Pensions Policy Institute

PPI

Supporting later life

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The Pensions Policy Institute (PPI)

The PPI is an educational, independent research organisation with a charitable objective to inform the policy debate on pensions and retirement income provision. The PPI's aim is to improve information and understanding about pensions and retirement provision through research and analysis, discussion and publication. It does not lobby for any particular issue or reform solution but works to make the pensions and retirement policy debate better informed.

Pensions affect everyone. But too few people understand them and what is needed for the provision of an adequate retirement income. The PPI wants to change that. We believe that better information and understanding will lead to a better policy framework and a better provision of retirement income for all. The PPI aims to be an authoritative voice on policy on pensions and the provision of retirement income in the UK.

The PPI has specific objectives to:

- Provide relevant and accessible information on the extent and nature of retirement provision
- Contribute fact-based analysis and commentary to the policy-making process
- Extend and encourage research and debate on policy on pensions and retirement provision
- Be a helpful sounding board for providers, policy makers and opinion formers
- Inform the public debate on policy on pensions and retirement provision.

We believe that the PPI is unique in the study of pensions and retirement provision, as it is:

- Independent, with no political bias or vested interest
- Led by experts focused on pensions and retirement provision
- Considering the whole pension framework: state, private, and the interaction between them
- Pursuing both academically rigorous analysis and practical policy commentary
- Taking a long-term perspective on policy outcomes on pensions and retirement income
- Encouraging dialogue and debate with multiple constituencies

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Executive Summary

Preparing for later life requires people to make complex plans for the unpredictable challenges they may face

The first report in this series, *Living through later life*, identified three phases of later life determined by level of disability or difficulty performing essential tasks (Independent, Decline, Dependent), while highlighting that transitions between these phases are unpredictable, can be sudden, and that not everyone will experience all three phases in order or even at all. In order to support these unpredictable challenges, people must make equally complex decisions about how to use their savings and assets in order to support later life.

Other non-financial factors that could influence people's decisions about how to access their retirement savings include:

- Household and family circumstances
- Expectations of retirement
- Desire to leave bequests

Low levels of financial capability and behavioural biases may prevent people from making choices which can maximise their retirement income

Many people struggle to understand financial fundamentals such as tax, probabilities and inflation risks or how investments and retirement income products work. People often struggle to understand charges, risks and value for money. This is in part because of the perceived lack of clarity in product information, but also because many people have little exposure to these products during their working lives.

Across all levels of financial capability, behavioural biases can act as a barrier to effective and timely later life plans. People tend to:

- Fear ageing and associated health declines
- Have low levels of trust in the pension industry
- Have low levels of personal savings and resources with which to support later life[1]

1 Citizens Advice (2015a)

Resources available to draw upon to support later life vary substantially across the wealth distribution

Total wealth varies drastically between those in different wealth quintiles. For example, someone in the top wealth quintile might have around £1,350,000 in total wealth at age 66, compared to just £13,000 for someone of the same age in the lowest wealth quintile. However, perhaps even more important than the disparity in total levels of wealth, is the difference in types of wealth held. For those in lower wealth quintiles, much of their wealth is concentrated in illiquid assets such as physical belongings and property, if they have been able to buy a house during working life, which many in lower quintiles have not. This leaves them heavily dependent on the State Pension to provide them an income in later life, and with limited choice as to how to use their assets to support themselves. Those in higher wealth quintiles have higher levels of liquid wealth, such as pension savings and financial wealth. As a result, they may require greater support in managing their money over the course of later life to achieve positive outcomes. Whereas those in lower wealth quintiles are likely to benefit more from well-designed safety nets and state support.

Following the introduction of Freedom and Choice, people are likely to need more ongoing guidance and advice throughout the course of later life

Given the complexity of retirement decisions, particularly since the introduction of pension freedoms, many people will find it difficult to make choices that will best meet their needs over the course of later life. For some people initiatives aimed at increasing engagement and financial capability will equip them to make appropriate decisions. Advice and guidance plays an important role in supporting people while making these choices, although most advice and guidance offerings currently focus on at-retirement decisions rather than ongoing support throughout later life. For those with lower levels of financial capability, greater support in making these decisions may be needed to improve later life outcomes, while those with low levels of savings are likely to need support from Government in meeting their later life needs.

Pre-retirement education and ongoing support throughout later life are vital to supporting positive later life outcomes

In order to make appropriate choices when faced with the complex retirement decisions described in this report, people are likely to need:

- Increased engagement and understanding of pensions, which can be promoted through pre-retirement education initiatives, as well as wake-up packs.
- Ongoing support throughout later life, through both advice and guidance, as well as the other policy levers.

While advice and guidance can help some people to achieve positive later life outcomes, others may need support from Government to achieve better outcomes

There are a range of policy levers beyond advice and guidance which could be used to improve later life outcomes:

- Compulsion: Unlikely to have a place in the post-pension freedoms landscape.
- Defaults: default offerings, such as the investment pathways currently being formulated, could help to guide people towards appropriate retirement decisions in cases where they are unwilling or unable to make informed active choices.
- Safety nets: essential to protecting older people from the poorest later life outcomes, but it is important that engagement and take-up rates are maximised.
- Consumer protection: recent policy changes from the Financial Conduct Authority (FCA) have been focused on increasing consumer protection and ensuring that people are protected from especially detrimental decisions, particularly where they result from inertia and lack of engagement.
- Behavioural interventions: alongside initiatives aimed at pre-retirement education and increasing engagement could help to improve later life outcomes.

Introduction

Decisions about how to achieve positive later life outcomes are becoming increasingly challenging. Increasing numbers are reaching retirement heavily dependent on Defined Contribution (DC) savings, with little or no Defined Benefit (DB) entitlement. Since the introduction of pension freedoms, people have greater flexibility in how they will access and use these savings. But they are also likely to live longer than previous generations of retirees and experience a more diverse range of later life trajectories. With low levels of engagement and understanding of pensions and later life planning, making informed decisions is a challenge that people will need to overcome if they are to achieve better later life outcomes. With the introduction of pension freedoms it is also likely that there will be a greater need for support in making decisions throughout the course of later life, rather than just at the point of retirement.

Following on from the first report in this series, *Living through later life*, this second report in the series explores the complexity of financial and practical decisions older people may face, the current frameworks in place for supporting these decisions, and ways in which later life outcomes could potentially be improved.

The next section summarises the phases of later life identified in the first report and the range of challenges people may face as they journey through later life.

Chapter one describes the challenging nature of decisions about retirement and later life and looks at the extent to which people are prepared for this challenge.

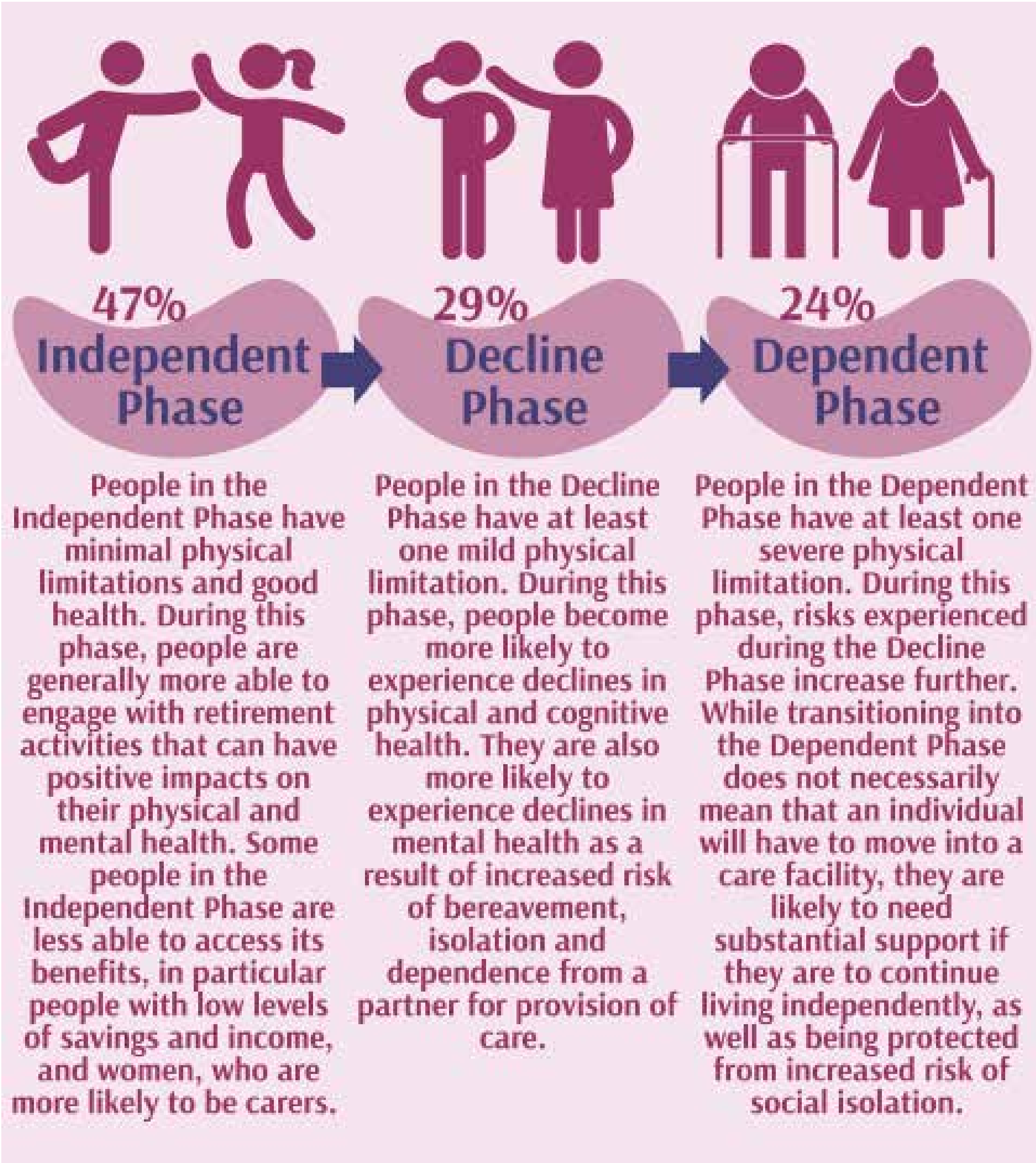
Chapter two analyses the way in which wealth evolves over the course of later life.

Chapter three discusses retirement income products and the impact they may have on later life outcomes.

Chapter four explores whether the current advice and guidance landscape adequately supports ongoing later life decisions, and potential policy levers which may improve later life outcomes.

Living through later life: The phases of later life

The first report in this series explored the range of challenges people may face in later life. Using data from the English Longitudinal Study of Ageing (ELSA), the research categorised later life into three phases.[2]



2 Wilkinson, L. Jethwa, C. (PPI) (2019)

The Independent Phase of later life, associated with:

- The capacity to engage more actively with work, volunteering and leisure activities:
  - On average, people in the Independent Phase spend more money on leisure activities and eating out than those in the Decline and Dependent Phases. They're also less likely to express wanting to engage in more leisure but being unable to do so.
  - Almost half (47%) of those in the Independent Phase are in paid employment, compared to around a third (30%) of people in the Decline Phase and just 11% of those in the Dependent Phase. Although this declines steadily with age, between ages 70-74 one in ten (10%) people in the Independent Phase are still in paid employment.
  - 17% of people in the Independent Phase volunteer at least once a month, compared to 14% and 10% of those in the Decline and Dependent Phase respectively.
- Good levels of general physical health and no physical limitations.
- Low risk of accelerated cognitive declines; some normal age-related cognitive decline may begin to occur, however people in the Independent Phase are more able to engage in activities which may slow these declines.
- The potential for improved mental and emotional wellbeing, as a result of increased freedom and relief from the stress of working life, although this will not be the case for everyone in the Independent Phase.
- A lower risk of changing household composition as a result of bereavement and the negative effects this can lead to.
- Low risk of social exclusion as people in this phase are more likely to be actively involved in their community than those who are restricted in their mobility.

The Decline Phase of later life, associated with:

- Declines in physical health, though less severe than those associated with the Dependent Phase.
- Increased risk of accelerated cognitive decline, though again less severe than those associated with the Dependent Phase.
- Less freedom and control over how time is spent, as physical limitations begin to reduce people's ability to engage with more strenuous activities. Poor health, low incomes and competing demands such as caring responsibilities can be a barrier to many older people accessing the benefits of pursuing positive retirement activities, particularly as they transition into the Decline and Dependent Phases.
- Increased likelihood of losing a spouse or partner, which can lead to declines in mental and emotional wellbeing, loneliness and further declines, particularly if not adequately prepared for this loss.

The Dependent Phase of later life, associated with:

- More severe physical declines and limitations, which may limit individuals in this phase from continued independent living. 12% of those aged 80 and over live in residential and nursing homes. Half (47%) of those in the Dependent Phase say that their health prevents them from doing things they would like to do.
- A significantly increased risk of experiencing accelerated cognitive decline as the probability of suffering dementia increases with age. One in three people aged 95 and over suffer from dementia, compared to one in six aged over 80 and one in fourteen aged over 65.
- High risk of loneliness and other experiences of adverse mental and emotional wellbeing. 14% of people in the Dependent Phase say they lack companionship, feel isolated from others or feel lonely often.
- High risk of social exclusion as severe physical limitations inhibit individuals from actively engaging with their community, as well as accessing basic services. Around one in five people in the Dependent Phase find it difficult or even impossible to access basic services such as banks, shops and GPs.

For more information about the way these phases were categorised see Appendix One: Technical Appendix.

Chapter One: How prepared are people for later life?

Most people are likely to find it difficult to make informed decisions about how to access their pension savings. Planning for later life is complex and requires people to draw on a range of skills to make decisions about unpredictable future events. People are likely to need considerable support with making these decisions if they are to achieve positive later life outcomes, both in the immediate future and increasingly going forward as more people will reach retirement with greater reliance on Defined Contribution (DC) savings. This chapter explores this challenge and the extent to which people are prepared for it.

In general people are underprepared for later life and the challenges they may face

Among those aged 50 to 59 only around half (53%) say they have hopes or ambitions for their later life, 22% say they have some ideas but have not thought about it that much, and the remaining quarter (25%) have not really thought about it at all.[3] And among those aged 55 to 64 who have a DC pension pot, over a third (35%) have yet to decide on how to convert this into an income.[4]

Among those aged 55 to 64 who have a DC pension pot, over a third (35%) have yet to decide on how to convert this into an income.

Box 1.1: The types of financial decision-making people might need to make when accessing their pension savings from age 55

- What are the different options for accessing and using savings and assets? What are the implications of choosing different options?
- Is my income sustainable?
- How do I differentiate between fraudsters and genuine providers?
- How much should I take from different savings sources in order to preserve my capital?
- What options are available if financial difficulties arise during retirement?
- How could different choices interact with eligibility for means-tested benefits?
- How can I ensure that contingencies are in place for if/when I am no longer capable of managing my own money?
- How could longevity, inflation, market turbulence and the need for care affect both my need for, and sources of, income?

