



# The evolving retirement landscape

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# Executive Summary

Since April 2015, people have had greater flexibility when they come to access Defined Contribution (DC) pension savings after age 55. Prior to these changes, people with DC savings who could not demonstrate a minimum level of secure income were required to purchase an annuity or take a rate of income capped by the Government. The introduction of freedom and choice in pensions has opened up new ways for people to access their pension savings. However, it has also opened them up to new challenges, complexity and risk. Surrounding the freedoms, there have been concerns about people making sub-optimal decisions which have the potential to have a significant negative impact on their retirement outcomes.

This report, the first in a series of two, focuses on the changes which have and are currently occurring in the retirement landscape, the way that pension savings and assets are evolving, and what this means for the decisions people are making about how to access their retirement savings.

## Demographic, market and policy changes affect needs and resources in retirement

There are several factors which will impact the retirement landscape now and in the future:

- Changes in the wider pensions landscape;
- Legislative changes, in particular the introduction of freedom and choice;

- Demographic changes, in particular increasing longevity; and
- Changing transitions into retirement, as opposed to having a single retirement point when both State Pension and private pension are accessed.

These changes will affect the needs and resources of, and risks faced by, people at retirement. Future retirees are likely to:

- Live longer;
- Take their State Pension later;
- Reach retirement with DC savings (and no or low levels of Defined Benefit (DB) entitlement), and
- Have near total flexibility in regard to accessing their savings.

Future retirees are likely to have a greater reliance on DC savings, alongside low, if any, DB entitlement, and have near total flexibility in accessing their savings

**Over the last decade, DC pension savings have become increasingly important for many individuals, although DB continues to be a significant component of retirement income for many of today's retirees**

DC pension savings have become increasingly important for many individuals in recent years. This has resulted primarily from a convergence of two factors:

- The decline of DB provision, with the employer cost of providing these schemes higher and less manageable than providing a workplace DC scheme; and
- The introduction of automatic enrolment, which has seen many new savers enrolled into pension saving, with the majority enrolled in DC schemes.

**The introduction of freedom and choice has increased the available options for accessing DC savings and individuals' decisions at and during retirement have evolved as a result**

Prior to the introduction of freedom and choice, annuities were the most commonly used retirement product, accounting for 90% of retirement products bought with pension pots in 2013. Following the introduction of the new pension freedoms, annuities account for around 12% of pots accessed. Full withdrawal has become the most popular means of accessing DC pension savings, accounting for more than 50% of pots accessed. Drawdown products have also become more popular, accounting for 30% of retirement product purchases.

**Full withdrawal is most common among those with smaller DC pot sizes, while drawdown products are most commonly purchased by those with larger pots**

Pots that are fully withdrawn are smaller on average than those used to purchase retirement income products, with 90% of withdrawn pots worth less than £30,000 compared to 30-46% of pots used to purchase income products (including drawdown and annuity products).

**Annuities remain more popular among individuals in older age groups, although even among these groups, they have become less prevalent than drawdown and full withdrawal**

Full withdrawal has been the most popular means of accessing DC savings across all age groups (between 42% and 60%), followed by drawdown (between 29% and 37%). However, annuities are more than twice as popular among those in older age groups compared to those in younger groups, accounting for around 20% of retirement product purchases for those aged over 65, compared to 6-8% for those aged under 64.

**The changes that have been observed in the three years since the introduction of freedom and choice are not necessarily representative of the decisions that will be made by future retirees**

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. This will depend on a number of factors, not the least of which being the extent to which providers create innovative solutions to the new retirement landscape. Furthermore, we will not be able to evaluate the outcomes of these decisions for some time.

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### **Income from private pensions and other savings and assets can help individuals stay out of poverty in retirement**

Income from State Pension in the UK gives individuals an average replacement rate of 29%. The Pensions Commission suggested that benchmark replacement rates could range from 50% for high earners to 80% for low earners. This means that individuals may need to generate a substantial proportion of their retirement income from private pension savings and other savings and assets in order to recreate working life living standards.

### **Individuals must consider a number of risks when making decisions about accessing private pension savings**

The main risks that are associated with accessing private pension savings include:

- Longevity risk.
- Inflation risk.
- Investment risk.
- Risk of missing out on investment growth.
- Time-of-purchase risk.
- The risk of changes in need or personal circumstances.

### **If individuals make sub-optimal decisions about how to access their retirement savings this could negatively impact them in a number of ways:**

- They could run out of pension savings sooner than anticipated.
- Individuals could end up paying more in tax and/or charges than they would otherwise have done.
- Individuals may be unable to utilise the most suitable investment strategy.
- They may not be able to access their pension savings as and when it suits them.
- They may lose valuable benefits (for example guaranteed annuity rates).

In the immediate future, the next five to ten years, there may be an increase in the number of people reaching retirement with both low levels of DB entitlement and low levels of DC savings, as those who have been automatically enrolled later in their working lives reach retirement. However, as millennials approach

retirement, there will be an increase in the number of people reaching retirement with low or no DB entitlement and moderate to high levels of DC savings. This is because future cohorts will have been automatically enrolled for much of their working life and are unlikely to have much, if any, DB entitlement.

### **As millennials approach retirement, there will be an increase in the number of people reaching retirement with low or no DB entitlement and moderate to high levels of DC savings**

### **In the future, fewer people will reach retirement with DB entitlement and this will make it harder for them to achieve target replacement rates**

Less than 10% of today's retirees reach retirement with only DC savings and no DB entitlement. By 2060, the number of people reaching retirement with only DC savings could be as high as 50%. Individuals with DB entitlement are more likely to achieve their target replacement rates than those with only DC savings.

### **Automatic enrolment may lead to improved outcomes for future retirees through higher levels of saving, provided increased contribution rates do not significantly increase opt-outs**

Automatic enrolment has seen pension participation among those aged between 22 and 29 years old double, from 36% in 2011/12 to 72% in 2015/16. Because millennials generally entered the workforce during the initial implementation of automatic enrolment, they may be the first cohort to spend their entire working life contributing to pension schemes into which they were automatically enrolled.

As minimum automatic enrolment contribution levels increase, the number of individuals choosing to opt-out may also increase, which would reduce the potential for improved retirement outcomes. However, there is unlikely to be a large increase in opt-out rates.

### **It is likely that future retirees will have less housing security than previous cohorts**

Since 2000, home ownership has been in decline for all age groups except those aged over 65. If this trend continues, there are likely to be more people reaching retirement either renting or still paying off their mortgage during retirement. This will increase their living costs and therefore the amount of income they will require to achieve an acceptable standard of living in retirement.

### **Groups that are most at risk of making sub-optimal decisions that could have a significant negative impact on their retirement outcomes are those with moderate to high levels of DC savings and no or low DB entitlement**

Around a quarter of individuals currently aged between 50 and State Pension age (SPa) have moderate to high levels of DC savings (more than £24,400) and either no DB entitlement or entitlement below £7,000 per year. Although this group is currently relatively small, it is likely to grow steadily in future cohorts.

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## **Individuals with moderate to high levels of DC savings and no or low DB entitlement are most at risk of making sub-optimal decisions that can have a significant negative impact on their retirement outcomes**

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Individuals in this group have DC savings of such a level that they have the potential to have a significant impact on individuals' retirement outcomes, however this also means that they have the potential to negatively impact

outcomes if individuals make sub-optimal outcomes. These individuals do not have much, if any, DB income to fall back on if they do make sub-optimal decisions about how to access their retirement savings (although they do have State Pension entitlement), and so are likely to experience significantly poorer outcomes.

### **Changing combinations of savings and wealth will affect the way that individuals make decisions about how to fund retirement**

People in the future, who will reach retirement with different combinations of saving and wealth to today's retirees, will face more complex decisions about how to access their retirement savings and how to convert them into an income that will support them throughout their retirement. The extent to which individuals will be able to achieve positive retirement outcomes under the new pension freedoms will depend on the success of policy makers and industry in providing and enabling:

- Financial education, advice and guidance; and
- Innovative product solutions to evolving retirement income needs.

