 90th percentile could increase by around 75% from £79,800 to £140,700
- There could be a dip in 2018 as many more pots are introduced as a result of auto-enrolment, but have not had very long to mature

DC pot sizes will become successively bigger for future cohorts of people reaching SPA

Percentiles (10th, 25th, 50th, 75th, 90th) of DC savings for individuals reaching SPA in 2015, 2018, 2021 and 2024 (2014 earnings terms)



Over the next ten to fifteen years people's pension savings portfolios vary



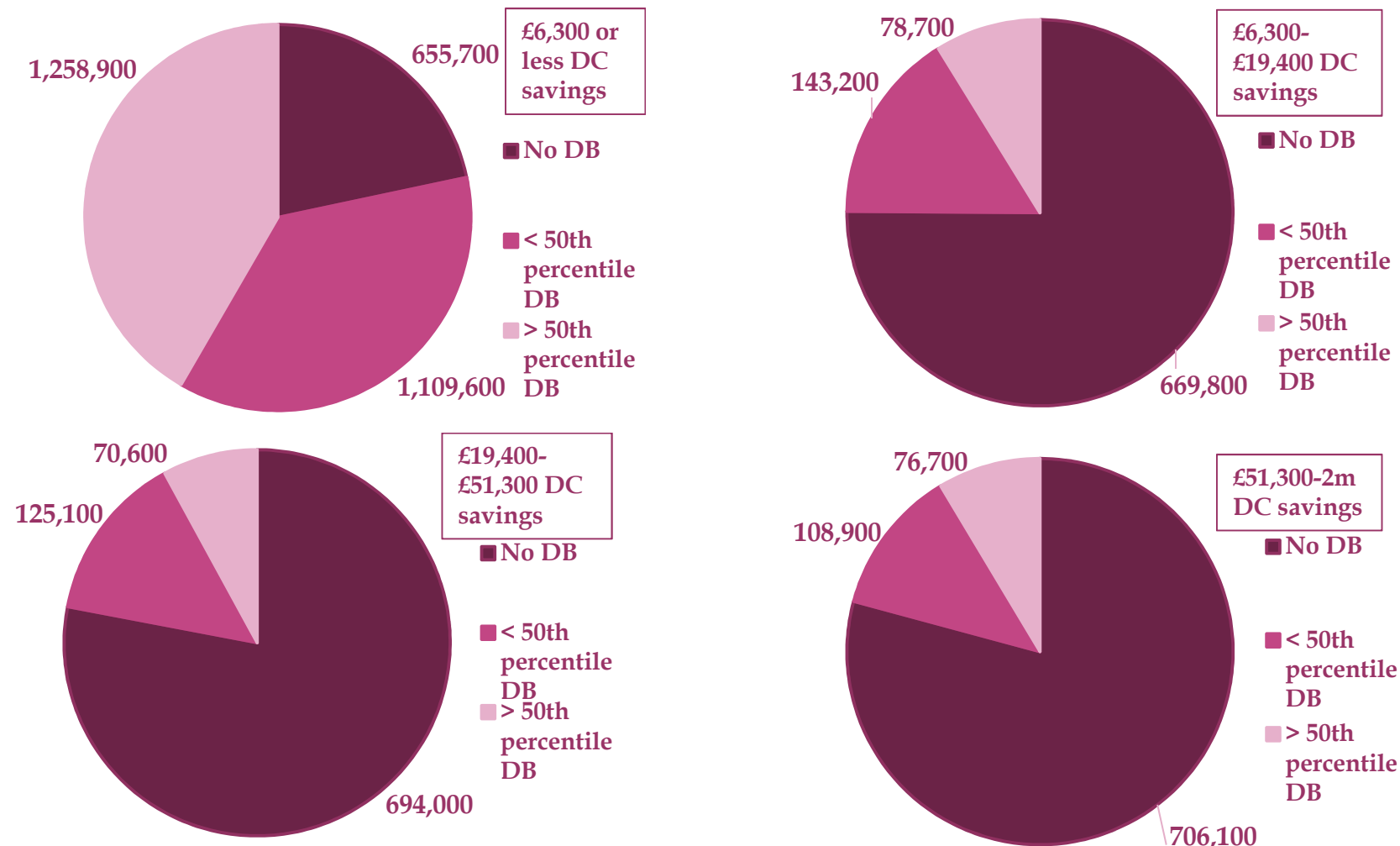
- Around 5.7 million people currently (2014) aged between 50 and SPA in England will have some private pension savings or entitlement at their SPA
- Around half of these people could have DC pots of £6,300 or less (including those who will have no DC savings).
 - Around three quarters of those with £6,300 or less, could have DB entitlement.
- Around 2.1 million (of the 5.7m) people have only DB at SPA, 2.7 million only DC at SPA

Those with high levels of DC savings are less likely to have DB entitlement

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Groups divided by 25th percentiles of DC savings and shaded by level of DB entitlement (people aged 50 to SPA in 2014 at their individual SPAs)



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Different segments face different levels of risk

- The research explores how different indicators correlate with pension saving portfolios.
- These provide information about the likely needs and characteristics of the segment groups.
 - Socio-economic class
 - Non-pension savings and assets
 - Proxy indicators of financial skill and engagement, including numeracy

Risk is associated with dependence on DC and low levels of financial skill and engagement