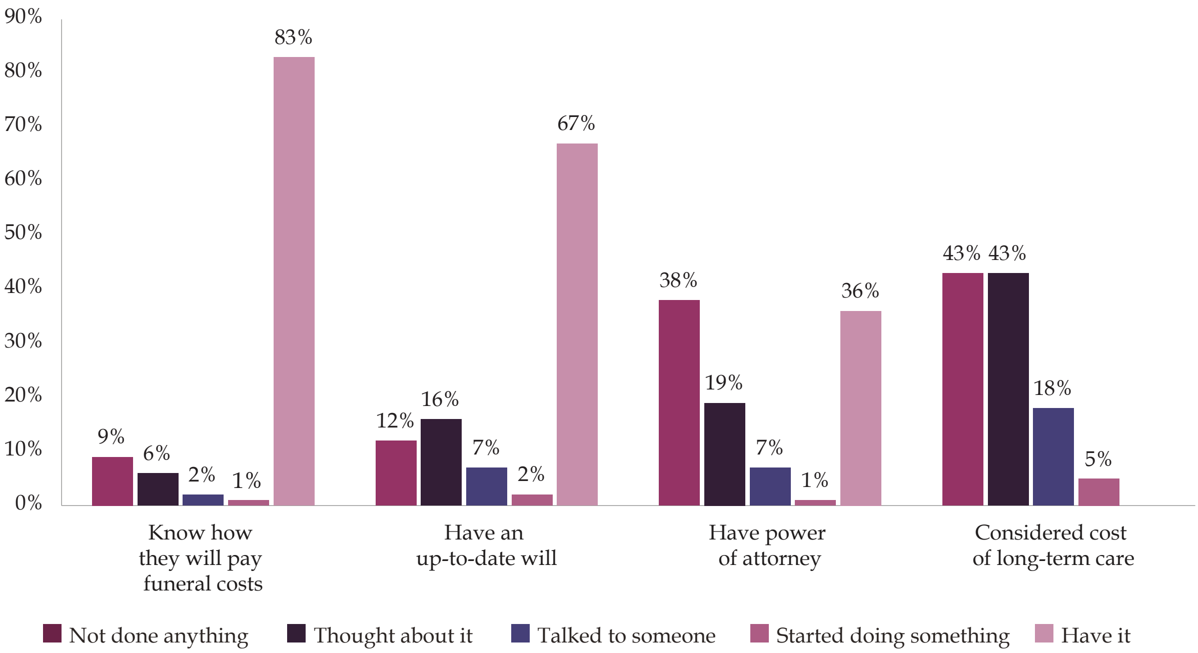
3 Centre for Ageing Better (2018)

4 Columbia Threadneedle Investments (2018)

Among people aged 65 and over, many have not put in place plans for challenges they may face as they reach older ages. While the majority (83%) of over 65s know how they will pay for their funeral, less than two in five (36%) have a power of attorney, while a similar proportion (38%) have not thought about this need at all (Chart 1.1). Although more people will put plans in place as they reach older ages, the health transitions they will face in later life are unpredictable so while people may expect to live for many years in good health post-65 they may find themselves experiencing sudden unexpected health declines that could be better navigated by making plans well before the need for them.

Chart 1.1[5]
More than half (57%) of over 65s have not taken any action to put in place a power of attorney

Extent of planning for later life among people aged 65+



Planning for later life requires people to draw on a broad range of skills to make complex decisions about unpredictable futures

Most people are not exposed to the types of decisions they will face in retirement during working life. In order to make an informed decision about accessing pension savings and structuring income in retirement people need to be able to understand economic factors such as inflation, market-based risks and longevity risk. People may struggle more with complex decisions about how to use DC savings to support themselves in later life than those with Defined Benefit (DB) savings who can make an informed decision based on a more limited understanding (as DB scheme members are protected against inflation, market-based risks and longevity risk).

While people who are good at managing money day to day tend to also be more prepared for retirement, the two require quite different skills and knowledge.[6]

Engagement with and understanding of pensions and other aspects of retirement decisions are low

Levels of engagement and understanding of pensions are on average low throughout working life, and there is no reason to expect these to suddenly improve at the point of retirement.

5 MAPS (2019)

6 MAS (2017a)

Non-engaged people:

Non-engaged people struggle to manage their own finances, do not actively budget or save, avoid making short or long-term financial decisions, but have the potential to become more engaged.[7]

Non-engaged people:

- Are more likely to fall into debt.
- Do not save for short or long-term goals.
- Generally feel that their financial management approach is "working".
- Have low general knowledge about personal finance, available financial products and support options.
- Generally have low levels of financial capability and confidence.
- Are less likely to demonstrate the behavioural attributes associated with managing finances well: preparedness, adaptability, taking responsibility and an ability to deal with their own emotions.
- Generally are not saving due to a lack of perceived affordability.
- Are motivated to delay saving because of the need to pay off existing debts.
- Tend to be on low to average incomes (but those on high incomes can also be non-engaged).[8]

Lower levels of financial capability can reinforce non-engagement

Low levels of financial capability makes simple financial choices more difficult, which can reinforce non-engagement.[9] Difficult or confusing choices often result in people abdicating decision-making to someone else or choosing the path of least resistance (the default or most available option).

Somewhat engaged people:

Somewhat engaged people are comfortable with managing their day-to-day finances and may be saving for short-term purchases (within the next few years) or save at a low level for emergencies.[10]

Somewhat engaged people:

- Have higher levels of financial capability and financial confidence than the non-engaged.
- Generally save for the short-term but are not engaged in long-term saving.
- Generally feel that they are "making ends meet".
- Tend to manage their finances through short cuts (influenced by anchoring and rules of thumb) such as sporadic balance checks and "mental accounting" which can lead to inaccuracies.
- Generally have a greater understanding of available guidance, information and support services but may not be aware of all of them.
- Are more aware of financial options than the non-engaged.
- Are more likely to be "over confident" beyond their level of capability than the non-engaged. Over-confidence can lead to poor decision-making.[11]

7 MAS (2014)
8 TNS BRMB (2015)
9 TNS BRMB (2015)
10 TNS BRMB (2015)
11 TNS BRMB (2015); MAS (2014)

Engaged people:

Engaged people generally have higher average incomes, though a minority of engaged people have low incomes. While issues of low engagement can be a barrier across the wealth distribution, high levels of engagement are often associated with higher levels of wealth.[12]

Engaged people:

- Have higher levels of financial capability than the non-engaged and somewhat engaged.
- Are more likely to be financially comfortable.
- Are more likely to have a "professional" job.
- Tend to have more automated systems of managing finances, for example, involving the use of spreadsheets.
- Are likely to be saving both for short-term needs and long-term goals.[13]

Low levels of financial capability and behavioural biases may prevent people from making choices which can maximise their retirement income

Many people struggle to understand financial fundamentals such as tax, probabilities and inflation risks or how investments and retirement income products work. People often struggle to understand charges, risks and value for money. This is in part because of the perceived lack of clarity in product information, but also because many people have little exposure to these products during their working lives.

Low levels of engagement and understanding pensions may be in part a result of long-term dependence on DB entitlement, which doesn't require members to be as engaged or to make as complex decisions. Over the next few decades, people will reach retirement with higher levels of DC savings and the potential negative impact of poor decision-making will increase.

Interventions to help people improve their levels of financial capability are shown to be effective when people are:

- Given a clear outcome to work towards.
- Provided with a structure and the relevant tools to help them work towards the stated outcome.
- Able to access salient information about the outcome they are working towards such as why it matters, and the difference it will make to them.
- Informed about their progress regularly.
- Not left feeling deprived by the intervention – it is important to acknowledge that spending fills an emotional and/or social need.
- Left feeling empowered, and in control of their financial situation.[14]

Cognitive decline over the course of later life may make it more difficult for people to make appropriate decisions about how to access their savings.

Cognitive decline over the course of later life may also make it more difficult for people to make appropriate decisions about how to access their savings. While someone accessing their savings for the first time at State Pension age (SPa) may have the financial capability to manage their own investments and withdrawal rates, this may not be the case as they reach older ages, at which point it may make more sense to annuitise remaining funds.

It is vital that people put in place plans while they are still in the Independent Phase that will prepare them for the challenges they may face as they reach older ages.

People in the Independent Phase are more likely to be able to make these decisions for themselves than those in the Decline and Dependent Phases,

12 ONS (2015)

13 TNS BRMB (2015); MAS (2014)

14 MAS (2014)

although low levels of financial capability and engagement can still be a barrier. As people transition through the Phases, the likelihood of experiencing accelerated cognitive decline increases, so it is vital to later life outcomes that people put in place plans while they are still in the Independent Phase (whether before, at or during retirement) that will prepare them for the challenges they may face as they reach older ages.

Numeracy levels, which are closely linked to financial capability, are currently low

People with higher levels of confidence and competence in dealing with numbers tend to be better at managing their money and making financial decisions. Higher levels of numeracy are correlated with:

- A greater likelihood of paying bills on time;
- Increased frequency of saving; and
- Higher levels of saving.[15]

However, numeracy levels are generally low. Four in five UK adults have low numeracy levels (below GCSE grade 'C'), and one in four believe school maths did not prepare them well for maths in everyday life.[16]

Levels of financial capability decline as people age, though confidence among older people remains high

On average, older people (over SPa or retired) are more confident compared to other age groups.[17] However, those aged SPa to age 75 tend to have financial capability just at or below the average for working age, but once people reach the age of 75, financial capability declines more quickly. Of those over age 75 only half are able to calculate the effects of interest and inflation and only 62% can correctly read a bank balance statement (compared to around 80% of those under age 75).[18] Many older people lack the knowledge and understanding to manage tax, benefits and pensions, and many are unaware whether they are eligible for Pension Credit, Housing Benefit, or Council Tax Reduction. It is estimated that more than four in 10 pensioner households (couples or single people) who are entitled to Pension Credit do not claim it.[19]

Behavioural biases can inhibit people from preparing effectively for later life

Across people with all levels of financial capability, behavioural biases can act as a barrier to effective and timely later life planning.

People tend to:

- Postpone complex or daunting decisions;
- Rely on inaccurate rules of thumb regarding their finances; and
- Take a short-term view, heavily discounting future income.[20]

Inertia can arise from competing priorities taking precedent, a lack of funds making people feel that there is no point trying to make decisions, or intimidation at the prospect of making decisions.

Inertia can arise from competing priorities taking precedent, a lack of funds making people feel that there is no point trying to make decisions, or intimidation at the prospect of making decisions. Natural tendencies towards inertia can be further exacerbated by complexity, uncertainty and a lack of understanding.

People may put off discussing or making decisions about pensions and later life because:

- They fear ageing and associated health declines,
- They have low levels of trust in the pension industry;
- They have low levels of personal savings and resources with which to support later life.[21]

In order to improve later life outcomes, people may need support in overcoming inertia and procrastination in order to make plans for the unpredictable challenges they may face as they age.

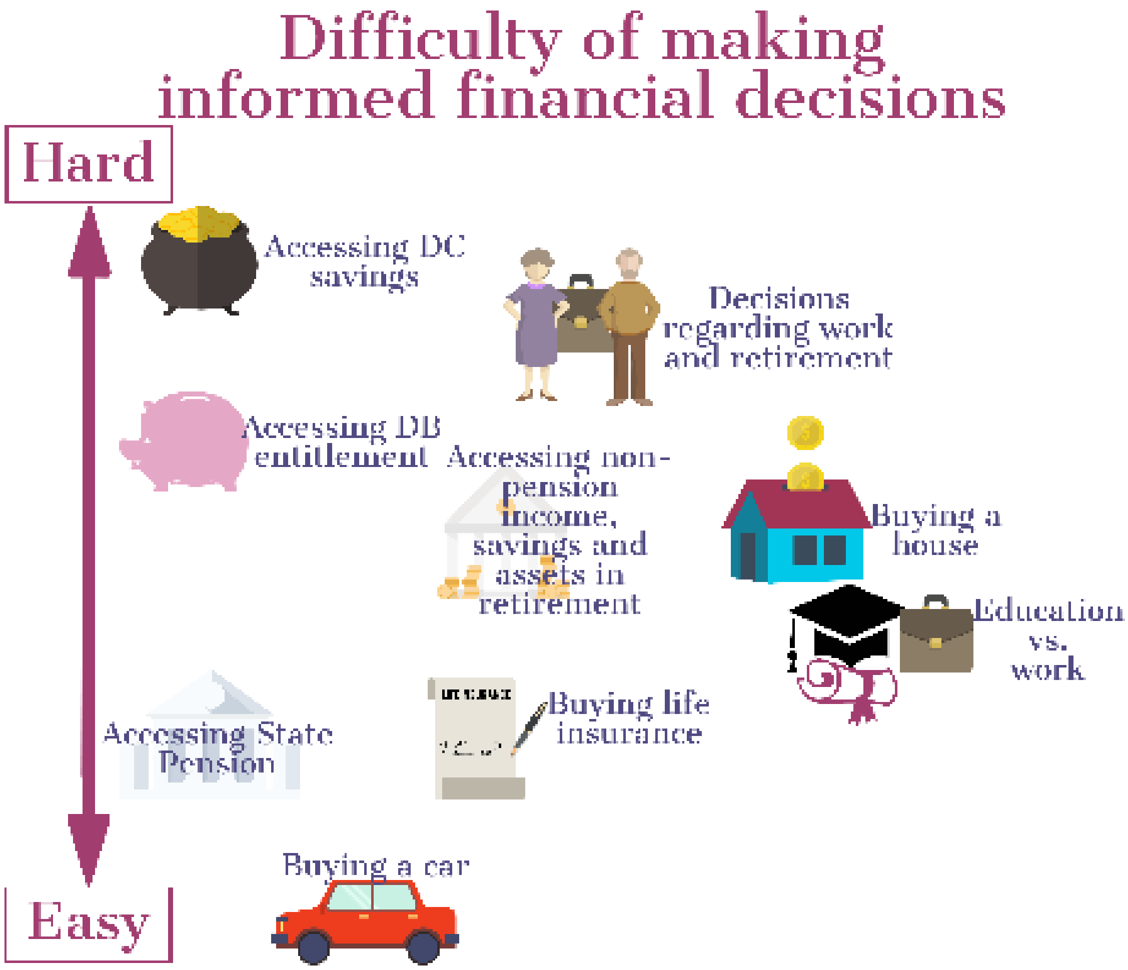
15 MAS (2017b)
16 https://www.nationalnumeracy.org.uk/what-issue
17 MAS (2017a)
18 Young (2016)
19 Independent Age (2019)
20 Work and Pensions Committee (2015)
21 Citizens Advice (2015a)

In order to improve later life outcomes, people may need to support in overcoming inertia and procrastination in order to make plans for the unpredictable challenges they may face as they age.

Decisions about accessing DC pensions are some of the most challenging financial choices people will have to make

Decisions about accessing DC pensions are considered the most challenging of pension and retirement decisions and other major financial decisions from across the life course. Prior to the introduction of pension freedoms the PPI worked with experts on behaviour and psychology of pensions and retirement decisions to rank them. Decisions related to pensions and retirement, and other major financial decisions from across the life course were ranked by the difficulty of making an informed decision on each. Their considered opinion was that making informed decisions about accessing DC savings was the most difficult of both working life and retirement financial decisions (Figure 1.1).

Figure 1.1[22]



The factors considered necessary to make informed decisions about DC savings involve knowledge of the economy and market risks, numerical skills and knowledge about the potential impact of unknown factors. Making an informed decision regarding work and retirement were ranked as second most difficult as these also involve a high degree of uncertainty.[23]

22 Rankings agreed by working group of experts including representatives from: Age UK, Citizens Advice Bureau, Centre on Household Assets and Savings Management, Fidelity, Ignition House, King's College, The Pensions Advisory Service, Which?.