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## **People in the future will face more complex decisions about how to access their retirement savings**

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The second report in this series, *Evolving retirement outcomes*, will focus on the potential outcomes that may be achieved through a range of retirement income decisions for individuals with different combinations of savings and assets. It will also explore the way that current products, advice and guidance meet the needs of people facing retirement decisions in terms of whose needs are met and whose are not, and the changes that may need to occur within the industry and wider pensions landscape in order to ensure that retirement outcomes are positive for as many people as possible.

# Introduction

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Since April 2015, people have had greater flexibility when they come to access DC pension savings after age 55. Prior to these changes, people with DC savings who could not demonstrate a minimum level of secure income were required to use a secure retirement income product, for example an annuity, in order to access their DC pension savings.

The introduction of freedom and choice in pensions has opened up new ways for individuals to access their pension savings. However, it also opens individuals up to new challenges, complexity and risks. This report explores the ways in which the retirement landscape has changed since the freedoms were introduced and what this might mean for future retirees.

Chapter one discusses the range of factors which are causing the retirement landscape to evolve, including the freedom and choice reforms, changes in broader pensions landscape (the shift from DB to DC and the introduction of automatic enrolment), demographic changes and changing transitions into retirement.

Chapter two explores how individuals' decisions about how to access their DC pension savings have changed since the introduction of freedom and choice, as well as identifying the factors that may be correlated with choosing particular options.

Chapter three discusses the needs of individuals in retirement, the challenges they may face in meeting them and how this has changed as a result of the freedom and choice reforms.

Chapter four investigates the way in which individuals' wealth is split across different forms of wealth and income, including DC savings, DB entitlement, housing wealth and other financial assets, exploring how this is likely to evolve in the foreseeable future and how this may impact individuals' decisions about how to access their retirement savings.



# Chapter one: why is the retirement landscape evolving?

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This chapter discusses the range of factors which are causing the retirement landscape to evolve, including the freedom and choice reforms, the shift from Defined Benefit (DB) to Defined Contribution (DC), the introduction of automatic enrolment, demographic changes and changing transitions into retirement.

## **Demographic, market and policy changes affect needs and resources in retirement**

The changes discussed in this chapter will affect the needs and resources of, and the risks faced by, people at and during retirement. Future retirees are likely to:

- Live longer;
- Take their State Pension later;
- Be more likely to reach retirement with DC savings (and no or low levels of DB entitlement), and
- Have near total flexibility in regard to accessing their savings.

Greater numbers of DC savers, coupled with increased flexibility of access, increases the risk and complexity that people with pension savings face at, and during, retirement.

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## **Greater numbers of DC savers, coupled with increased flexibility of access, increases the risk and complexity that people with pension savings face at, and during, retirement**

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There are several factors which will impact the retirement landscape now and in the future:

- Changes in the wider pensions landscape;
- Legislative changes, in particular the introduction of freedom and choice and the introduction of automatic enrolment;
- Demographic changes, in particular increasing longevity; and
- Changing transitions into retirement.

### **Over the last decade DC pension savings have become increasingly important for many individuals**

Automatic enrolment, which began in 2012, requires employers to enrol eligible employees into a qualifying pension scheme. Employees have a one month window of opportunity in which they may opt-out and receive back any contributions already made. At the end of January 2018, 9.3 million employees had been automatically enrolled.<sup>1</sup>

92% of individuals who have been automatically enrolled have been enrolled into pure DC schemes, with just 4% enrolled into DB schemes. Although DB schemes have been in decline for some time, largely as a result of rising costs, the introduction of automatic enrolment has accelerated the shift towards DC provision.

Average DC pot sizes have initially been reduced following the implementation of automatic enrolment as a result of millions of people being automatically enrolled and accruing initially small pension pots. Between 2010-2012 and 2017, the median DC pot size for those aged 16 and over decreased from £15,000 to £10,300. Over time, median pot sizes will increase as contributions and investment returns have a chance to embed and grow. The aggregate amount held within workplace DC pensions is expected to increase fivefold by 2030, from £340 billion in 2015 to £1.7 trillion.<sup>2</sup> This means that there will be more individuals reaching retirement with moderate to high levels of DC savings as they will have been automatically enrolled for a longer period of their working lives.

### **DB continues to be an important component of retirement income for many of today's retirees**

Although DC schemes are increasingly becoming the norm, DB entitlement will continue to be important for many retirees in the foreseeable future. In 2017, there were 1.3 million active members of private sector DB schemes, 4.2 million members already receiving income from a private sector DB scheme and 4.9 million expecting a future pension from schemes to which they are no longer contributing.<sup>3</sup> DB remains more prevalent in the public sector, with 5.7 million active members, 4.8 million pensions in payment and 4.2 million members with preserved pension entitlements.<sup>4</sup>

### **The introduction of freedom and choice has increased the available options for accessing DC savings**

In April 2015, the Government introduced freedom and choice, which allowed individuals a greater number of options for accessing pension savings. Individuals over the minimum pension age with DC savings are no longer required to purchase an annuity or a drawdown product in order to access their DC savings, and are able to withdraw from their DC pot in unlimited amounts, taxed at an individual's marginal rate (with 25% of the amount withdrawn tax-free).

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1. TPR (2017a)

2. FCA (2017)

3. TPR (2017b)

4. ONS (2017)

### Box 1: options for accessing DC savings before freedom and choice

Prior to the introduction of freedom and choice in April 2015, options for accessing DC savings were more limited:

#### **Tax-free lump sum**

- All DC savers were eligible to take 25% of savings as a tax-free lump sum.

#### **Pots below £18,000**

- Those with total pension savings of £18,000 or less could take the total as a lump sum, 25% tax free and 75% taxed at their marginal income tax rate. This was known as trivial commutation and could be executed any time after the age of 60 rather than the minimum pension age of 55.
- In addition to access to a pot of £18,000, a further two pots of £2,000 or less could be taken as a lump sum, after the age of 60.

#### **For those with a guaranteed minimum annual income of £20,000**

- Those who could provide themselves with a guaranteed lifetime income of £20,000 per year from State and private pensions (DB or DC) could purchase a flexible drawdown product and then withdraw their savings in unlimited amounts.

#### **Pots above £18,000 but without a guaranteed minimum income of £20,000**

- People who had DC savings pots of over £18,000 but were not able to secure a minimum income of £20,000 per year were required to use a product which provided a secure retirement income in order to access their savings (excluding the 25% tax-free lump sum). They could do this in one of two ways:
  - Purchasing an annuity, which provides a guaranteed income for life, or
  - Purchasing an income drawdown product, which allows investment and fund growth, and limits income withdrawals to 150% of an equivalent annuity based on rates set by the Government Actuary's Department. This is known as a Capped Drawdown product.

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.<sup>5</sup> 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.<sup>6</sup>

5. HM Treasury (2014)

6. FCA (2014)



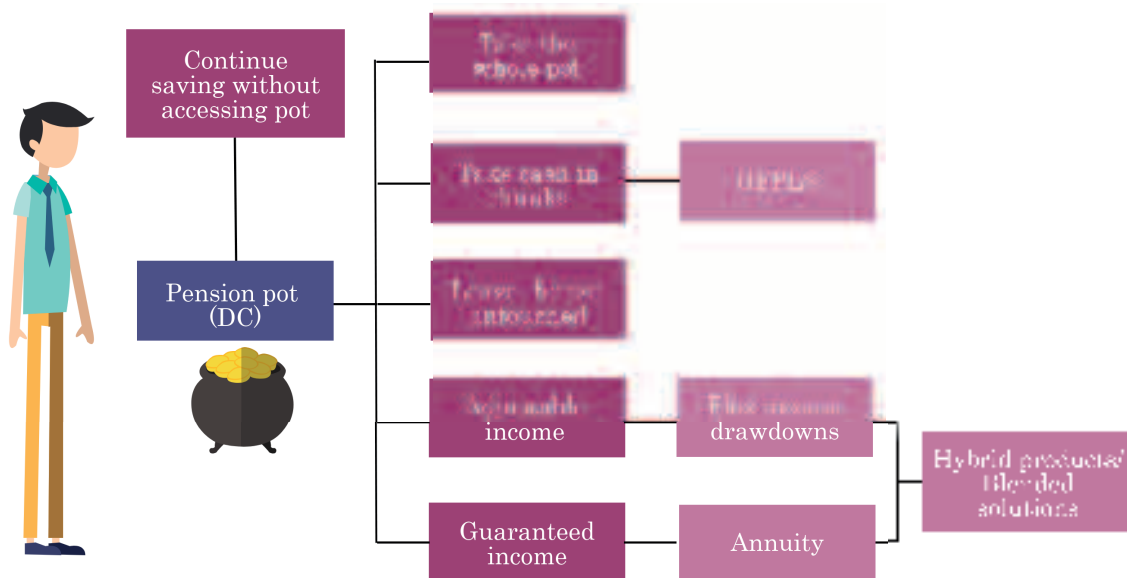
## Box 2: options for accessing DC savings under freedom and choice