- 12% of people reaching SPA with private pension savings over the next ten to fifteen years are classified as being at **high-risk** of making poor decisions with their DC savings
 - These are groups with a significant level of DC savings - between £19,400 and £51,300 at retirement
 - no additional DB pension to fall back on, little other savings and assets
 - Low levels of financial skill and engagement
 - Less likely to be targeted by advice industry

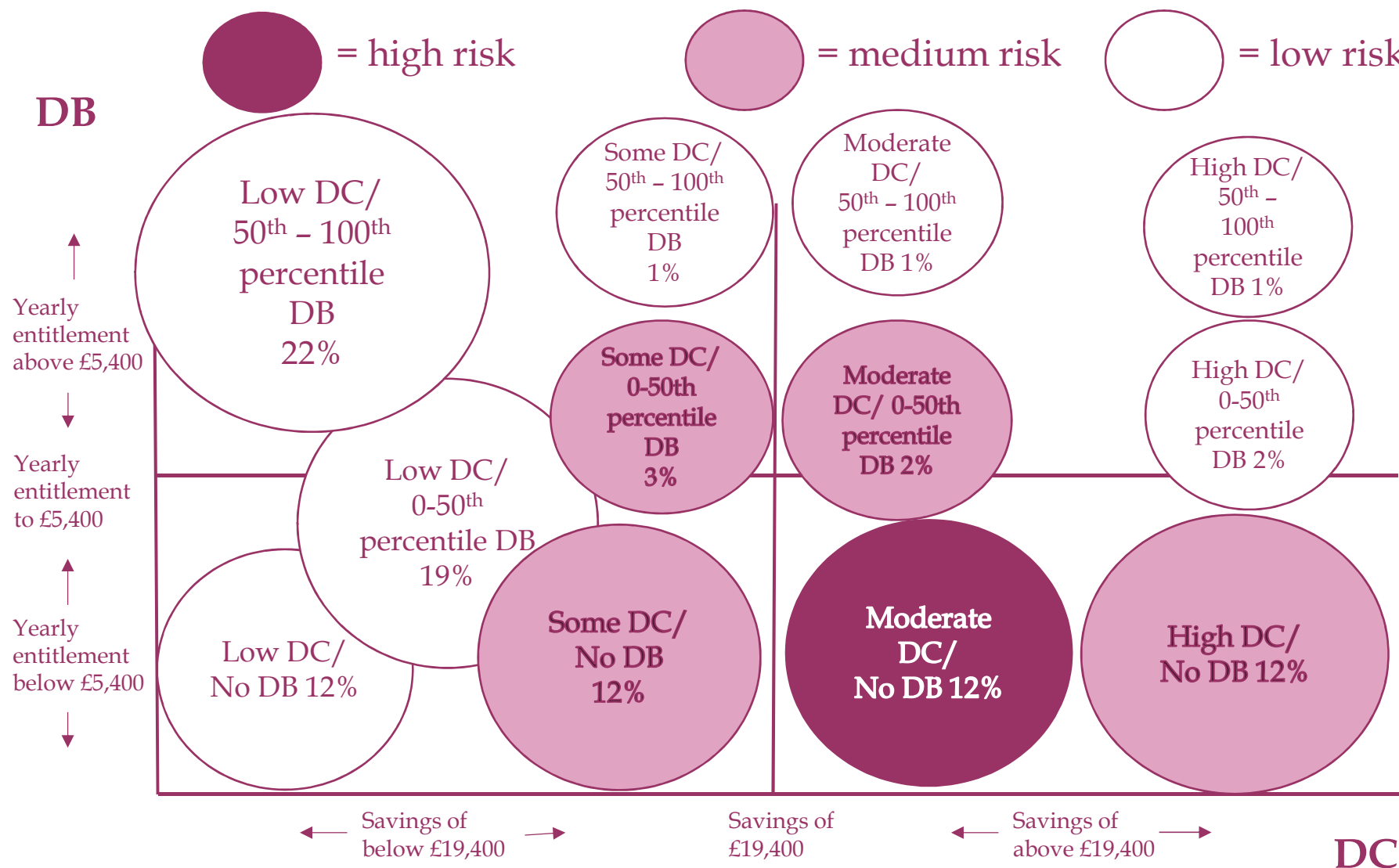
Risk is associated with dependence on DC and low levels of financial skill and engagement

- A further 29% of people (or 1.6 million over the next 10-15 years) aged 50-SPA in 2014 will be at **medium-risk** of making poor decisions with their DC savings
- Year on year the number with DC savings at **medium to high risk** could grow as a proportion of those *reaching SPA with private pension savings*
 - 2015 - around 100,000 or 20%
 - 2024 – around 240,000 or 55%

People with DC savings and low or no DB entitlement are most “at-risk” of making poor decisions

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Conclusions and issues for discussion

- Decisions about accessing DC pensions are becoming more complex – but majority will continue to have small pots (under £30,000)
 - What products and strategies will suit the majority of DC savers?
 - Should products, advice and support be designed to target people with particular pot sizes?
 - Should pot size determine what type of retirement income strategies and products people are “nudged” towards?

Conclusions and issues for discussion

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- Those at highest levels of risk of making poor decisions about their DC savings have lower levels of numeracy and engagement
 - How are these people likely to respond to the new flexibilities? Will they engage with the guidance service? Or are the majority likely to just take their DC savings as a lump sum or sums?
 - What guidance and advice services will be the most appropriate for these medium to high risk groups?
- Is there enough policy attention on groups of people likely to have low to medium levels of DC savings?