23 For more information see Silcock, D. et al (PPI) (2014)

The complexity and risks associated with accessing pension savings have increased following the introduction of pension freedoms

The introduction of pension freedoms in 2015 increased the flexibility people have in how they choose to access and use their pension savings. In theory, this could enable people to better match their retirement income streams to their needs and preferences in later life. However, given low levels of engagement and financial capability, coupled with the complexity of the pensions landscape, the reality is that it exposes people to greater risk of negative later life outcomes as a result of making less than optimal choices about how to access their savings.

Personal circumstances beyond financial capability can impact people's ability to cope with the complexity of later life decisions

While people in the Independent Phase may be more cognitively able to make decisions about later life than those in the Decline and Dependent Phases, there are other factors which may make it difficult for them to cope with the complexity of the decisions they face. For example, those with caring responsibilities, who are more likely to be women, are likely to have less time and mental bandwidth to deal with the complexity of these decisions through independent research and seeking advice or guidance.[24]

As well as uncertainty around finances, planning for later life also requires people to plan for unpredictable transitions between the phases of later life

In addition to low levels of financial capability, retirement income needs are difficult to predict. This is increasingly the case as the retirement period is extending due to increased longevity. People who are retiring as early as age 55 will find it particularly difficult to predict what their life might look like in the years to come, with many now living well into their eighties and beyond.[25]

Although the gap between expectations and reality of life expectancy is narrowing, people are still generally underestimating how long they will live. Men aged 50 to 60 underestimate their life expectancy on average by around two years, and women by four years. In particular, too few people expect to live to a very old age. Among those aged between 30 and 60, 9% of men and 10% of women expect to live to age 90; official estimates suggest that 18% of men and 29% of women in this age group will in fact reach this age.[26]

While some decisions may not make optimal financial sense, this does not mean that they are not the right decisions for individuals to make. It is important to take a holistic view of retirement within which other more subjective aspects can be equally, if not more, important as a result of unique personal circumstances and priorities. Even in cases where these decisions may lead to poorer financial outcomes, this is not to say that individuals will not make them because of the complexity associated with retirement income decisions.

While financial experts are easily able to focus on the financial outcomes of decisions about accessing savings, many individuals, particularly those who are less engaged, are less able to compartmentalise this aspect from other retirement considerations.

Non-financial factors that could influence people's decisions about how to access their retirement savings include:

- Household and family circumstances
- Health and overall wellbeing
- Expectations of retirement
- Desire to leave bequests

In order to make decisions which are likely to deliver the best outcomes for the individual, these considerations must also be considered holistically alongside strictly financial considerations.

24 Wilkinson, L. Jethwa, C. (PPI) (2019)

25 MAS (2017c)

26 Crawford & Tetlow (2012)

Chapter Two: How does wealth evolve over the course of later life?

While health transitions and personal circumstances have a significant impact on later life outcomes, levels of savings and assets available to support later life also influence the quality of outcomes. This chapter looks at the ways in which different types of wealth evolve over the course of later life. Five hypothetical individuals, introduced in the first report of this series, *Living through later life*, represent average individuals within each of the five wealth quintiles.

Resources available to draw upon to support later life vary substantially across the wealth distribution

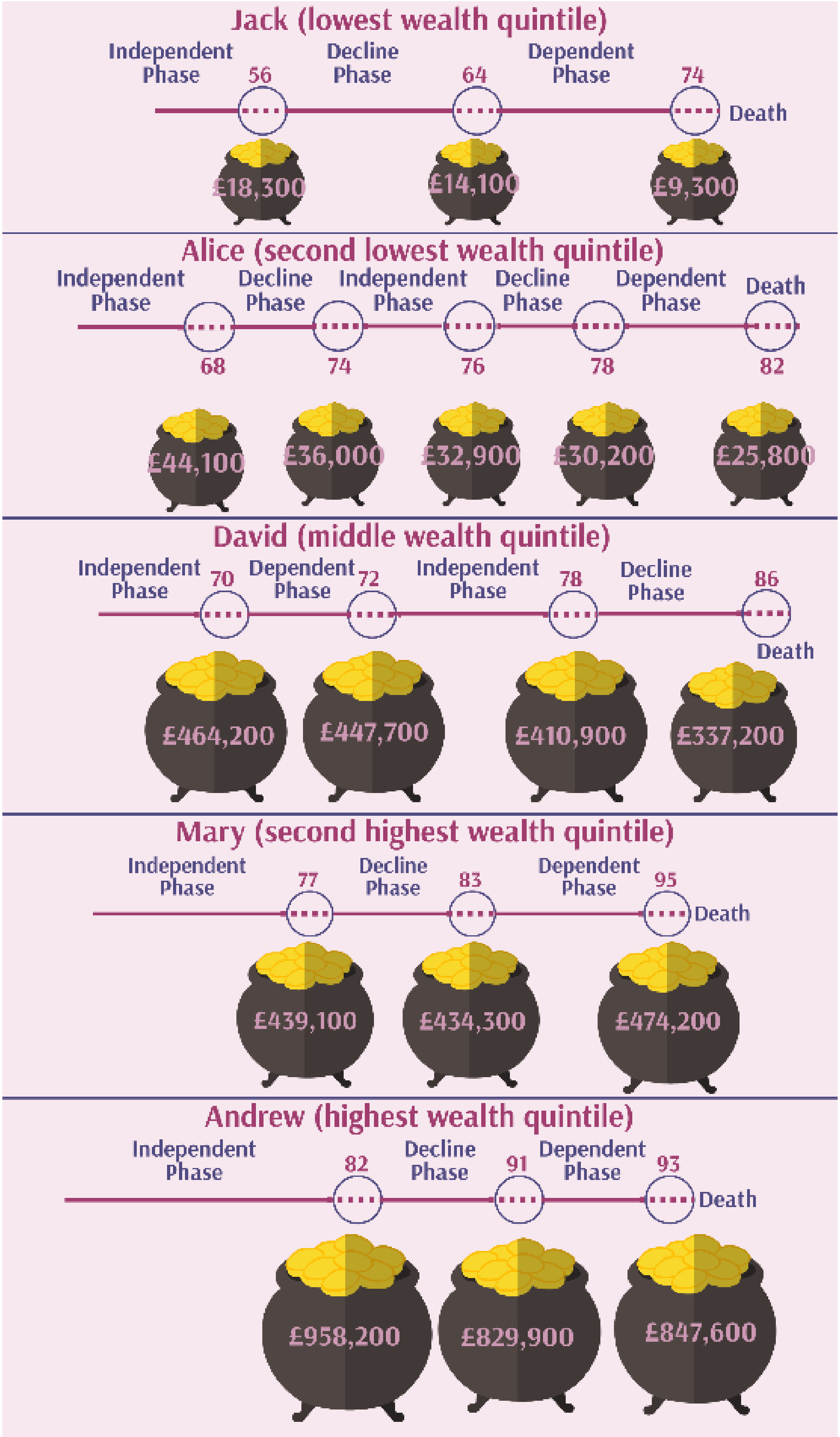
Most people reach retirement with a combination of savings and assets which fall broadly into four categories of wealth:

- Financial wealth: savings in bank accounts and other financial vehicles, such as ISAs and investments.
- Pension wealth: Defined Contribution (DC) savings and Defined Benefit (DB) entitlement.
- Property wealth: the value of properties owned, including main residence, second home and buy-to-let properties.
- Physical wealth: the value of personal possessions, including furniture, electronics, clothes, artwork, etc.

For illustrative purposes, this chapter and the next use five hypothetical individuals, representing a typical member of each wealth quintile, which were introduced in the first report.

Total levels of wealth vary drastically between individuals. The disparity between total wealth of those in the bottom two wealth quintiles (Jack and Alice) and those in the middle and upper two wealth quintiles (David, Mary and Andrew) is large (Figure 2.1).

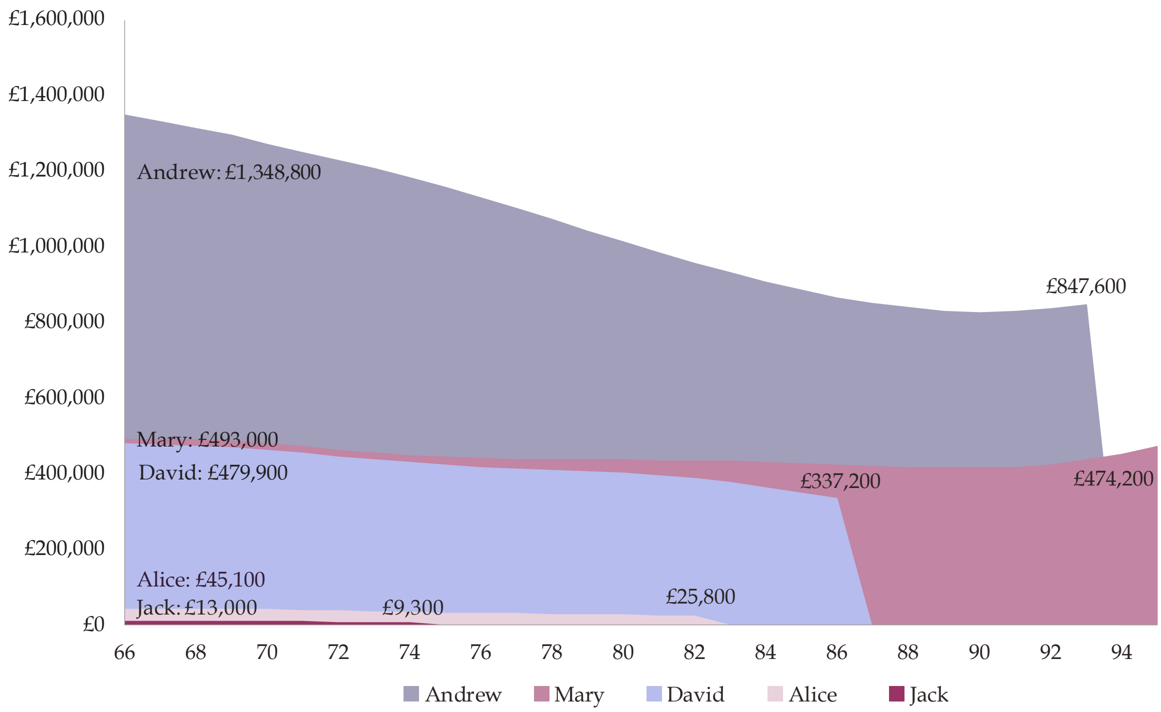
Figure 2.1: Transitions between phases of later life and total wealth at time of transition



Reductions in total wealth levels follow a similar pattern for most quintiles despite disparities in life expectancy

For Jack and Alice, total wealth, which is relatively low to begin with, declines by 30-40% between age 66 and their time of death (74 and 82 respectively). While their nominal wealth is higher, both David and Andrew's total wealth declines at a similar rate over the course of his later life, even though they live longer than Jack and Alice, with Andrew living almost 20 years longer than Jack. Mary, who is in the second highest quintile of wealth, is the exception to this rule. Her total wealth remains relatively stable over the course of her later life, declining by only around 4% between ages 66 and 95, when she dies (Chart 2.1).

Chart 2.1
With the exception of Mary, all other quintiles experience a 30-40% reduction in total wealth over the course of their later life



People in lower wealth quintiles are less likely to have pension and property wealth which could be used to support later life

Both Jack and Alice's respective wealth is concentrated in physical belongings, and to a lesser extent financial wealth (likely held in a current or savings account). People at the lower end of the wealth distribution are less likely to have substantial levels of pension and property wealth which could be used to help support later life income needs (Chart 2.2).

People in the two lower wealth quintiles are unlikely to have much, if any, property wealth. Neither Jack nor Alice has ever been able to purchase a house or save for a private pension, leaving both heavily dependent on the State Pension to provide an income in their later life. Among people in the lower two quintiles who do own a house, the average amount of property wealth is £69,000 and £106,500 respectively.

Chart 2.2
Total wealth is mainly comprised of physical and financial for those in lower wealth quintiles, while those in higher quintiles are likely to have higher levels of pension and property wealth

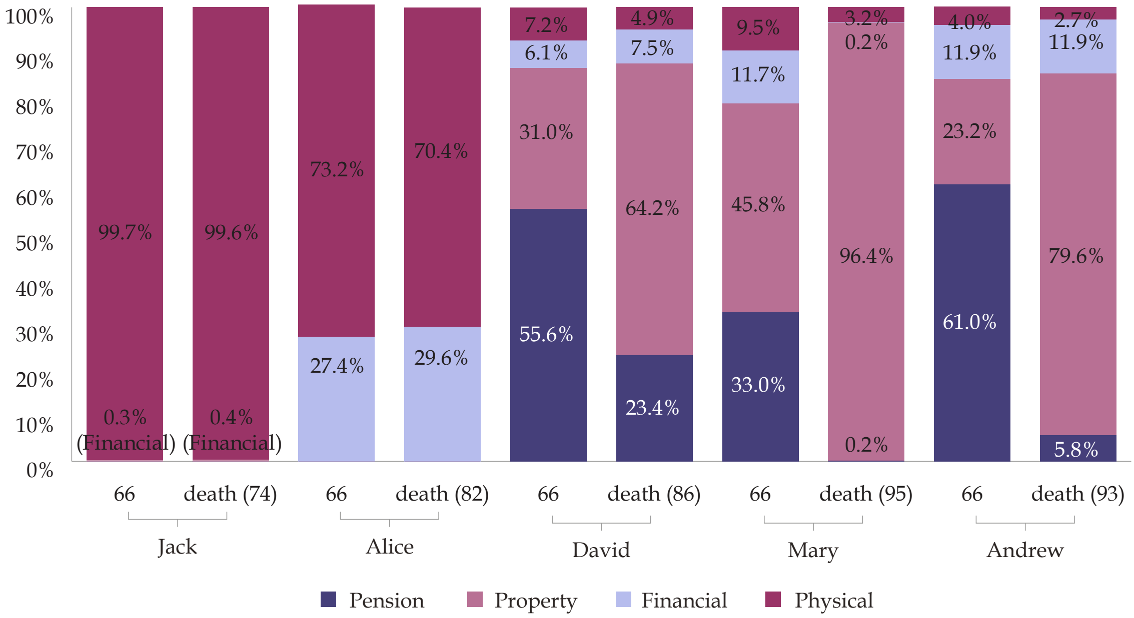
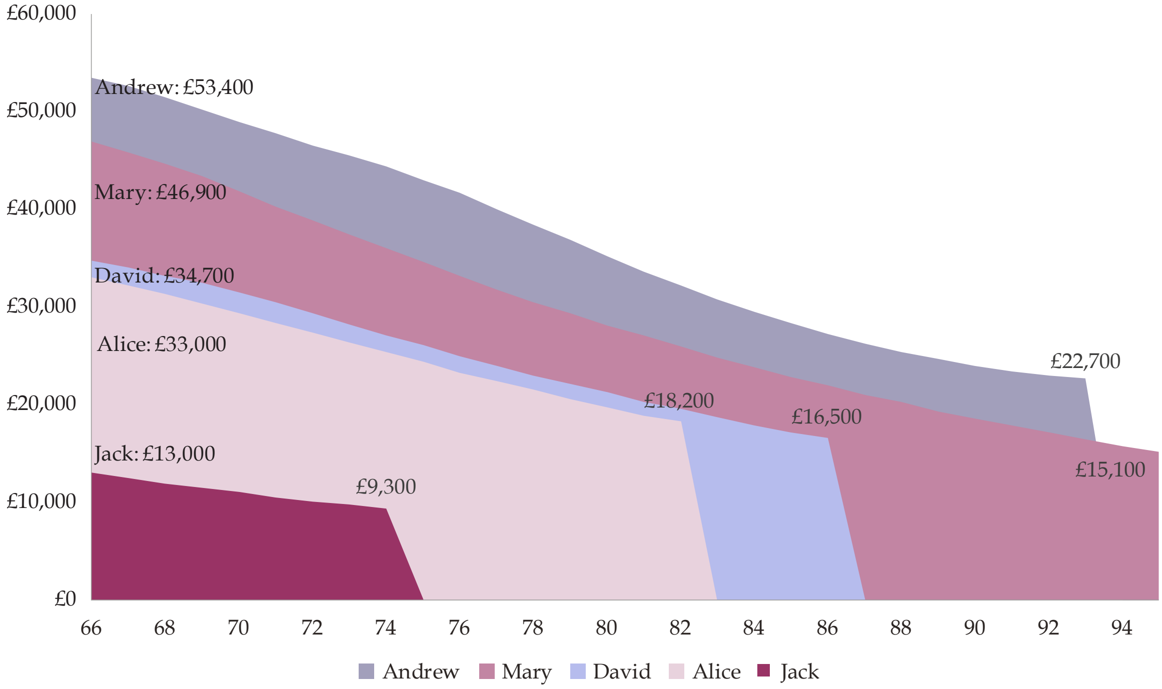


Chart 2.3
Physical wealth declines steadily over the course of later life across all wealth quintiles



Property wealth forms a substantial part of many people's wealth in later life but is not as liquid as pension or financial wealth

Alongside pension wealth, property wealth is the largest component of wealth for people in the top three quintiles, with the two types of wealth generally switching places over the course of later life (pension wealth decreasing while property wealth increases).