Following the introduction of freedom and choice in April 2015, there are several ways of accessing DC savings:

- Take 25% of savings as a tax-free lump sum.
- The remainder can be withdrawn in unlimited amounts, taxed at the individual's marginal rate. People can also do one or a combination of the following:
  - People are still able to purchase an annuity or a drawdown product, but are able to choose between several varieties of these.
  - People may leave their fund with their pension provider and withdraw directly from their pension fund, "uncrystallised funds pension lump sums" (UFPLS). In this case, 25% of each withdrawal is tax-free, with the remainder taxed at marginal rate.
  - Those who withdraw their total fund can choose whether to spend or re-invest the lump sum.

Prior to the introduction of freedom and choice, the most commonly taken option for those above the trivial commutation limit (and some below) was to take a 25% tax-free cash lump sum and use the remaining fund to purchase a lifetime annuity. Although drawdown was available, it was generally only used by those with large pots of £100,000 or more. Since its introduction, decisions about financing retirement have been more varied.

Figure 1: options for accessing DC savings post-freedom and choice



**Although it is no longer compulsory for individuals to purchase an annuity with their DC savings, people are still purchasing them, though in much smaller numbers**

When the Government proposed the new pensions freedoms in 2014, there was a recognition that 'for many people, purchasing an annuity [would] remain the best way to secure an income, at least at some point in retirement'.<sup>7</sup>

Although individuals can now choose to use their DC savings in many different ways, annuities will still be the best option for some. For example, those dependent on a medium amount of DC savings with few other retirement income sources other than the State Pension could benefit from a secure income for life and from the lack of risk of fund loss associated with other methods of accessing DC savings.

7. HM Treasury (2014)



Although individuals can now choose to use their DC savings in many different ways, annuities will still be the best option for some

Box 3: different types of annuity

Level annuities	Provide the same level of payments for the entire retirement period. Their real value is eroded over time by inflation.
Index-linked annuities	Provide payments which rise over time in line with some measure of inflation. However, because of this inflation protection, the initial payments will be lower than for a level annuity.
Escalating annuities	Provide payments which rise over time by a fixed amount every year. As with an index-linked annuity, the initial payments will be lower than for a level annuity.
Fixed-term annuities	Provide payments for a specified number of years and pay out a maturity amount at the end of the set period.
With profits annuities	Provide payments linked to investment performance.
Immediate needs annuities	Provide a guaranteed income for life to fund long-term care, either at home or in a care home.

Since the introduction of pension freedoms in 2015, several providers have stopped offering annuities, either by withdrawing from the open market, withdrawing altogether or by merging.

Even before the introduction of the new pension freedoms, annuities were coming to be viewed less positively. Many consumers did not feel that annuities offered sufficiently good value for money to justify the time and effort of shopping around.<sup>8</sup> Negative views of annuities have been exacerbated by annuity rates which have fallen steadily in recent years due to increasing longevity and falling gilt yields among other things.

Although annuities offer protection against the risk of individuals outliving their pension savings, as well as against investment risk and inflation risk, this comes at the cost of reduced flexibility to grow funds, vary payments or leave bequests.

The flexibility offered by drawdown products expose individuals to the risk that they will outlive their pension savings. Drawdown allows individuals control over the frequency with which they access their pension savings, as well as the amount that they withdraw at any one time. Although this is generally considered a positive aspect of drawdown, it also introduces

complexity and risk because individuals must identify a sustainable rate of withdrawal to ensure that their savings will last throughout the entirety of retirement; this is a difficult decision to make as individuals cannot be certain about how long this period will last.

Although flexibility is generally considered a positive aspect of drawdown, it also introduces complexity and risk because individuals must identify a sustainable rate of withdrawal

**As a result of the new pension freedoms, individuals can now access their pension savings without having to purchase a retirement income product**

A new option for accessing pension savings introduced along through the new pension freedoms is the option to withdraw uncrystallised funds pension lump sums (UFPLS). This enables individuals to withdraw either some or all of the DC savings from

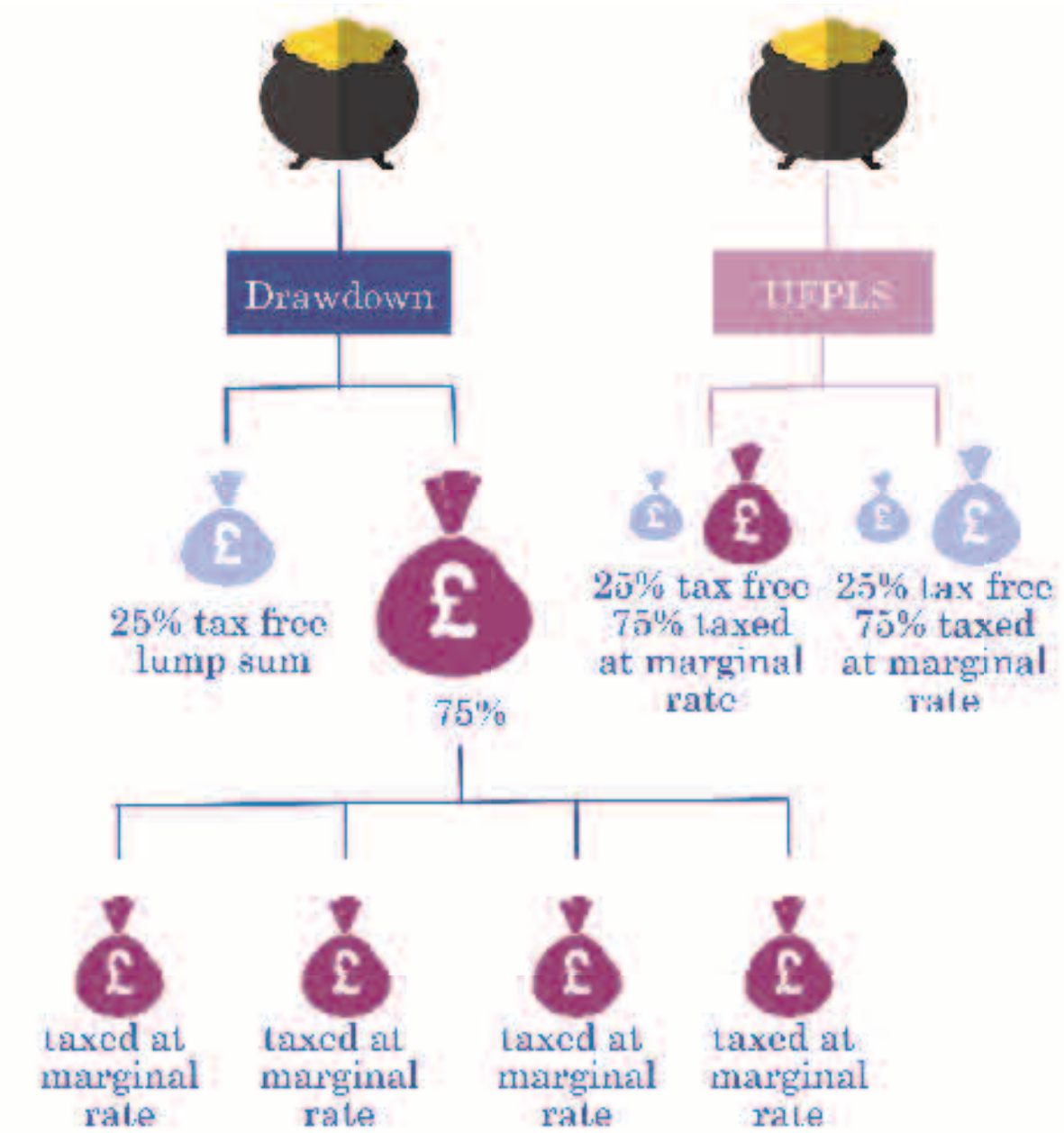
8. FSCP (2013)

their pension scheme without having to use it to purchase a recognised retirement income product such as an annuity or drawdown.

