

Call for evidence on DC Decumulation – Response from the Pensions Policy Institute

1. Response

- 1.1 This is the Pensions Policy Institute's submission to PLSA's call for evidence on DC Decumulation.
- 1.2 The Pensions Policy Institute (PPI) promotes the study of pensions and other provision for retirement and old age. The PPI is unique as it is independent (no political bias or vested interest), focused and expert in the field, and takes a long-term perspective across all elements of the pension system. The PPI exists to contribute facts, analysis and commentary to help all commentators and decision-makers to take informed policy decisions on pensions and retirement provision.
- 1.3 This submission does not address all the specific questions in the consultation, neither does it seek to make policy recommendations. Rather, the response points to relevant research that the PPI has conducted over recent years. These reports, which can be accessed by clicking the hyperlink in the title, contain evidence pertinent to key aspects of the PLSA consultation, specifically on the ways in which people approach and make decisions about their pensions, the risks that they may face and the changes to the wider pensions landscape as a result of freedom and choice.

2. Key points

- 2.1 The introduction of Freedom and Choice has led to people having to make more complex decisions about their pension savings, as a result, people are likely to need more ongoing guidance and advice throughout the course of later life.
- 2.2 Sub-optimal decisions about how to access retirement savings could negatively impact people in several ways, such as leading to running out of savings before death, losing out on innovative financial products or experiencing a lower standard of living than necessary.
- 2.3 Individuals must consider several risks when making decisions about accessing private pension savings, such as life expectancy, inflation, investment performance and changes to personal circumstances.
- 2.4 People are likely to need more ongoing guidance and advice throughout the course of later life.

- 2.5 Low levels of financial capability and behavioural biases may prevent some people from making choices which can maximise their retirement income.
- 2.6 For some people, initiatives aimed at increasing engagement and financial capability will equip them to make appropriate decisions.
- 2.7 To be most effective, targeted support in accessing retirement income will need to consider many factors, including socioeconomic background, age, race, gender, health, financial capability, life expectancies and healthy life expectancies.
- 2.8 Government and industry alone will not be able to ensure better pension outcomes. Tackling the barriers many people face in making optimal financial decisions will require a joint effort from Government, industry, employers, education providers and consumer support organisations.

The remainder of this response covers several PPI reports which support the above key points.

3. Supporting Later Life (2019)

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

- 3.1 Many people struggle to understand financial fundamentals such as tax, inflation or how investments and retirement income products work. People often struggle to understand charges, risks and value for money. This is in part because many people have little exposure to these products during their working lives.
- 3.2 In order to make appropriate choices when faced with complex retirement decisions, people are likely to need:
 - Increased engagement and understanding of pensions (potentially promoted through, for example, pre-retirement education initiatives and wake-up packs).
 - Ongoing support throughout later life, through both advice and guidance, as well as the other policy levers.

4. Living through later life (2019)

To be effective and targeted, at-retirement support will need to take into account life and healthy life expectancies, socioeconomic background and other characteristics.

- 4.1 People move between and experience Independent, Decline and Dependent phases during later life and these have an impact on needs in retirement. (We welcome the PLSA's use of the PPI typology of retirement phases in the consultation).
- 4.2 Variations in healthy life expectancy mean that some individuals are less likely to experience the benefits of the Independent Phase than others. This is particularly true of

older people in a lower socioeconomic position or those with lower life and healthy life expectancies.

- 4.3 As those with lower healthy life expectancies are more likely to skip the Independent Phase and retire directly into the Decline Phase, they would benefit from support to prolong this phase for as long as possible and protect against the greater risks associated with the Dependent Phase.

5. The Evolving Retirement Landscape (2018)

Individuals must consider a number of factors when making decisions about accessing private pension savings, such as potential life expectancy, and the way that inflation, investment performance and changes to personal circumstances could affect needs.