While property wealth can be used to provide additional resources to support later life, it is less liquid than other types of wealth like pension and financial wealth.

While property wealth can be used to provide additional resources to support later life, either through downsizing or equity release, it is less liquid than other types of wealth like pension and financial wealth.

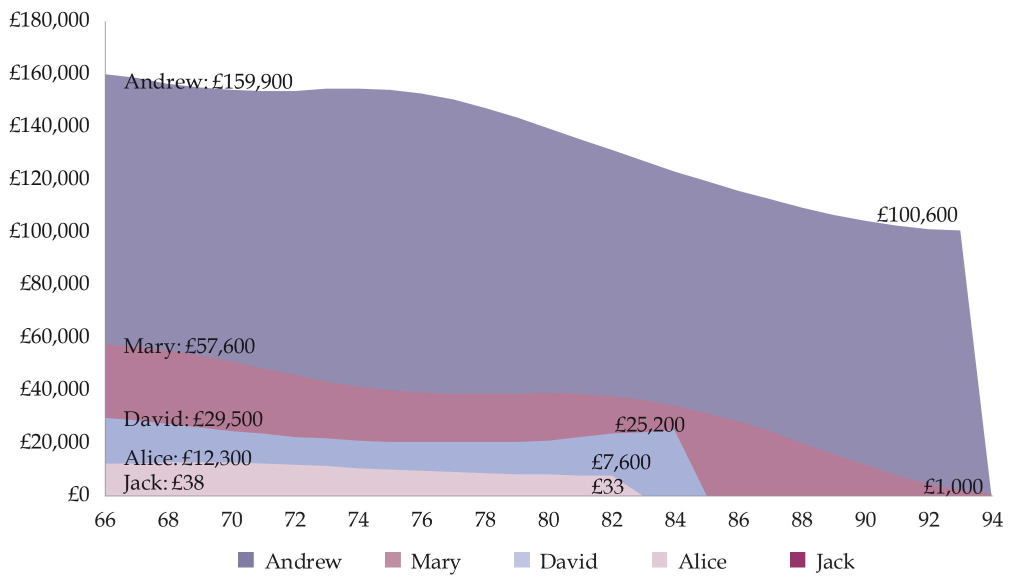
Physical wealth, while generally representing a much smaller amount of money than property wealth, is similarly not very liquid, particularly for those with low levels, as it is more likely to be made up of essential items.

Financial wealth, like pension wealth, is more liquid and available to be used to support later life

Financial wealth is more liquid than physical and property wealth and so more readily available to be used to support later life needs. However, levels of financial wealth are strongly correlated with levels of pension wealth, which is similarly liquid to support later life needs. Those at the higher end of the wealth distribution have both high levels of pension and financial wealth, meaning that financial wealth is unlikely to be needed to supplement income as pension wealth will in most cases provide ample support. Those at the lower end of the wealth distribution, who are likely to be most in need of the safety net financial wealth could provide, are also the least likely to have it, at least to any substantial degree. At age 66, Jack has just £38 in financial wealth and this remains relatively stable over the course of his later life (Chart 2.4). Alice has much more, with around £12,300 at age 66. However, given that she lives for a further twenty years, this is more likely to be used as a safety net for emergency needs, rather than a steady supplement to income.

Those at the lower end of the wealth distribution, who are likely to be most in need of the safety net financial wealth could provide, are also the least likely to have it, at least to any substantial degree.

Chart 2.4
Financial wealth is more liquid than physical or property wealth but levels are low for those in the bottom quintiles



Chapter Three: How do products impact later life outcomes?

The way people access their Defined Contribution (DC) savings has changed significantly since the introduction of pension freedoms: far fewer are purchasing annuities and far more are moving into drawdown or withdrawing their pension savings in their entirety. This means that more people will have to continue to make complex decisions about how to use their savings well into their older years. This chapter looks at the ways in which access to DC savings has changed since the introduction of pension freedoms and what this might mean for income in later life.

Prior to the introduction of pension freedoms, annuities were the most commonly used retirement product, but are now a much less common choice for people accessing their DC savings

In 2013, 90% of people who accessed their DC savings purchased an annuity, compared to 5% who purchased a drawdown product and 5% who fully withdrew their savings.[27]

The Government introduced Freedom and Choice as a means to 'ensure consumers are empowered and equipped to make the most of their pension savings, and to make decisions that best suit their personal circumstances and risk appetite for the duration of their retirement', following growing evidence that the existing market did not work in individuals' best interests.[28] For example, in 2012 60% of annuities were purchased from DC savers' existing pension provider, despite the fact that most could access better value for money on the open market.[29]

Many unengaged drawdown users have their pots invested in ways that are potentially detrimental to their future income

33% of non-advised drawdown customers hold their whole pot in cash accounts or exclusively in 'cash-like' funds. The Financial Conduct Authority (FCA) considers that over half of these are likely to be better served by an alternative strategy. The FCA have recently introduced rules which mean that people will need to actively opt-in to invest their drawdown pot in cash, which will hopefully reduce the number of people investing in this way.[30]

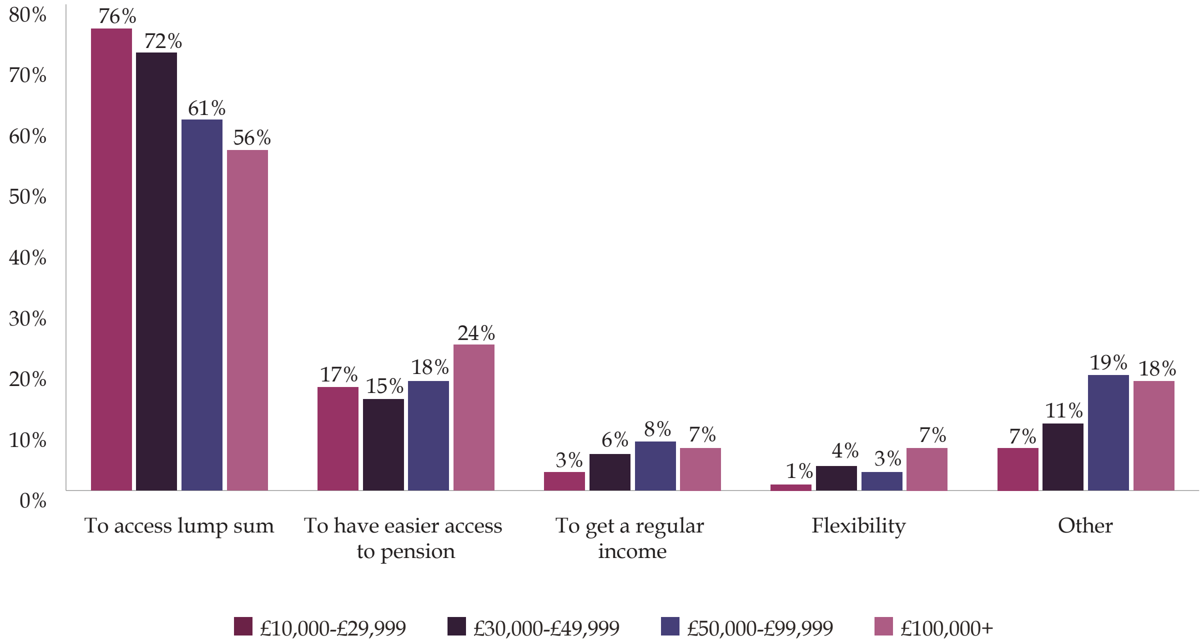
While 37% of drawdown customers say they know exactly where their money is invested, 34% have only a broad idea and 28% are not sure.

While 37% of drawdown customers say they know exactly where their money is invested, 34% have only a broad idea and 28% are not sure. Awareness of drawdown investment strategy is correlated with pot size, with three quarters (75%) of those with pots of £200,000 or more knowing exactly where their money is invested compared to one in five (19%) of those with pots between £10,000 and £29,999.[31] Since the Freedoms were introduced, most people who have moved into drawdown have done so in order to access their 25% tax-free lump sum (Chart 3.1).

27 FCA (2017)
28 HM Treasury (2014)
29 FCA (2014)
30 FCA (2019a)
31 FCA (2018a)

Chart 3.1[32]
The majority of people who have moved into drawdown since 2015 have done so in order to access their tax-free lump sum

Reasons for moving into drawdown, by pot size



As pension freedoms were introduced just four years ago, it remains to be seen what decisions people will make over the longer term.

As pension freedoms were introduced just four years ago, it remains to be seen what decisions people will make over the longer term, specifically whether those people who have moved into cash almost by default as a result of accessing their lump sum will reassess their investment choices upon reaching retirement. As this group is likely to include individuals who are on average less engaged with pensions, this may not be the case, but will be mitigated by new FCA rules about cash investment in drawdown. Those who have moved their pension savings into drawdown at younger ages and are primarily or wholly in cash are likely to experience the greatest detriment of missing out on potential investment returns.

Drawdown may be better suited to people in the Independent Phase, while those in the Decline or Dependent Phases may place a higher value on the security that can be provided by an annuity

Although there has been something of a rush to make use of the new options made available through the introduction of Freedom and Choice, the experience of the last three years is not necessarily representative of the decisions that people will make regarding retirement income in the future. Furthermore, we will not be able to evaluate the outcomes of these decisions for some time.

Some who have moved into drawdown, particularly those who have done so as an unintended effect of accessing their tax-free lump sum, may decide to purchase an annuity when they reach an older age.

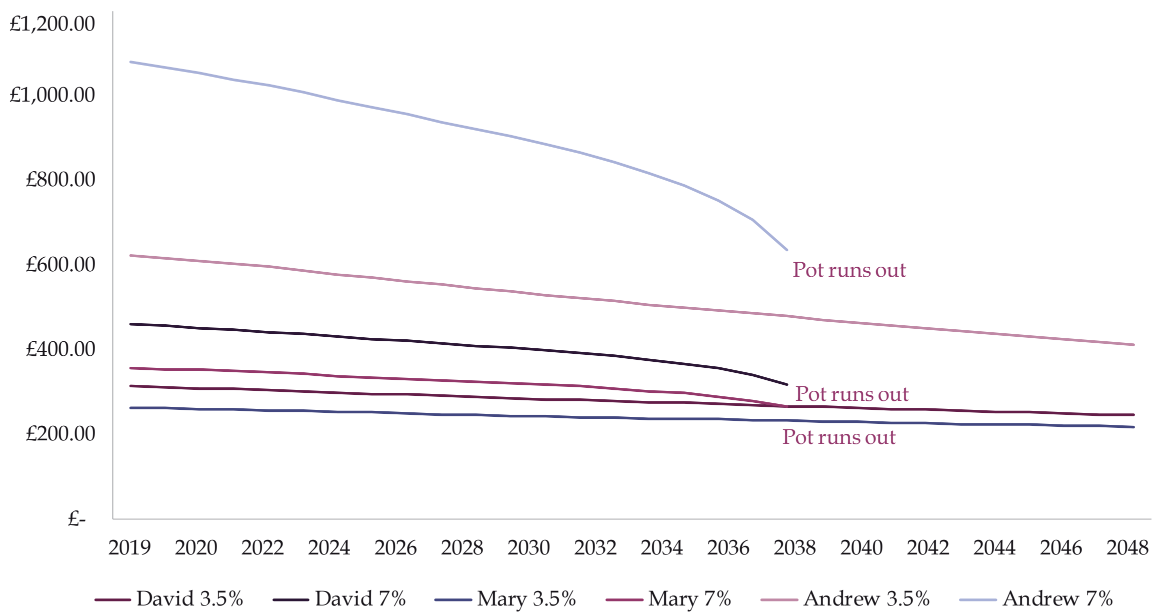
32 FCA (2018a)

While many have fully withdrawn their pot or moved into drawdown, where they would previously have been compelled to purchase an annuity, we do not yet know how these people will choose to use their savings in the long term. Some who have moved into drawdown, particularly those who have done so as an unintended effect of accessing their tax-free lump sum, may decide to purchase an annuity when they reach an older age. However, the level of annuity they are able to purchase will be dependent on the level of pension savings they have remaining, which in turn is dependent on the rate at which they drawdown in the early years of retirement and other factors. While annuitising at an older age, such as 75 for example, allows for flexibility in the early years of retirement and security in the later years, it does remove or reduce the flexibility to leave behind bequests, dependent on the proportion of the pot that is annuitised.

Identifying a sustainable drawdown rate while ensuring that income needs are met can be difficult, especially for those with low savings

A withdrawal rate of 3.5% ensures a 95% chance of not exhausting savings by time of death, while a withdrawal rate of 7% gives around a 50% chance of exhausting savings by average life expectancy, though the risk is increased for those who live longer than average, which is more likely for those at the upper end of the wealth distribution.[33] Drawing down at 7% would likely lead to pot exhaustion for David, Mary and Andrew at around age 85 (Chart 3.2). Because David dies at age 86, this is not a substantial concern, but for Mary and Andrew, who live until 95 and 93 respectively, running out of private pension savings at 85 would lead to significant drop in retirement income for the remainder of their lives.

Chart 3.2
Private savings can help people to achieve better retirement living standards, but high withdrawal rates increase the risk of exhausting savings before death



By assessing the cost of goods and services likely to be needed in retirement, the Pensions and Lifetime Savings Association (PLSA) has formulated annual incomes that might be needed in order to deliver 'comfortable', 'moderate' and 'minimum' living standards (Table 3.1).