As with drawdown, UFPLS allows individuals to have greater flexibility in how they choose to distribute their savings over their retirement, as well as the potential to benefit from investment returns as the uncrystallised funds (the money that remains in the pension pot) remain invested.

The key difference between drawdown and UFPLS is the time at which the 25% tax free sum is taken. In the case of drawdown, the 25% cash free lump sum is taken first. In the case of UFPLS on the other hand, each time a withdrawal is made, 25% of the withdrawal is tax free, while the other 75% of the withdrawal is taxed as income.

Figure 2: tax treatment of drawdown and UFPLS options



There may also be differences in terms of how savings are invested when left within the scheme and withdrawn through UFPLS, compared to the way in which savings within drawdown accounts may be invested. If pension savings are left within the same scheme as was

used for accumulation, investment strategies may be designed to be most suitable for the accumulation phase and less suited for those in retirement who are no longer saving. Although there is little evidence so far that this has been the case.

## **Increases in life expectancy affect the ability of individuals to support their needs throughout the entirety of retirement**

In 1981, the average male life expectancy at age 65 was estimated to be 14 years; this has since increased to almost 22 years. The average female life expectancy at age 65 increased from 18 years to 22½ years over the same period. Spending longer periods in retirement means that pension savings have to last longer, which coupled with the new options for accessing pension savings makes decisions about retirement income more complex.

Although the gap between expectations and reality of life expectancy is narrowing, on average individuals are still 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 until a very old age. Among those aged between 30 and 60, 9% of men and 10% of women expect to live until at least age 90. Official estimates suggest that 18% of men and 29% of women in this age group will live until at least age 90.<sup>9</sup> Healthy life expectancy also impacts retirement decisions and outcomes because this will impact spending patterns in retirement.

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**On average, men underestimate their life expectancy by around two years, while women underestimate by an average of four years**

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## **There is no longer a single ‘typical’ journey into retirement**

Previously, it was considered the norm for individuals to work until State Pension age, take their pensions (either in the form of DB entitlement or by purchasing an annuity with their DC savings), and withdraw from work. Today, an increasing number of individuals are making a more gradual transition into

retirement, for example by reducing their working hours and supplementing their income with pension savings. In 2015, 39% of workers aged over 50 considered working part-time or flexible hours before stopping working altogether as the optimal transition into retirement.<sup>10</sup>

For some, a more gradual transition into retirement is a willing choice. However, others may need to work longer in order to afford living expenses and accumulate more savings.

Pension provision in the UK has historically been provided through a combination of a DB model, sponsored by employers, and the State Pension or State benefits. The DB and State Pension models, coupled with a Default Retirement age have all encouraged people to take their pension at the same time that they retire, as a single “taking a private and/or State Pension and leaving work” event, whether this be at Normal Pension age or at State Pension age.

Over the past few decades, the DC model has become more popular with employers, largely as a result of perceived affordability compared to provision of DB and supported by the introduction of automatic enrolment, creating more variation in the pension and retirement landscape. DC pension savings generally involve more choice by the consumer than DB pensions, as to the structure of the income stream and the age at which to commence, but they also involve more individual risk.

This change, considered alongside other changes such as rises to State Pension age, and some Normal Pension ages (the expected age at which to take a DB pension as income), the removal of the Default Retirement age (the age at which an employer was legally allowed to terminate employment on the basis of age), increases in longevity, and economic challenges, have all resulted in changes to the way that people approach pensions and retirement transitions. What was traditionally a single event (leaving work and taking a pension) has for many people become more staged and gradual as people work longer, and often more flexibly, and as opportunities for taking pensions in stages have become more readily available.

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9. Crawford & Tetlow (2012)

10. FCA (2017)

For those contemplating a work transition there are several options, though the accessibility of each option will be affected by the availability of appropriate employment, health, financial circumstances and care responsibilities. Some people may have greater levels of autonomy than others over how and when they leave work. The self-employed in particular may have more control over working hours and how to transition out of work. On the other hand, especially for employed people, some work transitions are involuntary, though the removal of the Default Retirement age should have made it easier for some people to stay in work for longer.

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For those contemplating a work transition there are several options, though the accessibility of each option will be affected by the availability of appropriate employment, health, financial circumstances and care responsibilities

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This change in the way that individuals are transitioning into retirement combined with the increased number of options available for converting retirement savings into income since the introduction of pensions freedoms means that for many individuals, the choice of a retirement income product is no longer a one-off decision, but rather part of a continuous journey.

## Chapter two: what are individuals currently doing with DC funds?

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This chapter explores how individuals' decisions about how to access their Defined Contribution (DC) pension savings have changed since the introduction of freedom and choice.

Since the introduction of pension freedoms in 2015, the decisions individuals are making about accessing their pension savings have changed significantly. The number of annuity purchases has decreased as retirees have made use of the range of options newly available to them.

**Although decisions about how to access retirement savings have changed since the introduction of freedom and choice, the majority of pots have not been accessed**

While 58% of people who have retired since the introduction of freedom and choice have accessed their pension savings, more than half (64%) of people aged over 55 who are not retired have not yet accessed their pension pot (Chart 1).

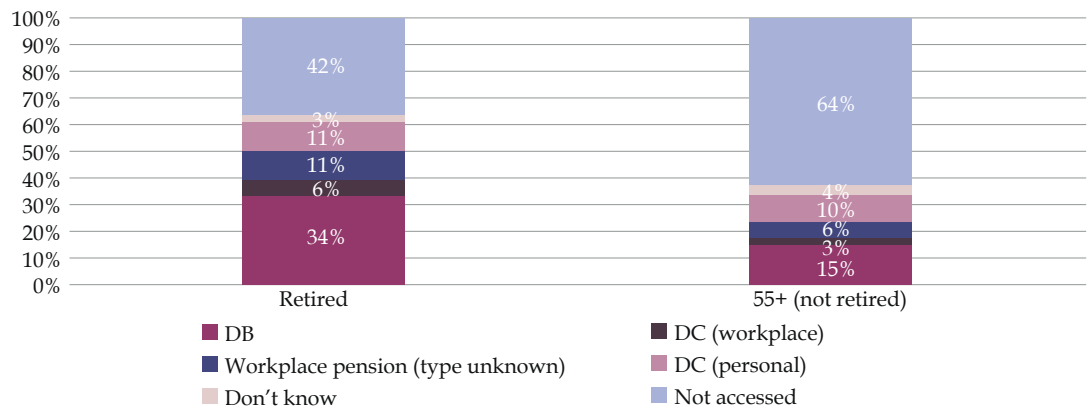
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While earlier access to pension savings has become more common since the freedoms were introduced, more than half of people aged over 55 who are still in work have not yet accessed their pension pot

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Chart 1<sup>11</sup>  
**Only one in five pots have been accessed since the introduction of freedom and choice**

Proportion of UK adults who have accessed a pension (by type of pension) (%)



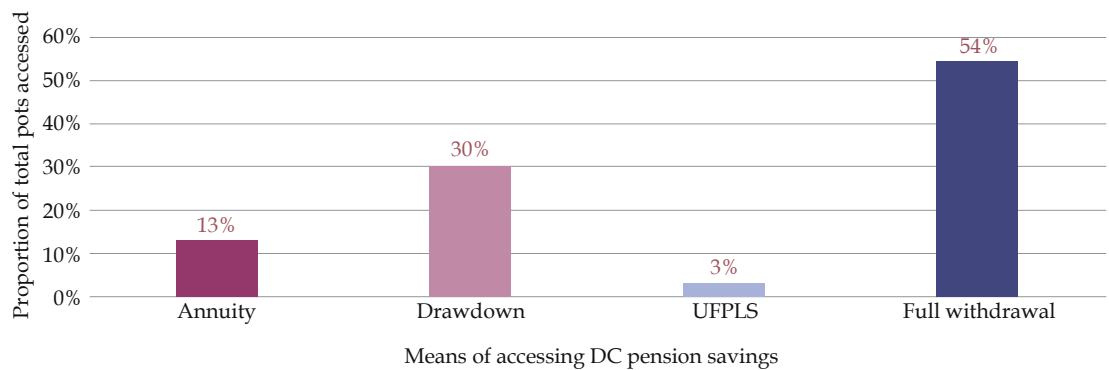
**The introduction of freedom and choice has increased the available options for accessing DC savings and individuals' decisions at and during retirement have evolved as a result**