- 5.1 In future, people are likely to reach retirement with lower levels of Defined Benefit entitlement and higher levels of Defined Contribution savings than today's pensioners and will face more complex decisions about how to access and convert retirement savings into an income that will support them throughout their retirement. They are likely to benefit from greater financial education, advice and guidance combined with innovative product solutions.
- 5.2 Sub-optimal decisions about how to access retirement savings could negatively impact people in several ways, as they may:
- Run out of pension savings sooner than anticipated.
 - End up paying more in tax and/or charges than they would otherwise have done.
 - Be unable to utilise the most suitable investment strategy.
 - Not be able to access their pension savings as and when it suits them.
 - Lose valuable benefits (for example guaranteed annuity rates).

6. Consumer engagement: the role of policy through the lifecycle (2017)

A variety of policy levers, including behavioural interventions, can help people to achieve better retirement outcomes.

- 6.1 Many poor outcomes arise from socio-economic inequalities. Tackling structural barriers will require a joint effort from Government, industry, employers, education providers and consumer support organisations.
- 6.2 Behavioural interventions are more likely to be effective during "teachable moments", when individuals are more open to receiving and acting on financial information, such as moving house, starting a new job, having a child, or purchasing financial products.
- 6.3 Different policy levers are more likely to be successful with different groups:

- Younger people are more likely to engage with digital behavioural interventions while older people are generally more comfortable with face-to-face approaches.
- Defaults will particularly benefit the non-engaged. Alongside work around raising financial capability (and defaults or compulsion), it is vital for non-engaged people to have safety nets they can fall back on, as they may be more vulnerable to high rate services such as payday lenders.
- Engaged people are the main consumers of financial products, and therefore benefit from regulation and consumer protection which governs overcharging, misconduct and fraud by financial services. The highly engaged benefit more from these policy levers than from defaults, compulsion or safety nets.

6.4 For many marginalised people, safety nets such as means-tested and disability benefits will be their main sources of income during working life and retirement, and they are less likely to have the financial capability or resources to respond to behavioural interventions.

6.5 Information campaigns can motivate people to take action without sufficient financial capability to make optimal decisions, leading to poorer outcomes.

7. Funding The Future Life - the implications of a longer life (2018)

Longer life means that the way people approach later life will need to change.

7.1 The three stage life (study, work, retirement) concept is becoming obsolete as people move towards living multi-stage lives with breaks and overlaps between stages. Financial health during a multi-stage life relies on a greater emphasis on thinking proactively in terms of skills, health and overall wellbeing.

7.2 Financial planning around multi-stage lives will require more flexibility regarding how long people work, what careers look like, the nature of retirement, budgeting, saving and the development of resilience and agility in relation to all aspects of life.

8. Evolving Retirement Outcomes (2018)

While existing products do provide good outcomes for some, there will need to be innovation if products are to meet the needs of retirees over the next ten to fifteen years.

8.1 Decisions about how to access retirement savings are complex and require people to make trade-offs between a number of factors, in particular security and flexibility.

8.2 Despite the complexity of these decisions, take-up of advice and guidance remains relatively low, and innovative solutions may be required to tackle the problem of low engagement.

8.3 Policies aimed at increasing engagement in the lead up to retirement could help people to make more informed choices and potentially achieve better retirement outcomes.

8.4 Guided (or 'default') pathways may be a remedy for low levels of engagement or for those for whom high levels of engagement and financial capability are not practicable. Guided pathways may also serve to make people less likely to engage in the long-term.

9. Transitions to Retirement: How Complex are the decisions that pension savers need to make at retirement (2014)

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.

- 9.1 The people reaching State Pension age over the next five to ten years vary considerably in their pension and non-pension saving and asset portfolios. Within this population, there are segments who will require greater support than others as a result of being more reliant on their DC savings to secure an adequate income.
- 9.2 Traditional pension scheme communications are unlikely to fill the gap in knowledge or provide the support that people with DC savings might need to make complex decisions.
- 9.3 Even with greater engagement, it is unlikely that savers will have clear or definitive views on their expectations and preferences in retirement. It is more likely that gradually raising awareness ahead of retirement around the choices and trade-offs they will face, will help them to become comfortable with choosing between options.
- 9.4 When customers do engage, they are likely to have varying numeracy levels and therefore potentially varied abilities to understand and engage with decision-making or to understand the implications of different options. Clear and concise communication is vital if engagement is to be sustained.

For further information or if you have any additional questions please contact:

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