Table 3.1: PLSA retirement living standards[34]

	Single person	Weekly	Couple	Weekly
Comfortable	£33,000	£635	£47,500	£913
Moderate	£20,200	£388	£29,100	£560
Minimum	£10,200	£196	£15,700	£302

33 Based on drawdown from age 66 to average life expectancy.
34 PLSA (2019)

People in the bottom two wealth quintiles are likely to have low or no private pension savings and so will be heavily dependent on the State Pension to support their retirement. Jack and Alice, who represent the bottom two quintiles, have no private pension savings, and so will rely on an income of £168.60 per week from the State Pension, around £30 below the income needed to deliver minimum retirement living standards.

Actual average consumption levels vary significantly between wealth quintiles, although most experience a spike in consumption around their mid-60s before a steady decline in spending over the course of later life (Chart 3.3). Consumption in the lower wealth quintiles is largely composed of spending on essentials (food, housing, etc.). For example, someone in the bottom wealth quintile spends twice as much on essentials as they do on non-essentials and leisure, whereas someone in the top wealth quintile is likely to spend more on leisure than essentials.

Chart 3.3

Many people experience a spike in consumption in their mid-60s, before a steady decline in spending

Total consumption by wealth quintile

Private pension savings allow those in higher wealth quintiles to achieve better retirement living standards (Table 3.2).

Table 3.2: Weekly income from drawdown (State Pension income included)

	David 3.5%	David 7%	Mary 3.5%	Mary 7%	Andrew 3.5%	Andrew 7%
Income	£315	£460	£263	£358	£624	£1,080

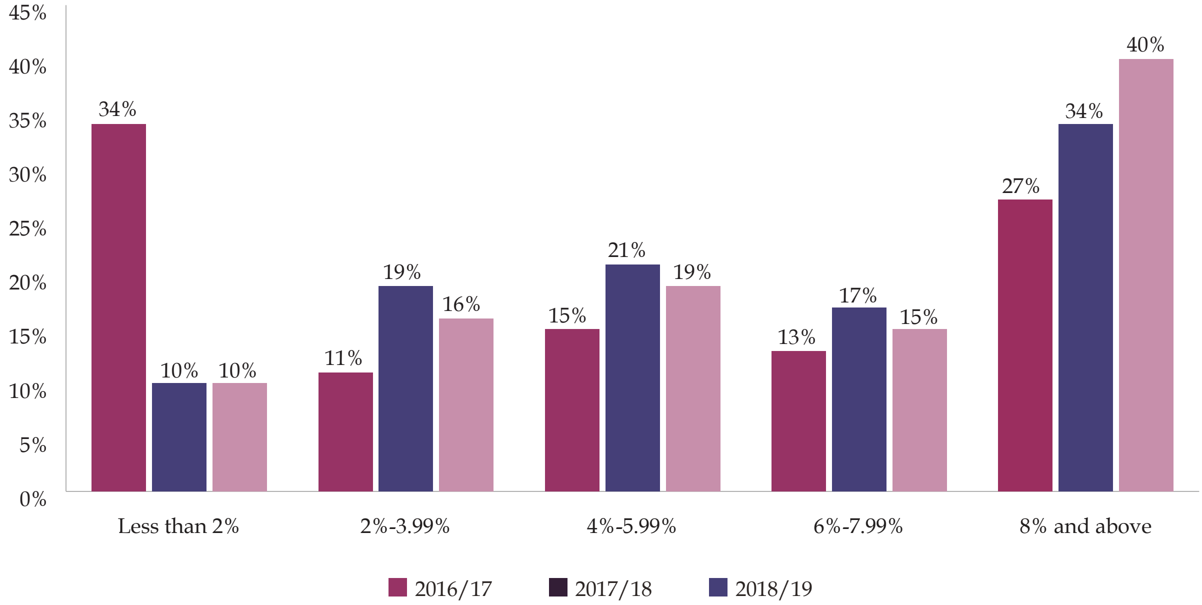
At both 3.5% and 7% withdrawal rates all three individuals would meet the income necessary to achieve minimum retirement living standards.

While higher withdrawal rates are slightly more common among those with smaller pots, the likelihood of exhausting a pot by withdrawing at a particular percentage rate remains the same regardless of pot size.

Average drawdown withdrawal rates have been gradually increasing (Chart 3.4). While higher withdrawal rates are slightly more common among those with smaller pots, the likelihood of exhausting a pot by withdrawing at a particular percentage rate remains the same regardless of pot size.

Chart 3.4[35]
Average withdrawal rates have been increasing

Annual withdrawal rates for new and existing drawdown and UFPLS plans where a regular payment is set up



Innovation has been somewhat limited since the introduction of pension freedoms

Part of the Government's rationale behind introducing the freedoms was that competitive pressures would encourage innovation in the market, leading to the 'development of new products that better suit people's changing needs'.[36] There has been some innovation in the four years since the freedoms were introduced, particularly around developing tools to help people to better understand their options and tools that help them compare products and the implications of their decisions, although these are often limited to advised customers.[37] However, there is broad agreement that innovation has been somewhat limited over the past four years.[38]

While there has been some innovation around developing tools to help people to better understand their options, these are often limited to advised customers.

Some have suggested that limited innovation is a result of the short time since the freedoms were introduced, although this becomes a less compelling argument as time passes, or because of a perceived lack of competition in the retirement income market. Others have argued that innovation in terms of new products is not necessary. Instead, existing products need to be used more effectively in order to meet the needs of retirees. The market could offer a simple range of products but function well if individuals understand them and freely shop around for the best deal. However, this may require innovation in other areas such as guidance and advice.[39] This latter view is supported by over half of advisers, who feel that the level of innovation and response has been satisfactory since the introduction of the freedoms.[40]

35 FCA (2019b)
36 HM Treasury (2014)
37 FCA (2017); Age UK (2019)
38 Work and Pensions Committee (2018)
39 ABI (2017)
40 AKG (2018)

Investment pathways, which are currently in development, may help to support better later life outcomes

The FCA Retirement Outcomes Review found evidence that:

- Consumers with providers offering more structured choice processes are on average invested in assets more consistent with expectations based on their pot characteristics and behaviour.
- There is more variation in investment performance for non-advised drawdown customers in providers with a less structured choice architecture.[41]

As a result, in July 2019 the FCA published a policy statement establishing new rules on investment pathways. Drawdown providers must now offer non-advised consumers four options for how they might want to use their drawdown pot, for example:

- Option 1: I have no plans to touch my money in the next five years
- Option 2: I plan to use my money to set up a guaranteed income (annuity) within the next five years
- Option 3: I plan to start taking my money as a long-term income within the next five years
- Option 4: I plan to take out all my money within the next five years[42]

These options will help to guide people towards appropriate investment strategies that are likely to suit their aims. However, people are still likely to need considerable support in achieving positive later life outcomes, particularly if they have characteristics which make them more vulnerable.

The industry are likely to deal with an increasing number of vulnerable customers as people who choose not to annuitise will need to make ongoing pensions decisions well into later life

The FCA defines a vulnerable customer as:

Someone who, due to their personal circumstances, is especially susceptible to detriment, particularly when a firm is not acting with appropriate levels of care.[43]

The risk of experiencing many of the drivers of vulnerability identified by the FCA increases with age, including:

- Physical disability
- Severe or long-term illness
- Hearing or visual impairments
- Cognitive disabilities
- Caring responsibilities
- Bereavement
- Low income/savings
- Lack of support structure
- Poor or non-existent digital skills[44]

Dealing with vulnerable customers can be challenging, but clearer guidance could help to improve the process and, as a result, outcomes

The way that industry deals with vulnerable customers may be improved by clear guidance from the FCA on how to understand their needs and support for a flexible approach to their treatment rather than driving a tick box compliance mentality.[45]

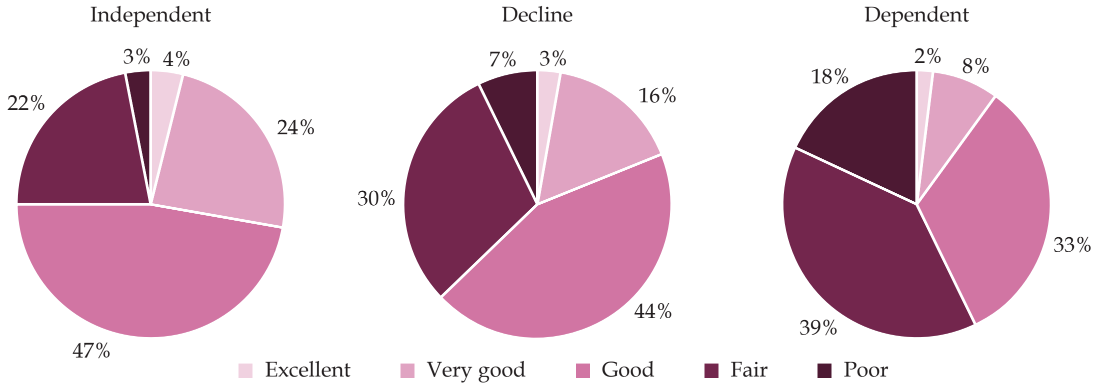
As people transition into the Decline and Dependent Phases they are more likely to become vulnerable as a result of cognitive decline

There is a trend towards cognitive decline over the course of later life as people age and transition through the phases. 7% of people in the Decline Phase rate their memory to be ‘poor’, compared to 3% of people in the Independent Phase. This increases to almost one in five (18%) for those in the Dependent Phase (Chart 3.5). The likelihood of experiencing accelerated cognitive declines, such as dementia, also increases with age.[46]

41 FCA (2018a)
42 FCA (2019a)
43 FCA (2018b)
44 FCA (2019c)
45 FCA (2019c)
46 Age UK (2018a)

Chart 3.5
Memory declines as people transition through the phases

Self-rated memory by phase



Even those without any characteristics of vulnerability can find themselves vulnerable to pension scams

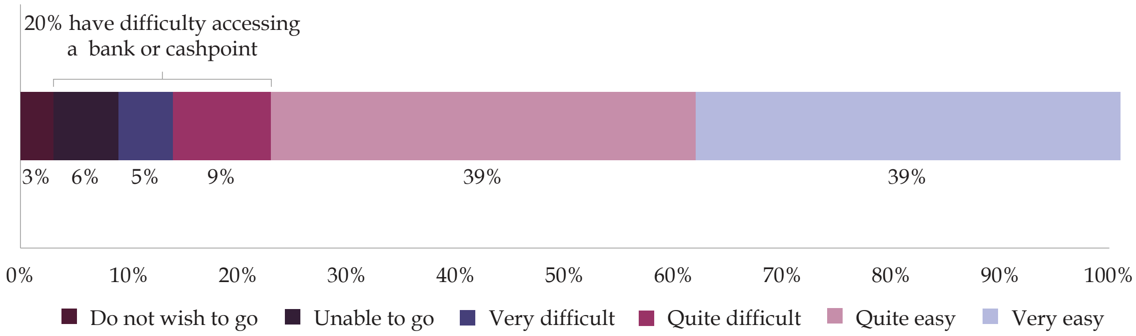
Between the introduction of pension freedoms and 2017, around 130,000 people over 65 suffered financial abuse and more than £43 million of people's retirement savings was lost to fraud.[47] The FCA estimates the average loss for victims of scams at £91,000 each.[48]

Three quarters (76%) of people feel confident at spotting pension scams. However, in 2016 Citizens Advice carried out an experiment in which participants were shown mock pension adverts. Almost nine in ten (88%) participants selected a pension access offer containing pension scam warning signs.[49]

Exclusion from direct contact with financial services may make it more difficult for older people to build up resilience and confidence in protecting themselves against fraud and scams.

Older people in the Dependent Phase are increasingly likely to experience financial exclusion, with a significant minority struggling to access a bank or cashpoint (Chart 3.6). Exclusion from direct contact with financial services may make it more difficult for older people to build up resilience and confidence in protecting themselves against fraud and scams.

Chart 3.6
One in five people in the Dependent Phase have difficulty accessing a bank or cashpoint



47 https://www.gov.uk/government/consultations/pension-scams/pension-scams-consultation

48 https://www.fca.org.uk/news/press-releases/regulators-warn-public-pension-scammer-tactics-victims-report-losing-average-91000-2017

49 Citizens Advice (2016a)

Chapter Four: How are people supported to achieve positive later life outcomes?

Given the complexity of retirement decisions, described in chapter One, many people will find it difficult to make choices that will best meet their needs over the course of later life. For some people, initiatives aimed at increasing engagement and financial capability will equip them to make appropriate decisions. Advice and guidance plays an important role in supporting people while making these choices, although most advice and guidance offerings currently focus on at-retirement decisions rather than ongoing support throughout later life. For those with lower levels of financial capability, greater support in making these decisions may be needed to improve later life outcomes, while those with low levels of savings are likely to need support from Government in meeting their later life needs.

This chapter discusses the support available to older people, including advice and guidance, and explores the potential policy levers which may be used to improve later life outcomes.

Following the introduction of Freedom and Choice, people are likely to need more ongoing guidance and advice throughout the course of later life

At present the focus appears to be on providing guidance and advice during the accumulation phase and especially at the point of transition into retirement. However, since the introduction of the pension freedoms in 2015, the decisions people must make at and during retirement have increased significantly in complexity. People are therefore likely to need much greater support in terms of ongoing guidance and advice in later life in order to be able to make appropriate decisions about how to access and utilise their retirement savings and other available assets to meet their needs. Over the next ten to fifteen years, the need for appropriate and accessible advice and guidance is likely to grow as the proportion of people reaching retirement with significant levels of Defined Contribution (DC) savings and low or no Defined Benefit (DB) entitlement increases.

Over the next ten to fifteen years, the need for appropriate and accessible advice and guidance is likely to grow as the proportion of people reaching retirement with significant levels of DC savings and low or no DB entitlement increases.