Prior to the introduction of freedom and choice, annuities were the most commonly used retirement product. In 2013, 90% of individuals

accessing DC savings purchased an annuity, compared to 5% who purchased a drawdown product and 5% who fully withdrew their savings.<sup>12</sup> Between October 2015 and September 2017, annuities accounted for 13% of retirement product purchases (Chart 2).<sup>13</sup>

Chart 2<sup>14</sup>  
**Full withdrawal has become the most common way for people to access their DC pension pots since the introduction of freedom and choice**

Retirement product purchases October 2015 – September 2017



11. FCA (2018)  
12. FCA (2017)  
13. FCA (2018)  
14. FCA (2018)



## Annuity purchases are uncommon among individuals with low levels of DC savings

Among those with DC pots of less than £10,000, annuities accounted for 4% of retirement product purchases between October 2016 and September 2017. Annuities are most popular among those with DC savings of between £30,000 and £99,000, accounting for 20% of purchases, closely followed by those with between £100,000 and £249,000 (19%). Those with DC savings over £250,000 are less likely to purchase an annuity, accounting for 8% of product purchases (Chart 3).<sup>15</sup>

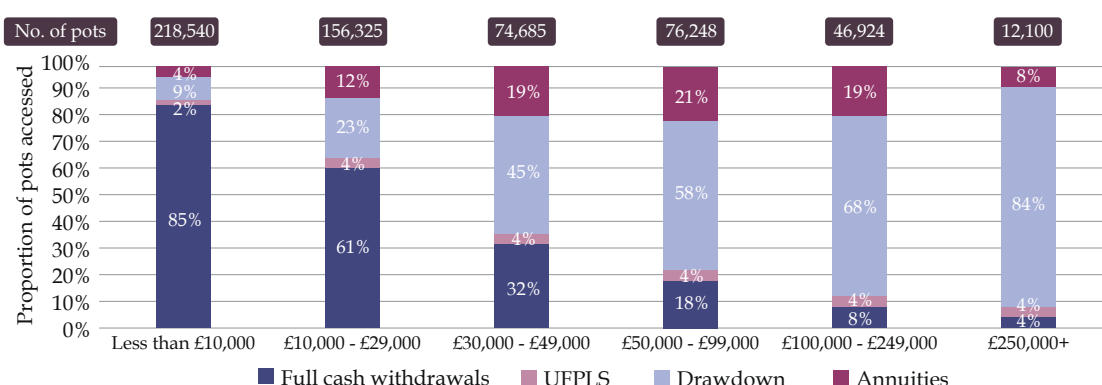
During the first nine months after the introduction of the new pension freedoms £4.2 billion was invested in around 80,000 annuities, making the average fund invested around £52,500.<sup>16</sup>

## Annuity purchases are more common for pots worth between £30,000 and £99,000

Chart 3<sup>17</sup>

### The majority of pots accessed since the introduction of freedom and choice have been fully withdrawn

Retirement product purchases October 2016-September 2017 by pot size



Following the introduction of pension freedoms, around 57% of individuals with a guaranteed annuity rate (GAR)<sup>18</sup> who have accessed their pension pot opted to give it up. In some cases, this was done by fully withdrawing retirement savings in a lump sum. Because GARs generally offer annuity rates that are higher than those available on the open market, this can mean that individuals are giving up valuable retirement income security.

However, individuals who choose to give up GARs generally have smaller pots, with 51% worth less than £10,000 and an additional 27% worth between £10,000 and £30,000 (Chart 4). Because the pots for which GAR is forfeited are relatively small, it may be that the individuals have more than one DC pot and will use their larger pot to provide income during retirement, while the second smaller pot is viewed as supplementary.<sup>19</sup>

## Half of pots for which GAR is given up are worth less than £10,000

15. FCA (2018)

16. Opinium (2017)

17. FCA (2018)

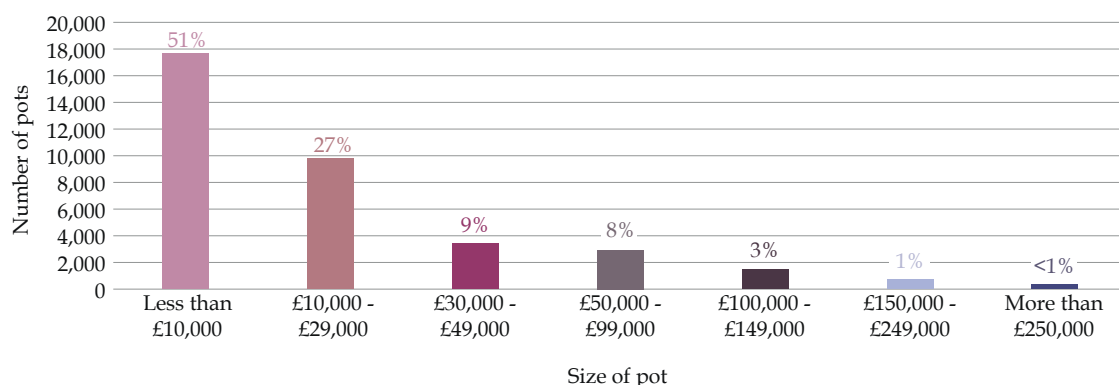
18. A guaranteed annuity rate provides individuals with a guaranteed rate of income (i.e. as a percentage of the accumulated fund) if they choose to convert their DC savings into an annuity.

19. FCA (2017)

Chart 4<sup>20</sup>

### People who give up GARs generally have relatively small pots

Size of pots received in exchange for giving up GARs, October 2015 – September 2016



### Annuities remain more popular among individuals in older age groups, although even among these groups they have become less prevalent than drawdown and full withdrawal

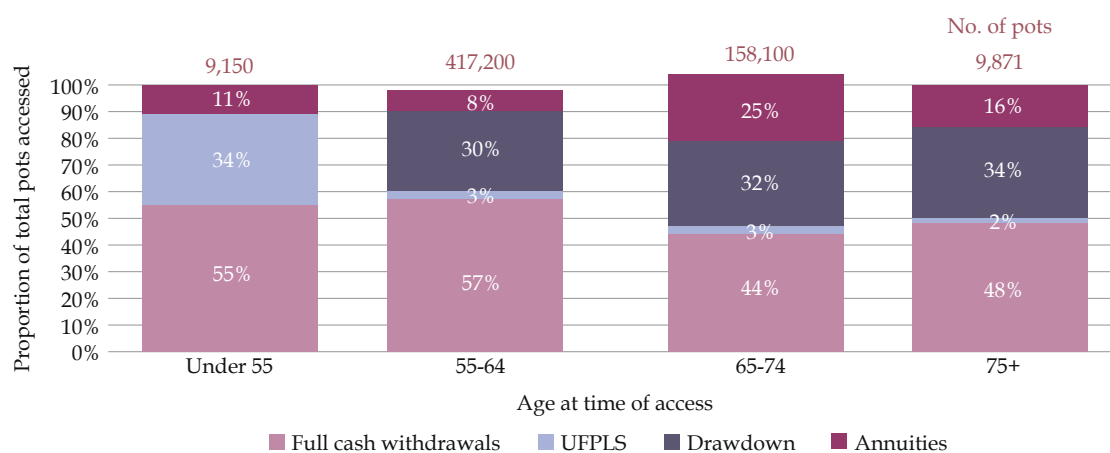
Between October 2016 and September 2017, annuities accounted for a quarter (25%) of retirement products purchased by individuals

aged between 65 and 74 and 16% of products purchased by individuals aged 75 or older. Annuity purchases accounted for a smaller proportion of product purchases among younger groups, 11% for those aged under 55 and 8% for those aged 55 to 64 (Chart 5).<sup>21</sup>

Chart 5<sup>22</sup>

### Annuities are more popular among those aged over 65, but full withdrawal is the most popular option for all age groups

Retirement product purchases October 2016 - September 2017 by age



### Although annuity sales have declined considerably, they still account for more than 10% of retirement product purchases

Annuity sales decreased rapidly following the introduction of freedom and choice, and are currently around 20,000 sales per quarter (Chart 6). This still constitutes a considerable proportion of the retirement income market.