Levels of take up of advice and guidance are relatively low compared to those who would likely benefit from the support

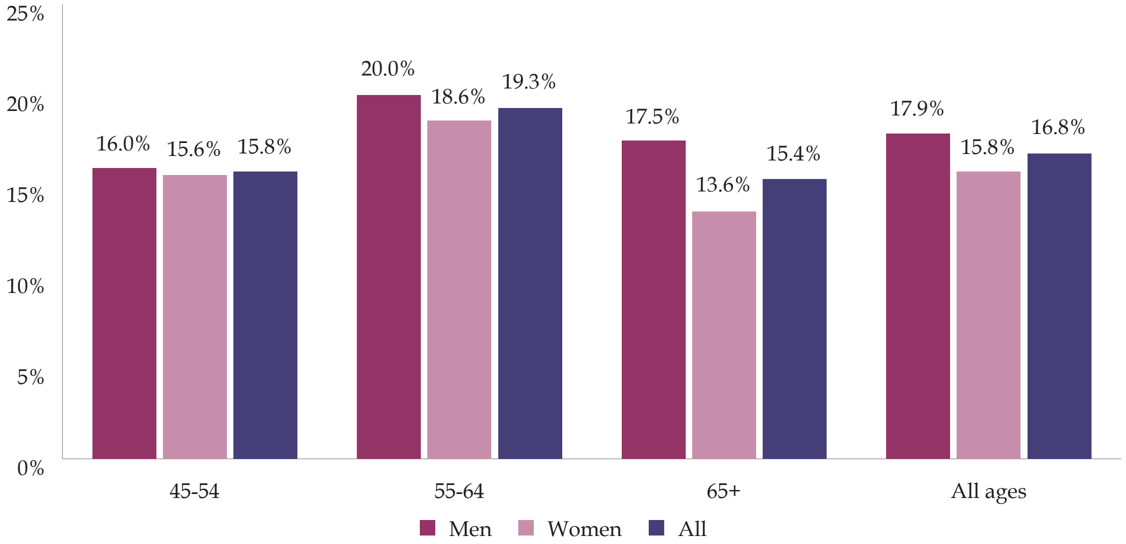
Before retirement three in five (62%) expect to take expert help when making a decision about how to access their DC savings.[50] However, this level of demand is not fully reflected by the number who actually do access advice and guidance at retirement. Levels of take-up appear to be lower among those with lower levels of wealth, who may be more likely to be less engaged and therefore stand to benefit more from advice or guidance: Almost half (45%) of those with household incomes below £20,000 are not getting any support, compared to one-fifth (19%) amongst those earning incomes of more than £40,000.[51]

50 Citizens Advice (2015a)

51 Citizens Advice (2016b)

Chart 4.1[52]
People aged 65+ are less likely than average to use financial advice

'Have you received any expert financial advice in the last two years?'



Specific areas where there may be an advice gap include:

- Holistic guidance that looks at someone's personal finances in the round;
- Problem debt and pension assets;
- People with small sums of money in pensions, savings and investments; and
- People with complex circumstances, for example a combination of DB entitlement and DC savings.[53]

While advice and guidance are available, many find it difficult to recognise the value of seeking it

Many people struggle to place a value on advice and, likely as a result of this, demonstrate a reluctance to pay for advice.[54] However, the proportion of advised drawdown purchases has increased over the last two years, from 68% in 2016 to 77% in 2018.[55]

The value of advice

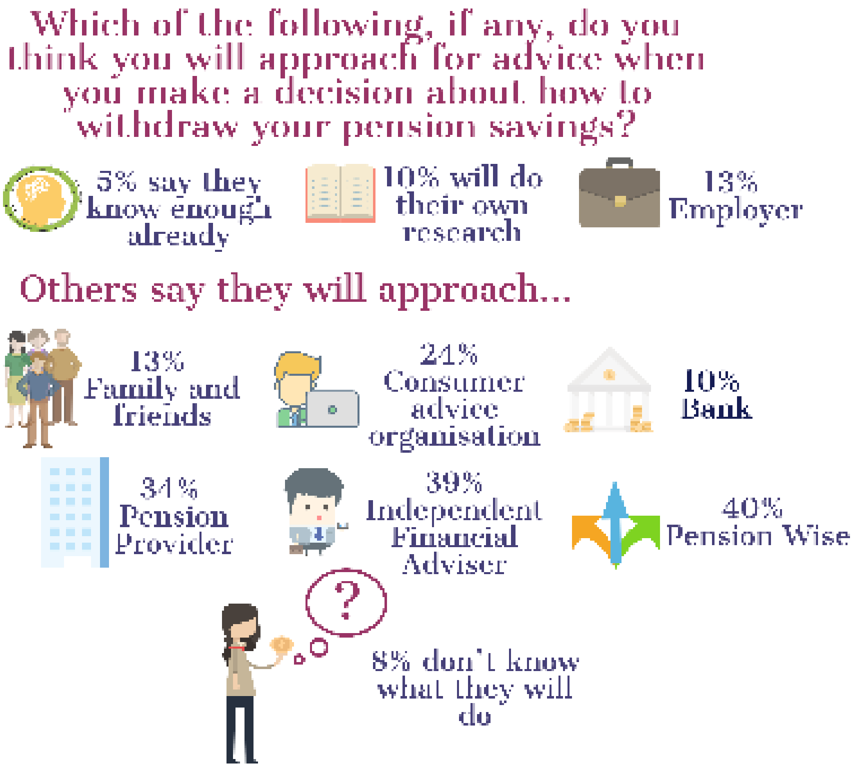
'If we add up financial assets and pension wealth, we can quantify the value of advice at approximately £41,099 additional wealth per person for all the advised over a period of 5-13 years. In percentage terms that means that the advised have accumulated around 20% more financial and pension assets than the non-advised. Meanwhile, advice also appears to have a material positive impact on pension income – boosting incomes by nearly £800 per annum.'[56]

Initiatives aimed at helping people to better understand the value of advice could help to increase take-up levels.

52 ILC (2017)
53 MAS (2017c)
54 Work and Pensions Committee (2015)
55 ABI (2019)
56 ILC (2017)

People are likely to seek advice and guidance from a broad range of sources, including informal support from outside of financial services

Figure 4.1[57]



It is important that people can access support through a range of channels

71% say that face-to-face help would be their first choice in receiving advice or guidance.[58] However, when considering the potential affordable advice gap, other forms of advice or guidance, for example digital, could help to improve outcomes for some.

When considering the potential affordable advice gap, other forms of advice or guidance, for example digital, could help to improve outcomes for some.

Digital channels can improve how people engage in a number of ways:

- Continuous access – not constrained by distance or opening hours;
- Access to a larger amount of information;
- The ability to contrast and compare different alternatives.[59]

Retired people are less likely to use the internet for help with financial decisions (17% compared to 27% of working age).[60] This could be because they are less willing or less able to go online or have less access to computers. This also needs to be viewed within the context of low basic online skills among many older people. Almost a quarter (23%) of 55-64 year olds lack basic online skills, rising to 50% among over 60s.[61] Women over 75 and on lower incomes are among the most digitally excluded.[62]

57 Citizens Advice (2015b)
58 Citizens Advice (2015a)
59 Straker, Wrigley & Rosemann (2015)
60 Citizens Advice (2016b)
61 Dot Everyone (2015)
62 Age UK (2018b)

Low levels of digital competence among older people may be a cohort issue, as younger generations will continue to be more digitally capable as they move into old age, having been exposed to computers for most or all of their life. However, as technology evolves relatively quickly, younger generations may find themselves similarly ill-equipped to deal with the latest technological advancements when they reach retirement.

While digital channels can provide vast amounts of information, the responsibility of understanding that information, and the risk of making poorly informed decisions if it is not understood, generally falls upon the individual.

Digital channels of engagement, such as robo-advice, may be effective in providing a good source of standardised information, but they are unlikely to be able to provide advice which recognises the diversity of personal preferences and the complex emotions associated with retirement decisions in the same way that a financial advisor could take these factors into consideration and offer advice accordingly. While digital channels can provide vast amounts of information, the responsibility of understanding that information, and the risk of making poorly informed decisions if it is not understood, generally falls upon the individual.[63]

While increased use of digital platforms allows for easier access without restriction, it may also increase the likelihood that people will make less optimal decisions as a result of insufficient guidance. Robo-advice may go some way to mitigate this effect, but it is likely that digital platforms will continue to be most effective when offered in conjunction with traditional face-to-face advice and guidance.

Robo-advice has the potential to offer a wide range of impartial support that can be accessed easily, particularly by those who might otherwise not have access to any formal financial advice. However, there are some aspects relating to the decision-making process that look set to remain best catered for by human advisers, including:

- Explaining complex and confusing topics (and ensuring that customers have understood them
- Offering reassurance and support
- Persuading customers to action

While advice and guidance can help some people to achieve positive later life outcomes, others may need support from Government to achieve better outcomes

There are a range of policy levers beyond advice and guidance which could be used to improve later life outcomes:

- Compulsion: options that people must take whether they want to make an active decision or not.
- Defaults: options given to people who do not wish to or are unable to make an active choice.
- Safety nets: policy mechanisms designed to help those in financial hardship in order to protect them from the worst later life outcomes.
- Consumer protection: legal and regulatory measures which protect people from fraud or poor governance (including high charges).
- Behavioural interventions: policies aimed at encouraging people to make decisions (or not make decisions) which result in better financial outcomes.

Compulsion is unlikely to have a place in a post-pension freedoms landscape

Before the introduction of pension freedoms, compulsion was used to ensure that people with any substantial pension savings converted these into an income which would support them over the course of later life. Following concerns that the annuity market was not working in the best interests of retirees, the Government introduced pension freedoms which allow people to access their pension savings in a number of

63 Breit & Salomon (2015)

ways, including full withdrawal, irrespective of the amount. While compulsion can be used to prevent people from making particularly poor choices, it is unlikely to present an option which suits the needs of all retirees considering the broad range of savings in terms of both amount and type. Prior to the introduction of the freedoms, some people were compelled to purchase annuities which provide an extremely small income, where they may have been better served by taking their money as a lump sum or moving into drawdown. The Government is committed to keeping pension freedoms in place so that people have more flexibility to utilise their pension savings in a way that suits their needs and preferences. However, softer policy measures aimed at guiding people towards choices that can deliver better later life outcomes can be used.

Defaults can be used to improve later life outcomes for people who either do not wish to or are unable to make active choices about how to utilise their pension savings

Default investment pathways, described in Chapter Three, could help to guide people towards appropriate retirement decisions in cases where they are unwilling or unable to make informed active choices. While defaults will not be the best solution for all people's retirement needs, investment pathways are a 'soft default' as they are an opt-in option, and as such avoid the issues faced by compulsion or opt-out defaults of forcing people into a pathway that will not necessarily be most appropriate for them. Because default pathways will be designed in order to meet particular drawdown intentions, they are likely to broadly meet people's needs and preferences. Default pathways will deliver better outcomes than making a poor active choice, so can act as a safety net protecting people from particularly poor later life outcomes that could result from an uninformed active choice.

Tackling engagement is easier said than done, and will take time to embed and may not be practicable for everyone.

There are some concerns that default pathways do not tackle the real issue, low levels of engagement. However, tackling engagement is easier said than done, and will take time to embed and may not be practicable for everyone. In the meantime, default pathways could help to protect people from particularly poor retirement outcomes.

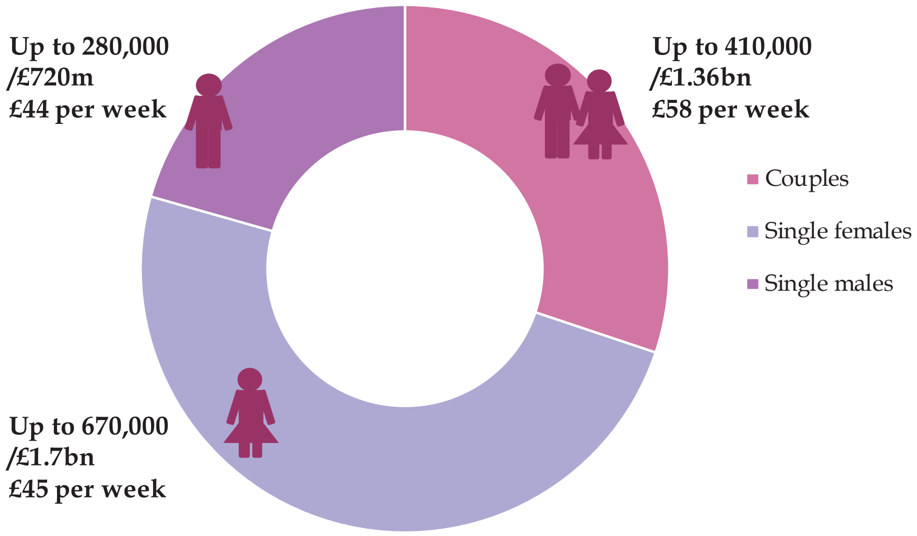
Safety nets are essential to achieving positive later life outcomes for those with low levels of savings

Initiatives aimed at improving financial capability, as well as defaults to save for a pension, such as automatic enrolment, can help people to achieve better later life outcomes. However, for those who are less engaged and have less resources, safety nets are vital to protecting them from particularly poor later life outcomes. Safety nets are any support offered by Government, such as means-tested benefits, to help those in financial difficulties. Safety nets can also be provided "in kind" through guidance, support, legal assistance, or care and support for those with health problems or struggling families. Those who are less engaged are more likely than engaged people to be unprepared for financial difficulties and are therefore more dependent on social safety nets than more fully engaged people.

It is important that people who need and are eligible for safety nets are encouraged to use them. It is estimated that more than 4 in 10 pensioner households (couples or single people) who are entitled to Pension Credit do not claim it, amounting to as many as 1.3 million pensioner households entitled to around £3.5 billion unclaimed Pension Credit each year (Chart 4.2). People eligible for Pension Credit who do not claim it miss out on an average of £49 per week, which is just under the average amount that the poorest fifth of pensioner couples spend on food and non-alcoholic drinks in a week.[64]

64 Independent Age (2019)

Chart 4.2[65]
Up to £3.5 billion of Pension Credit goes unclaimed each year



Research into the reasons for low levels of benefit take-up could help to increase understanding of the diverse needs of older people and inform innovative solutions which could drive up take-up levels.[66]

Recent policy changes from the Financial Conduct Authority (FCA) have been focused on enhancing consumer protection

As well as introducing rules for investment pathways, the FCA has also introduced rules around:

- Ensuring that consumers entering drawdown invest predominantly in cash only if they take an active decision to do so.
- Giving consumers in decumulation annual information on all the costs and charges they have paid, expressed as a single pound and pence figure.[67]

Behavioural interventions, which have been used to increase coverage in accumulation of pension savings, could be used to guide people towards choices which can deliver better later life outcomes

Inertia has been used effectively through the introduction of automatic enrolment to increase coverage in private pension savings. Behavioural insights could also be used to improve later life outcomes around retirement, although some active choices will have to be made. In some ways, default investment pathways could be designated as a behavioural intervention, guiding less engaged, non-advised individuals towards investment strategies which are likely to meet their aims. Behavioural interventions around withdrawal rates could also be used to improve later life outcomes. For example, greater focus on sustainable withdrawal rates and providing information about what withdrawal rates mean for the likelihood of running out of money and/or leaving bequests, could help people to make their money last over the course of later life. Even if they do not adhere to the specific sustainable withdrawal rates suggested and withdraw at a somewhat higher rate, their chosen withdrawal rate may be more reasonable than it would otherwise have been as a result of 'anchoring' and adjustment from the suggested withdrawal rate.

65 Independent Age (2019) - Figures exclude people living in care homes

66 Independent Age (2019)

67 FCA (2019a)

Pre-retirement education and ongoing support throughout later life are vital to supporting positive later life outcomes

In order to make appropriate choices when faced with the complex retirement decisions described in this report, people are likely to need:

- Increased engagement and understanding of pensions, which can be promoted through pre-retirement education initiatives, as well as wake-up packs.
- Ongoing support throughout later life, through both advice and guidance, as well as the other policy levers outlined in this chapter.

New rules around pension wake-up packs could help to get people engaged earlier with decisions about how to use their pension savings

At present, pension providers are required to send members wake-up packs a few months before their intended retirement date. However, from November 2019, providers will be required to send an initial wake-up pack at age 50, and then one every five years until the member's pot is fully crystallised. Sending these packs, which include a one-page headline document setting out the options for people as they consider how to access their retirement savings, should help to get people engaged with these decisions earlier. This could potentially be improved by distributing these packs even earlier to coincide with major life events. In order to maximise effectiveness, this strategy would require research on which life events would be most appropriate to use as engagement points.

Appendix One: Technical Appendix

Modelling and the resulting analysis conducted in this report has been based on data from the English Longitudinal Study of Ageing (ELSA). Data from ELSA was developed by researchers based at University College London, the Institute for Fiscal Studies and the National Centre for Social Research (NatCen) and are made available through the UK Data Archive (UKDA).

The survey tracks multiple complex characteristics, including health and social care, retirement and pensions policy, and social and civic participation, of individuals through later life (those aged 50 or over).

Data Collection Key: C = CAPI, S = Self Completion, U = Nurse

Wave/Year	Data Collection Key	Sample	Refreshment
Wave 1 (2002/3)	C	12,099	
Wave 2 (2004/5)	C + U	9,432 + 7,666	
Wave 3 (2006/7)	C	9,771	HSE 2001-4
Wave 4 (2008/9)	C + U	11,050 + 8,643	HSE 2006
Wave 5 (2010/11)	C	10,274	
Wave 6 (2012/13)	C + U	10,601 + 8,054	HSE 2009-11
Wave 7 (2014/15)	C	9,666	HSE 2011-12
Wave 8 (2016/17)	C + U(50%)	8,445 + 3,525	
Wave 9 (2018/19)	C + U(50%)		HSE 2013-15

HSE = Health Survey for England, CAPI = Computer Aided Personal Interviewing

Independent, Decline and Dependent phases

Individuals in the Decline Phase of retirement have difficulty with one or more of the following activities:

- Walking 100 yards (Hemobwa)
- Sitting for about two hours (Hemobsi)
- Getting up from a chair after sitting for long periods (Hemobch)
- Climbing several flights of stairs without resting (Hemobcs)
- Stooping, kneeling or crouching (Hemobst)
- Reaching or extending arms above shoulder level (either arm) (Hemobre)
- Pulling or pushing large objects, like a living room chair (Hemobpu)
- Lifting or carrying weights over 10 pounds, like a heavy shopping bag of groceries (Hemobli)
- Picking up a 5p coin from a table (Hemobpi)
- Using a map to figure out how to get around in a strange place (Headlma)
- Recognising when you are in physical danger (Headlda)
- Preparing a hot meal (Headlpr)
- Shopping for groceries (Headlsh)
- Doing work around the house or garden (Headlho)

Individuals in the Dependent Phase of Retirement have difficulty with one or more of the following activities:

- Climbing one flight of stairs without resting (Hemobcl)
- Dressing, including putting on shoes and socks (Headldr)
- Walking across a room (Headlwa)
- Bathing or showering (Headlba)
- Eating, such as cutting up food (Headlea)
- Getting in or out of bed (Headlbe)
- Using the toilet, including getting up or down (Headlwc)
- Making telephone calls (Headlph)
- Communication (speech, hearing or eyesight) (Headlsp)
- Taking medications (Headlme)
- Managing money, such as paying bills and keeping track of expenses (Headlmo)

They may also have some of the difficulties described in the Decline Phase, in addition to these difficulties.

Individuals are defined as 'Dead' using the variable 'w8indout'. 'R7IntStat' was used for previous waves.

Individuals in the Independent Phase of Retirement are those who do not meet the criteria of the Decline or Dependent phases and are confirmed to have not died. Missing data is either ignored in the analysis or is attempted to be filled in with logic. For example:

"Independent", "Dead", "", "", "Dead" turns into.... "Independent", "Dead", "**Dead**", "**Dead**", "Dead"

Missing values between two states are filled in with the status in the previous wave. For example:

"Independent", "", "Decline", "" turns into.... "Independent", "**Independent**", "Decline", ""

A similar process is used to fill in ages and wealth quintiles of individuals where possible.

Each of these characteristics are given its own variable name and are defined as seen above. The variable names above are related to the names given in the wave 8 data dictionary or the last wave the variable was available. Variable names may differ in earlier waves however the description between waves are identical.

The four states (Independent, Decline, Dependent and Dead) are assumed to form a Markov jump process where a 10-year rolling average was used as the transition probabilities from one state to another for a certain period of time.

The transition probabilities into the dead state were put in line with life tables for England and Wales from population projections published by the Office of National Statistics (ONS). The remaining probabilities were therefore adjusted to fit with the properties of a transition probability matrix.

Normalised weights have been used based on the cross-sectional weights in each wave.

An individual's wealth was split into quintiles with '1' being the bottom fifth and '5' being the top fifth of individuals with wealth. The ranking was conditional on individuals either being above State Pension age (SPa) in the latest wave or are classified as in the independent phase in the previous wave. This was done to section out those who were in long-term illness during their working lives.

Living Costs and Food Survey

The Living Costs and Food Survey (LCF), undertaken by ONS Social Surveys, focuses on an individual's or household's consumption of goods such as clothing, transport costs or beverages. It is a continuous survey with interviews spread evenly over the year to ensure that estimates are not biased by seasonal variation.

The individual income was calculated depending on the number of individuals within a household and their respective statuses (child or adult). This was based on statistics and commentary provided by the Department for Work and Pensions (DWP) on Households Below Average Income (HBAI). The equivalisation allowed for an appropriate weighting to be applied on different individuals within a household. The scoring system went as follows:

	Score value
First adult	0.67
Other adult	0.33
Children 14 years and over	0.33
Children under 14 years	0.2

Individuals were then ranked on their weekly gross normal household income.

Wealth and Assets Survey (WAS) analysis

The modelling for this report uses longitudinal data to analyse the progression of different aspects of wealth belonging to individuals over the period 2012/14 to 2014/16. This is used to derive wealth transition rates associated with the characteristics of five illustrative individuals. These characteristics include initial wealth levels, housing tenure, gender and marital status.

Types of wealth analysed:

- Property wealth
- Physical wealth
- Pension wealth
- Financial wealth (split into financial assets and liabilities)

The variables considered are:

- Marital Status (DVMrDFW5)
- Household dynamics (R01W5 – R11W5, HHoldTypeW5, NumAdultW5)
- Household Tenure (Ten1W5)
- Gender (SexW5)
- Age (DVAge17w5, DVAgew5Band)

A unique ID was created to track individuals across waves in order to see the difference in wealth between the two waves.

A new variable (DVCoupleWX) was created for each wave from DVMrDFWX. This variable categorised individuals into four states:

- Unknown
- Single
- Couple
- Previously a couple

Quadratic interpolation was used to smooth the data set in order to calculate the change in wealth at specific ages. This was then used to calculate the amount of wealth an individual has at those ages for the five individuals in this report.

Specific ages are assumed to be spread uniformly within age bands. For the age band of "80+", the median age of individuals above the age of 80 was calculated based on national population projections from the ONS.

These wealth figures were projected using the last available set of information. For example, data looking at the change in wealth for men at ages 72, 77 and 84 was used to extrapolate the amount of wealth a 91-year old male would have. Attempting to determine the value of an individual's wealth using this method does therefore assume that the change in wealth will follow the same quadratic trajectory based on the last three data points. This could lead to inaccuracies in calculating wealth figures for later ages due to WAS not specifying the age of individuals beyond 80 years old.

Pension wealth figures from WAS and consumption patterns analysed from LCF were both used in PPI's Individual Model.

The areas of modelling performed in this report consider the projection of an individual using the PPI's Individual Model using a stochastic approach of economic assumptions. The economic scenarios are generated using the PPIs Economic Scenario Generator. Both models are detailed below. All results are based in current (2019) earnings terms.

PPI Individual Model

The Individual Model is the PPI's tool for modelling illustrative individual's income during retirement. It can model income for different individuals under current policy, or look at how an individual's income would be affected by policy changes. This income includes benefits from the State Pension system and private pension arrangements, and can also include income from earnings and equity release. It is useful to see how changes in policy can affect individuals' incomes in the future.

This model can be used in conjunction with economic stochastic scenarios derived from the PPI's Economic Scenario Generator to produce stochastic output.

The case studies in the report were generated using the Individual Model from the PPI's Modelling Suite. The Individual Model was run 3,000 times for each case study using the output of 3,000 runs of the Economic Scenario Generator.

The PPI's Individual Model calculates streams of retirement incomes for constructed individuals. The streams of income include State Pension, private pension and various State benefits in retirement. The Individual Model uses flexible policy parameters to define the pensions landscape throughout the individual's working life and retirement. The individual is constructed by setting out the work history in terms of working patterns and salary level throughout their working life, along with pension scheme membership details.

Key assumptions

Except where explicitly stated in the report, the key assumptions used in the report are detailed below.

The pensions system

The pension system modelled is as currently legislated. The triple lock is assumed to be maintained. Individuals are assumed to be members of a Defined Contribution (DC) occupational pension scheme.

Investment returns

The Economic Scenario Generator uses volatility derived from historical data and central rates from the Office for Budget Responsibility projected figures. Where volatility has been adjusted this is measured against the historical volatility of equity returns.

Other economic assumptions

Other economic assumptions are taken from the Office for Budget Responsibility's Economic and Fiscal Outlook (for short-term assumptions) and Fiscal Sustainability Report (for long-term assumptions).

Limitations of analysis

Care should be taken when interpreting the modelling results used in this report. In particular, individuals are not considered to change their behaviour in response to investment performance. For example, if investments are performing poorly, an individual may choose to decrease their withdrawal rate and vice versa.

Monte Carlo simulation can be a powerful tool when trying to gain an understanding of the distribution of possible future outcomes. However, in common with other projection techniques, it is highly dependent on the assumptions made about the future. In this case, the choice of distribution and parameters of the underlying variables, the investment returns of equities, gilts and cash are important to the results.

Key results

The key output from the model is the built-up pension wealth and entitlement over the course of the individual's work history and the post-retirement income that results from this.

The post-retirement income is presented as projected cashflows from retirement over the future lifespan of the individual. These are annual cashflows which include the following key items:

- State Pension
    - Reflects entitlement and the projected benefit level of State Pension components.

- Private pension
  - Derived from the decumulation of the pension pot, allowing for tax-free cash lump sum and the chosen decumulation style (e.g. annuity or drawdown).
- Other state benefits
  - Other benefits contributing to post-retirement income such as pension credit.
- Tax
  - Tax payable on the post-retirement income, to understand the net income available to the individual.

These cashflows are calculated as nominal amounts and restated in current earnings terms.

Outcomes are expressed in current earnings terms for two reasons; it improves the comprehension of the results and reduces the liability of either overly optimistic or cautious economic assumptions.

Application of output

The model is best used to compare outcomes between different individuals, policy options, or other scenarios. The results are best used in conjunction with an appropriate counterfactual to illustrate the variables under test.

Key data sources

The specification of a model run is based upon three areas:

1. The individual

The individual to be modelled is specified based upon an earnings and career profile. Saving behaviour for private pension accumulation is considered, as well as the behaviour at retirement.

These are generally parameterised according to the project in question, designed to create vignettes to highlight representative individuals of the groups under investigation.

2. The policy options

The policy options maps the pension framework in which the individual exists. It can accommodate the current system and alternatives derived through parameterisation. This allows flexing of the current system to consider potential policy options to assess their impact upon individuals under investigation.

This area has the scope to consider the build-up of pensions in their framework such as the auto-enrolment regulations for private pensions and the qualification for entitlement to state benefits.

The framework in retirement allows for the tax treatment and decumulation options taken by the individual as well as other sources of state benefits which influence the post-retirement outcomes for individuals.

3. Economic assumptions and scenarios

The model is capable of running with either deterministic or stochastic economic assumptions.

The deterministic assumptions used are generally taken from the Office of Budget Responsibility Economic and Fiscal Outlook to ensure consistency. They cover both historical data and future projected values. Alternatively the model can be used in conjunction with the PPI's Economic Scenario Generator to produce a distribution of outputs based upon potential future economic conditions.

The Economic Scenario Generator

The PPI's Economic Scenario Generator is used to produce randomly generated future economic scenarios based upon historical returns and an assumption of the median long-term rates of return. It was developed by the financial mathematics department at King's College London. It is used to test how the distribution of outcomes is influenced by the uncertainty of future economic assumptions.

Key results

The model generates projected future inflation rates, and earnings growth

- Inflation rates
  - Future CPI increases and earnings inflation rates.
- Investment returns
  - Returns are produced for the major asset classes of equity, cash and gilts.

This produces nominal returns which can be combined to produce investment returns for a more complex portfolio.

Application of output

The output of the Economic Scenario Generator is a number of economic scenarios which are employed by the PPI's other Models to analyse the distribution of impacts on a stochastic economic basis.

Key data sources

The specification of the model is based upon historical information to determine a base volatility and future assumptions to determine a median future return:

1. Historical returns

Historical yields and returns as well as inflation measures are used to determine the key attributes for the projected rates.

2. Future returns

Future returns are generally taken from the Office for Budget Responsibility Economic and Fiscal Outlook to ensure consistency with other assumptions used in the model for which the economic scenarios are being generated. Volatility can also be scaled against historical levels.

Summary of modelling approach

The six identified risk factors modelled are:

G Nominal GDP
P CPI
W Average weekly earnings
Y^l Long-term yields
Y^s Money market yields
S Stock returns

Using these variables, a six dimensional process, x_t is defined.

$$x_t = \begin{bmatrix} \ln G_t - \ln G_{t-12} \\ \ln(P_t - \ln P_{t-12} + 0.02) \\ \ln W_t - \ln W_{t-12} \\ \ln\left(e^{Y_t^l} - 1\right) \\ \ln\left(e^{Y_t^s} - 1\right) \\ \ln S_t \end{bmatrix}$$

Where t denotes time in months.

The development of the vector x_t is modelled by the first order stochastic difference equation:

$$\Delta x_t = A x_t - 1 + a + \varepsilon_t$$

Where A is a 6 by 6 matrix, a is a six dimensional vector and ε_t are independent multivariate Gaussian random variables with zero mean. The matrix A and the covariance matrix of ε_t were determined by calibrating against the historical data. The coefficients of a were then selected to match the long-term economic assumptions.

It follows that the values of x_t will have a multivariate normal distribution. Simulated investment returns will, however, be non-Gaussian partly because of the non-linear transformations above. Moreover, the yields are nonlinearly related to bond investments.

The first component and third components of x_t give the annual growth rates of GDP and wages, respectively. The fourth and fifth components are transformed yields. The transformation applied ensures that the yields are always positive in simulations. Similarly the second component gives a transformed growth rate of CPI. In this case, the transformation applied ensures that inflation never drops below -2% in the simulations. This figure was selected to be twice the maximum rate of deflation ever found in the historical data.

The model projects the pension features of the individual, both in accumulation (pre-retirement) and decumulation (post-retirement) phases.