20. FCA (2017)

21. FCA (2018)

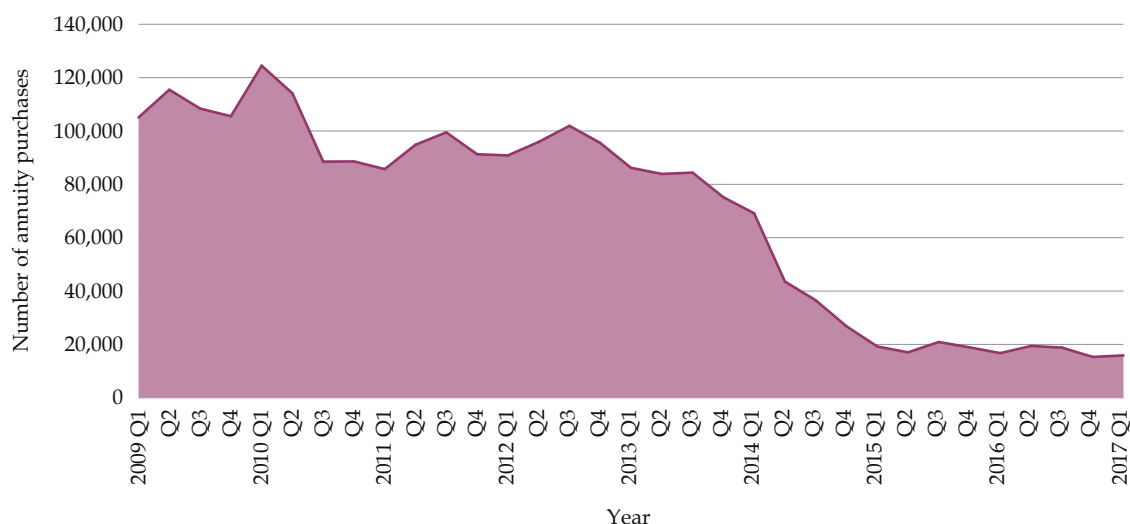
22. FCA (2018)



Chart 6<sup>23</sup>

## Annuity sales have decreased since 2009 but are currently around 20,000 per quarter

Number of annuities sold by ABI members by quarter



## Use of drawdown has increased since the introduction of the freedoms and is now more popular than annuitisation

When the new pension freedoms were introduced in 2015, HM Treasury estimated that the policy changes would see around 30% of people (roughly 130,000 a year) in DC schemes deciding to drawdown their pensions at a faster rate than via an annuity.<sup>24</sup> Following the introduction of the new freedoms 30% of retirement product purchases have been drawdown accounts (October 2015 – September 2017).<sup>25</sup> However, it remains to be seen what withdrawal patterns will be over a longer period and whether these will exceed annuity rates.

## Pots used to purchase drawdown are larger on average than those that are fully withdrawn or used to purchase annuities

Although the prevalence of drawdown products has increased significantly since the introduction of freedom and choice, they

remain most popular among those with higher levels of DC savings. 84% of individuals with more than £250,000 in DC savings who purchased a retirement product between October 2016 and September 2017 chose to purchase a drawdown product, compared to 8% who purchased an annuity, 4% with UFPLS and 4% who made a full cash withdrawal.<sup>26</sup>

## Drawdown products are most popular among those with higher levels of DC savings, accounting for more than 4 in 5 products purchased with pots worth above £250,000

Drawdown was also the most popular option among those with between £30,000 and £249,000 in DC savings. For those with between £30,000 and £49,000, 45% purchased a drawdown product during the October 2016 to September 2017 period, with full withdrawal the second

23. ABI statistics

24. Thurley (2017)

25. FCA (2018)

26. FCA (2018)

most preferred option at 32%. Among those with DC pots of £50,000 to £99,000, 58% purchased a drawdown product, 21% an annuity, and 18% made a full withdrawal. For those with DC savings of between £100,000 and £249,000, 68% purchased a drawdown product during this period.<sup>27</sup>

Among those with lower levels of DC savings, drawdown is less prevalent, although still accounts for a considerable number of product purchases. For those with between £10,000 and £29,000 in DC savings, drawdown accounted for 23% of purchases between October 2016 and September 2017, and 9% of purchases for those with less than £10,000. Full cash withdrawal is the most popular option among both of these groups (Chart 3).<sup>28</sup>

In the first nine months following the introduction of pension freedoms, £6.1 billion was invested in 90,700 income drawdown products, an average fund of £67,500. Over the same period, £3.9 billion was paid out through 1.03 million income drawdown payments, with an average payment of around £3,800.<sup>29</sup>

Proportionally, drawdown users with larger pot sizes withdraw at a lower rate compared to those with smaller pots, which are being withdrawn at a faster rate. For individuals with pots worth less than £10,000, the average income taken upon entering drawdown is around 30% of the total pot. In comparison, this is around 2% for individuals with pots valued at £50,000.<sup>30</sup>

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**For pots worth less than £10,000, the average income taken upon entering drawdown is around a third of the pot**

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The proportion of drawdown products purchased without advice has increased from 5% before the introduction of pension freedoms,

to 30% in 2017.<sup>31</sup> 94% of non-advised drawdown sales were made to existing customers. This supports behavioural theories that individuals will often choose the ‘path of least resistance’. It also suggests that there may be limited competitive pressure to offer good deals to consumers, which can potentially lead to higher charges, lower quality products and less innovation in the future. Individuals who access advice are more likely to shop around when choosing a drawdown product, with 65% of advised drawdown sales to new customers.<sup>32</sup>

Unlike annuities, which generally involve a single decision at the point of purchase, drawdown requires individuals to make decisions about how to manage their drawdown account throughout retirement (e.g. withdrawal patterns and investments). In many cases, people entering drawdown do so by taking a tax-free lump sum and do not commence with taking any income from their drawdown account, and as such may not see entering drawdown as buying a retirement income product. For many drawdown users, advice or guidance may be just as important during retirement as at the point of purchase.

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**Unlike annuities, which generally involve a single decision at the point of purchase, drawdown requires individuals to make decisions about how to manage their savings throughout retirement**

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Although there have been some concerns about the potential for unsustainable withdrawal patterns, more than half of drawdown users are withdrawing less than 1% each year (Chart 7).

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27. FCA (2018)

28. FCA (2018)

29. Opinium (2017)

30. ABI (2017)

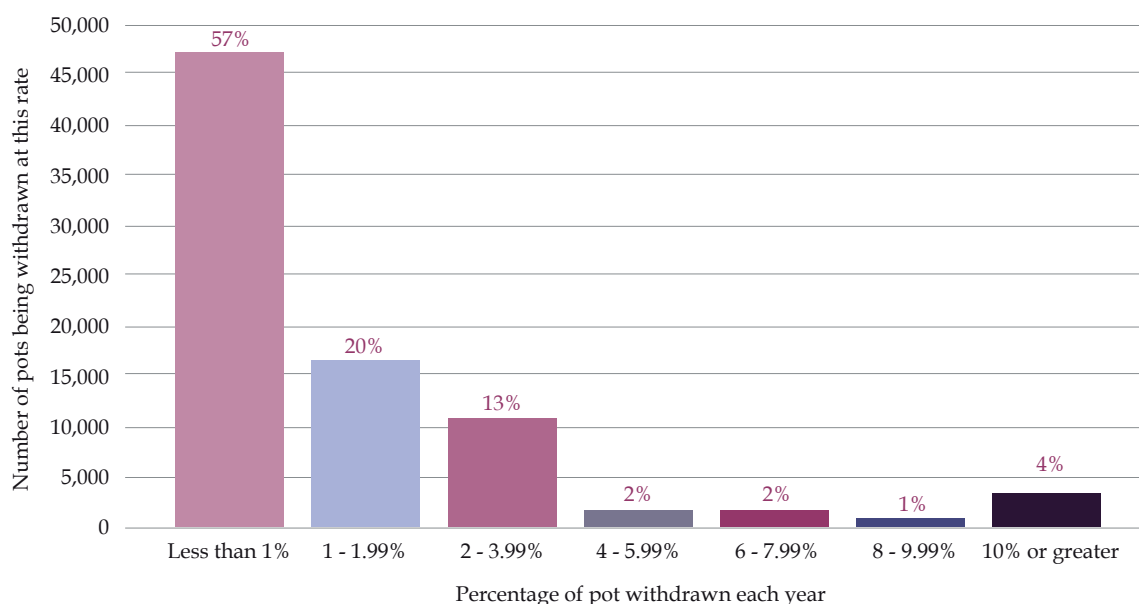
31. FCA (2017)

32. FCA (2017)

Chart 7<sup>33</sup>

### More than half of drawdown users are withdrawing less than 1% yearly

Rate of withdrawal for drawdown and lump sums, Q1 2016



### Drawdown products are popular across all age groups

Between October 2016 and September 2017, drawdown products accounted for between 30% (those aged between 55 and 64) and 34% (those aged under 55 or 75 or older) of purchases. For those aged between 55 and 64, drawdown products were more than three times as popular as annuities (8%), while those aged 75 or older were twice as likely to purchase a drawdown product as opposed to an annuity (Chart 5).<sup>34</sup>

72% of consumers who partially accessed their pots through drawdown or UFPLS are aged between 55 and 65. Individuals who choose to access their pension savings early via drawdown are most likely to take the 'path of least resistance' and purchase drawdown from their current provider.<sup>35</sup>

Almost three quarters of people who have partially accessed their pots through drawdown or UFPLS were aged between 55 and 65 at the point of first access

### Full withdrawal has become the most popular means of accessing DC pension savings since pension freedoms

Following the introduction of the new pension freedoms, the most popular option for consumers is to fully withdraw their pot. More than half of the pots accessed under the freedoms have been fully withdrawn.

33. ABI (2016)

34. FCA (2018)

35. FCA (2017)

Pots that are fully withdrawn are smaller on average than those used to purchase retirement income products, with 90% of withdrawn pots worth less than £30,000 compared to 30-46% of pots used to purchase retirement income products (Chart 8).<sup>36</sup>

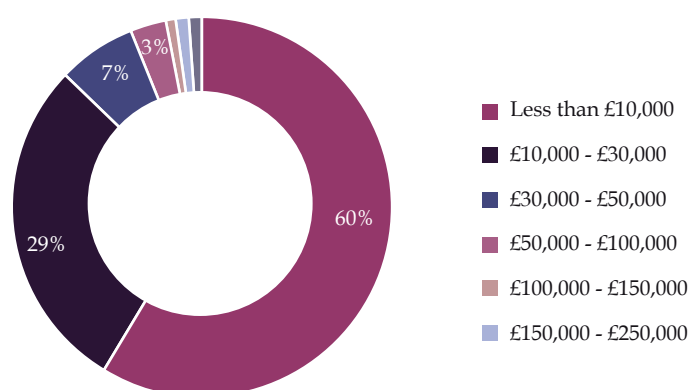
The average size of fully withdrawn DC pension pots is £14,500, while larger pots are likely to be used to provide a regular retirement income, either through an annuity or regular patterns of drawdown. During the first nine months following the introduction of pension freedoms, £4.3 billion was paid out in just over 300,000 cash lump sum payments.<sup>37</sup>

Although there was an initial rush to take advantage of the new pensions freedoms, data from ABI and HMRC suggests that the use of lump sums has declined somewhat in favour of retirement income products since then. In Q2 2015, the average size of 'flexible payments' recorded by HMRC was £12,900. In Q4 2016, this had declined to £4,000, a reduction of 69%. Over the same period, the average number of payments per individual per quarter increased from 1.4 to 2.4 payments.<sup>38</sup>

Chart 8<sup>39</sup>

### 60% of withdrawn pots are worth less than £10,000

Sizes of pots that were fully withdrawn October 2015 – September 2016



In some cases, individuals' decision to fully withdraw their DC savings may stem from a general mistrust of the pensions industry, with individuals preferring to utilise other savings vehicles. Although withdrawal may be the right decision for some individuals, for example those with other sources of income in addition to the State Pension, for others it may lead to poorer outcomes in retirement. Full withdrawal at

an early age may result in individuals paying more tax than they would otherwise have done if they had withdrawn over a longer period of time, or missing out on the potential benefits of leaving their savings invested for longer. Individuals with DC pension savings, who have greater flexibility in how to access those savings, are more likely to be mistrustful of pensions (Chart 9).

36. FCA (2017)

37. Opinium (2017)

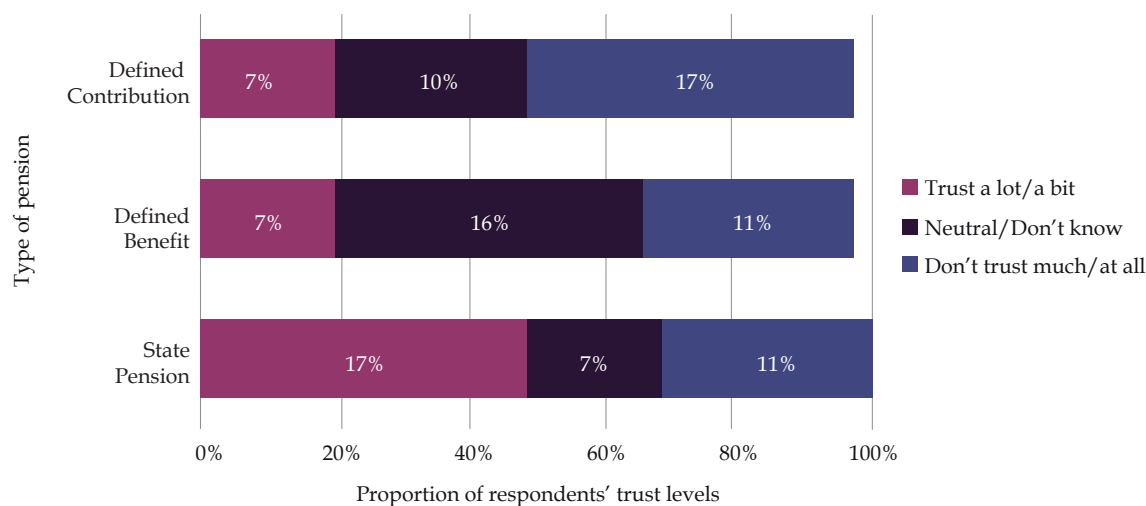
38. ABI (2017)