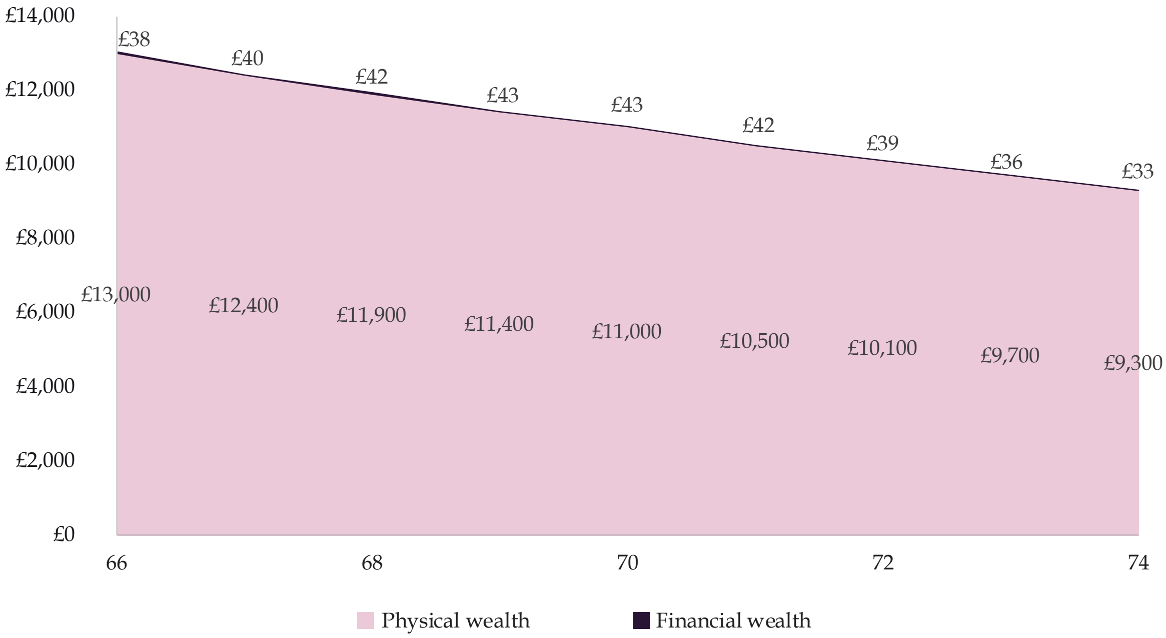
It projects the pre-retirement features of the individual through the accumulation of pension entitlement, both state benefits and occupational Defined Benefit schemes. This is done through the modelling of the career history of the individual, deriving pension contributions and entitlement from the projected earnings profile.

The entitlement to and the level of state benefits are projected such that from retirement, their contribution to the income of the individual can be calculated. Private pension income is modelled and assumes a decision about the behaviour of the individual at retirement. This allows for the chosen decumulation path of any accrued private pension wealth.

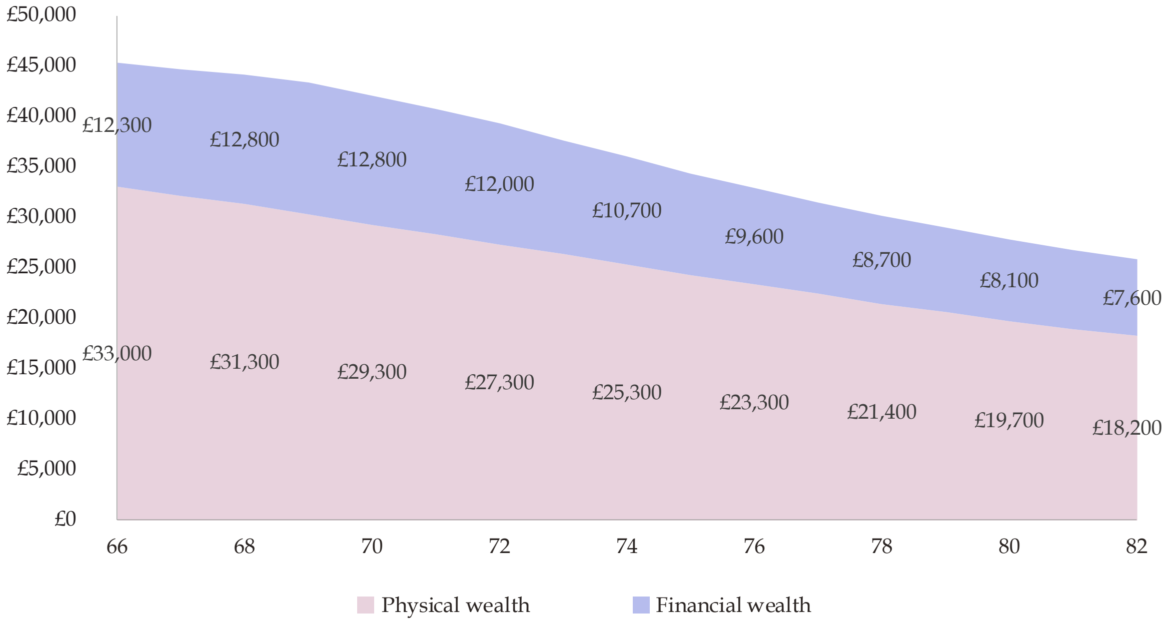
Appendix Two: Additional Charts

Jack

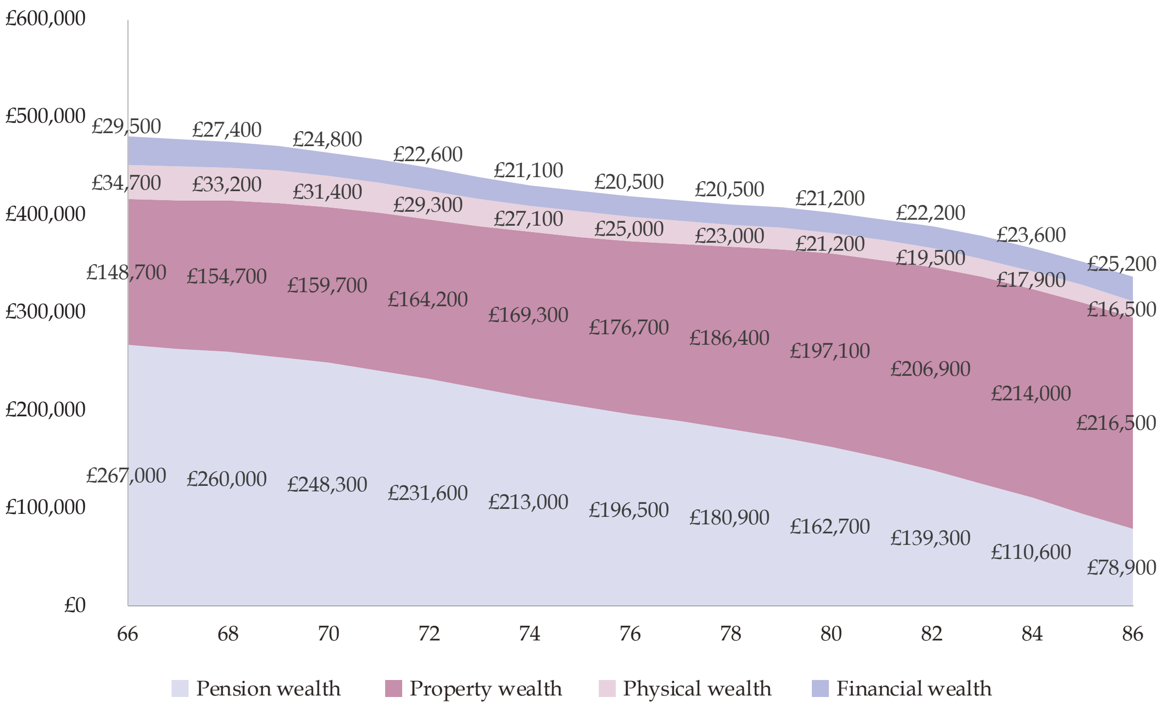
Wealth of a typical individual in the lowest wealth quintile between age 66 and death at age 74



Alice
Wealth of a typical individual in the second lowest quintile between age 66 and death at age 82

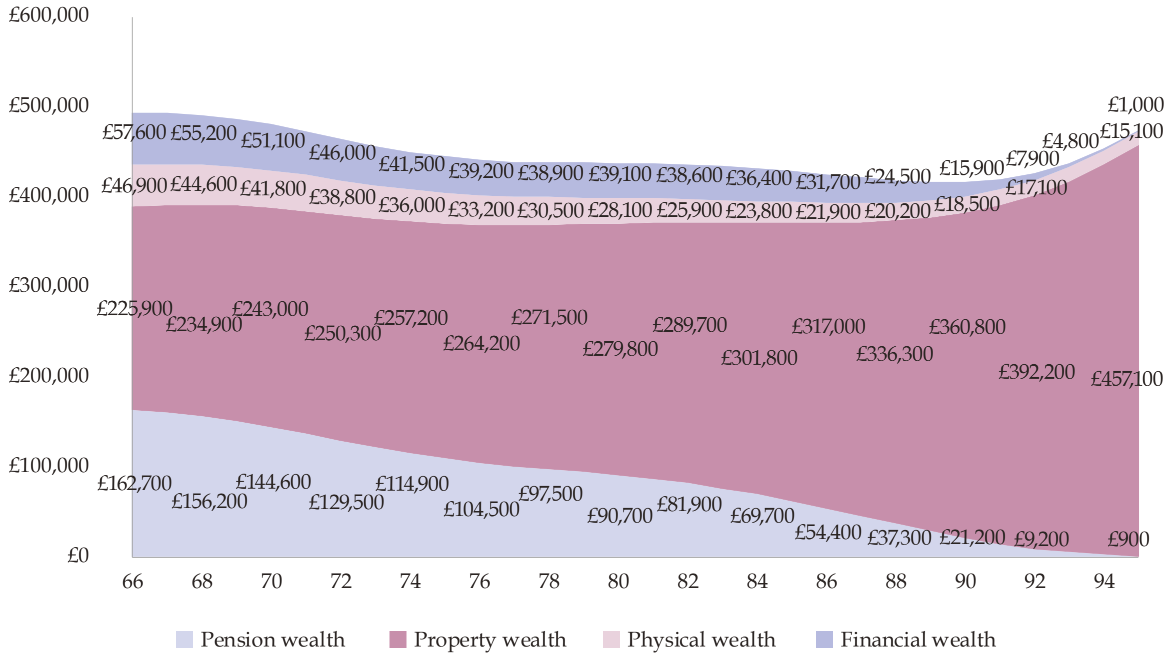


David
Wealth of a typical individual in the middle quintile between age 66 and death at age 86



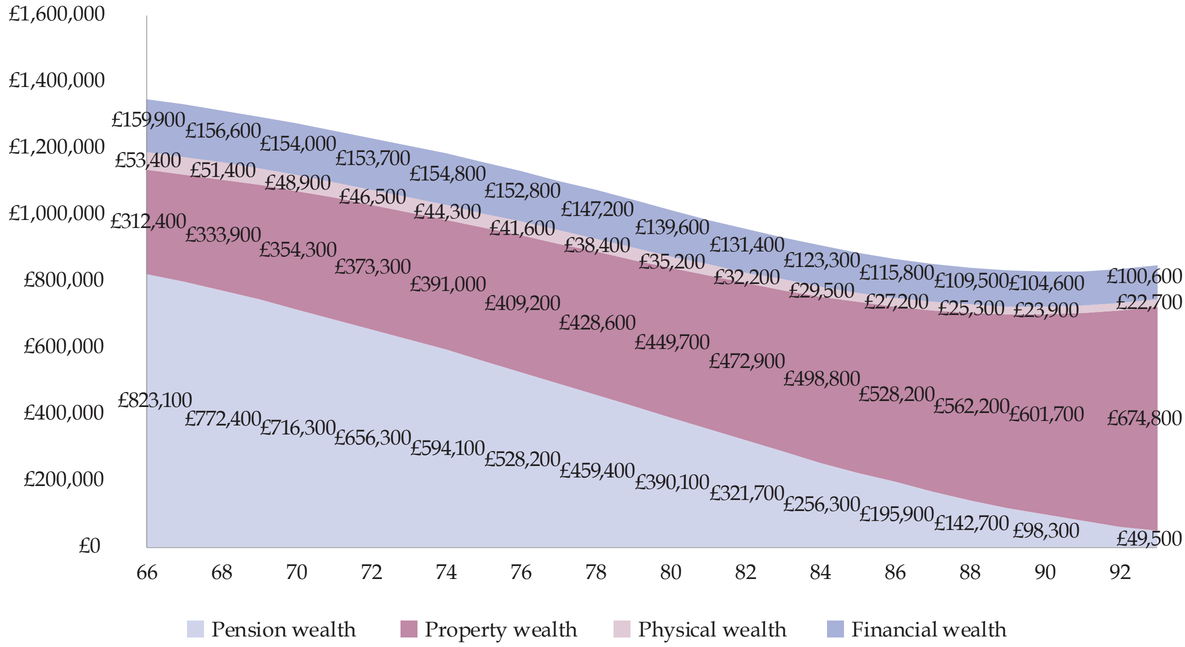
Mary

Wealth of a typical individual in the second highest quintile between age 66 and death at age 95



Andrew

Wealth of a typical individual in the highest quintile of wealth between age 66 and death at 93



Glossary

Annuity: A financial product that pays an income for a pre-determined period of time, generally from the date of purchase until the date of the annuitant's death.

Automatic enrolment: A policy requiring employers to enrol eligible employees into a workplace pension scheme. Employees have the right to opt out of the scheme. Employers (and usually employees) must pay at least a minimum level of contributions, on a band of earnings, into the scheme if the employee does not opt out.

Defined Benefit (DB): an employee sponsored pension in which benefits are calculated based on years of contributions and salary (generally average or final salary).

Defined Contribution (DC) Pension Scheme: A trust-based or contract-based pension scheme that provides pension scheme benefits based on the contributions invested, the returns received on that investment (minus any charges incurred) and the way the savings are accessed.

Department for Work and Pensions (DWP): The DWP is the government department responsible for welfare and social security, including pensions, working age benefits, and disability services.

Drawdown: A retirement income product which allows people to continue to invest their pension savings and receive investment returns while also drawing down an income.

Enhanced Annuity: An annuity that offers a higher rate for individuals who have a shortened life expectancy due to health or lifestyle factors for example, smoking, cancer, or heart disease.

Equity:[68] Shares in a company which are bought and sold on a stock exchange. Owning shares makes shareholders part owners of the company in question and usually entitles them to a share of the profits.

Equity Release: A product which allows people aged 55 and over to release lump sums or income from housing equity, to be paid out of their estate on death.

68 http://www.thepensionsregulator.gov.uk/glossary.aspx#s21610

Financial Conduct Authority (FCA): The organisation which regulates firms and individuals (including financial advisers) that promote, arrange or provide contract-based pension schemes.

Freedom and Choice/ pension freedoms: Prior to April 2015, those with DC savings of a certain level were required to purchase a secure retirement income product in order to access their DC savings. The new pension flexibilities "Freedom and Choice" loosened restrictions so that those aged 55 and over may withdraw DC savings in any amount they like, taxed at their marginal rate, with 25% tax free.

Office for Budget Responsibility (OBR): The OBR was created in 2010 to provide independent and authoritative analysis of the UK's public finances. It is one of a growing number of official independent fiscal watchdogs around the world.

Office for National Statistics (ONS): The UK's largest independent producer of official statistics and the recognised statistical institute of the UK.

Robo-Advice: An online service that provides automated algorithm-based financial advice, typically without the use of a human financial planner.[69]

State Pension: The public pension provided by the UK Government to people from State pension age with sufficient years of National Insurance entitlement.

State Pension age (SPa): The age when people can claim their State Pension. SPa is increasing and depends on an individual's birthdate.

The Pensions Regulator (tPR): The organisation which regulates trust-based pension schemes and the administration of work-based personal pension schemes.

69 www.investopedia.com/terms/r/roboadvisor-roboadviser.asp

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