39. FCA (2017) FCA analysis of retirement income market data collected from 56 providers

Chart 9<sup>40</sup>

## People with DC pensions are more likely to have lower levels of trust in pensions

Mistrustful respondents' level of trust in different types of pensions



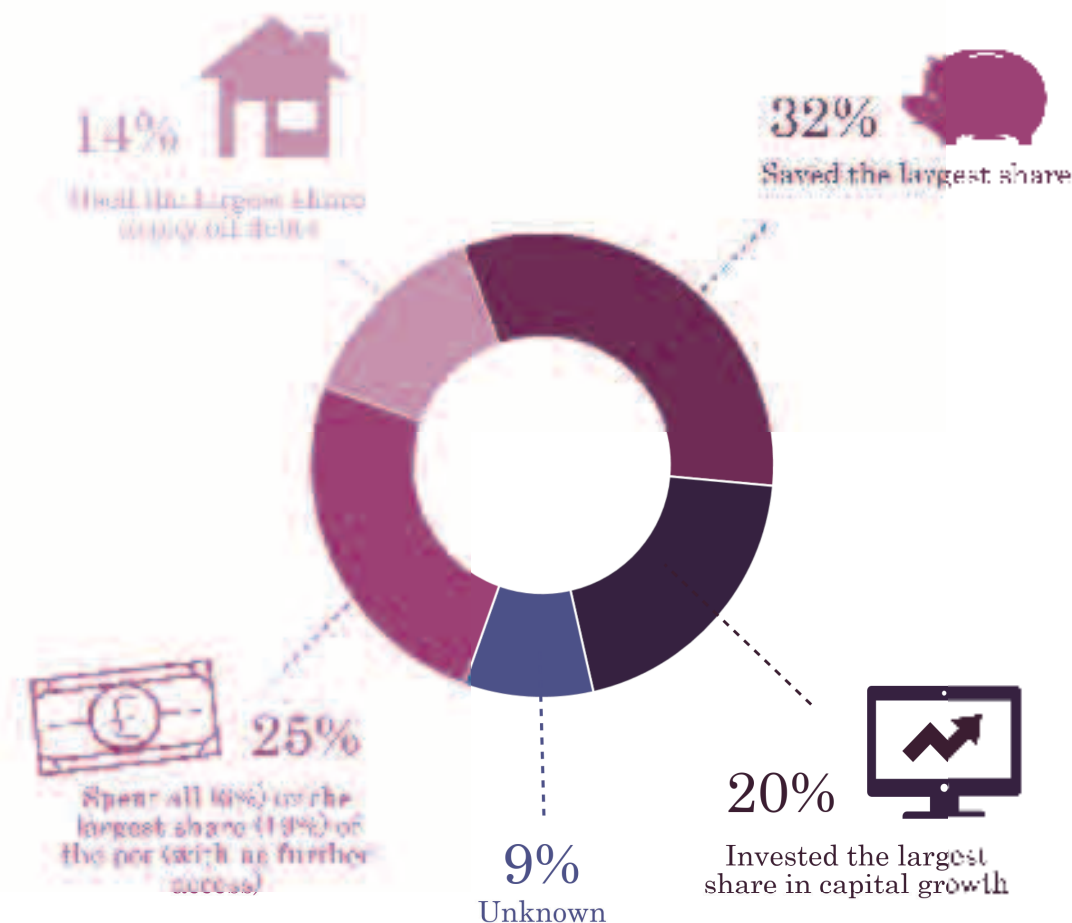
### Most withdrawn DC pots have been saved or reinvested, while a minority have been spent

Although there have been some concerns expressed about the way in which fully withdrawn DC pots may be spent, more

than half (52%) of pots that have been fully withdrawn since the introduction of pension freedoms have been transferred into other savings or investments, or spent on property (Chart 10).<sup>41</sup>

40. Just (2018)

41. FCA (2017)

Chart 10: How has the money from fully withdrawn DC pension pots been used? <sup>42</sup>

94% of those who have fully withdrawn their pot since the introduction of freedom and choice have other sources of income in addition to the State Pension.<sup>43</sup>

The trend towards full withdrawal of pots that has occurred as a result of the pension freedoms is higher among those aged under 65. From April to September 2016, 64% of 55 to 59 year olds who accessed their DC savings chose to fully withdraw; among those aged 60 to 64, 55% chose to fully withdraw their pot.<sup>44</sup>

### Partial UFPLS is the least used way of accessing their DC savings

Partial UFPLS is the least commonly used option for accessing DC savings. Between October 2016 and September 2017, around 3% of

the total number of pots accessed were accessed in this way.<sup>45</sup> This may be largely down to the tax treatment of UFPLS which may appear less favourable in the short-term.

### Individuals who do not make use of advice or guidance are more likely to access their DC pot at a younger age

Among those with DC savings, 58% say they are aware of Pension Wise. However, among those with DC savings who have accessed their pot in any way, awareness is lower than average, with 44% saying they are aware of Pension Wise.<sup>46</sup>

Since the introduction of pension freedoms, it has become more common for individuals to access their pension pots earlier and in many cases before retirement. Of pots that have

42. FCA (2017)

43. Thurley (2017)

44. FCA (2017)

45. FCA (2018)

46. Just (2017)



been accessed under pension freedoms, 40% were accessed by individuals aged between 55 and 59, and a further 31% by individuals aged 60 to 64.<sup>47</sup>

### **The changes that have been observed in the three years since the introduction of freedom and choice are not necessarily representative of the decisions that will be made by future retirees**

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.

There are a number of other countries with established DC markets where annuitisation in its different forms has played, or still plays,

a role in the retirement landscape, to a greater or lesser extent, despite being non-compulsory. These countries may offer some insight into what the future might hold for the UK annuity market, however there is not a consistent trend across international examples:

- In **Australia**, annuitisation is uncommon;
- In **Switzerland**, annuitisation is the most common option for accessing pension savings, despite freedom of access;
- The experience in **Ireland** falls somewhere in the middle, with annuitisation lower than before freedoms were introduced, but remaining an important part of the retirement landscape.

Trends observed in these international examples may also be affected by the State Pension, tax and benefits regimes in each country.

#### **Australia: a case study<sup>48</sup>**

In Australia, where compulsory superannuation and pension freedoms have been in practice since 1993, there is virtually no annuity market.

- Around half of Australian retirees withdraw their savings as a lump sum. Of these:
  - 44% use it to pay off housing or other debts, to purchase a home, or to make home improvements.
  - 28% use their lump sum to repay loans or to purchase a holiday or a new vehicle.

- The majority of those who do not choose to fully withdraw access their savings through an account-based system similar to drawdown:
  - 94% of pension assets that are not withdrawn are held within these accounts.
- Around 5% of Australian pension assets that are not withdrawn are used to purchase an annuity.
- Hybrid products account for the remaining 1% of Australian pension assets.

In the UK there is already a developed annuity market, so the Australian experience may not be representative of trends to come in the UK retirement landscape. Prior to the introduction of freedom and choice, the UK was recognised as having one of the most dominant and

established annuity markets internationally (relative to the size of the economy)<sup>49</sup> and so it could be argued that, culturally, UK retirees might expect their pensions to deliver them a secure income in retirement, particularly given the history of DB provision in the UK.

47. FCA (2017)

48. American Academy of Actuaries, Institute and Faculty of Actuaries & Actuaries Institute Australia (2015); Mercer (2014)

49. Harrison (2012)

**Switzerland: a case study<sup>50</sup>**

Despite Swiss savers being permitted unlimited access to their private pension savings (though some schemes restrict access), annuitisation levels in Switzerland are high:

- Around 80% of DC assets are put into lifetime annuities.

This may be in part due to cultural attitudes:

- Swiss workers are described as being “financially conservative” and “preferring guaranteed incomes for life” over taking lump sums.

However, Swiss annuity rates (which are regulated by the Government) are considered to be very generous given current low interest rates in the Swiss market and low mortality rates among annuitants.

**Ireland: a case study<sup>51</sup>**

Since 1999, Irish DC savers who meet the Minimum Income Requirement (MIR) (of €12,700 per year, equal to around £10,500) have the option of purchasing an “Approved Retirement Fund” (ARF), similar to income drawdown, or withdrawing their entire savings pot as a lump sum. Those with occupational DC pensions are still required to take their pension through an annuity.

The minimum income must be secured through State Pension and a combination of an occupational pension, an annuity or purchase of a more restrictive income drawdown product, an “Approved Minimum Retirement FUN” (AMRF) similar to Capped Drawdown. From age 75, AMRFs convert to ARFs and people can withdraw funds from them without limits, regardless of whether they meet the MIR.

Around 30% of those retiring with private pension savings currently purchase an annuity (the majority of which are flat rate, lifetime annuities), though this figure includes individuals with an occupational DC pension

who are still effectively obliged to purchase an annuity. Therefore, it is difficult to assess how many people are making an active choice to purchase an annuity.

A 2007 review of the Irish annuity market notes that those with a choice between an annuity and an ARF generally chose an ARF because of the flexibility they offer and because Irish annuities are perceived as giving poor value. However, the review showed that people purchasing an ARF and withdrawing from it in the same amounts that they would receive from an equivalent annuity, had a 50%-60% chance of exhausting their fund before they died.

The annuities market in Ireland is relatively small. The 2007 review suggested that this could be attributed to:

- Poor understanding by consumers;
- The reluctance of consumers to sacrifice capital;
- The lack of flexibility in available products; and
- Faults in the marketing and distribution strategy of annuity companies.

The examples of Switzerland and Ireland (and to a lesser extent Australia), illustrate annuitisation remains desirable for many people even when it is not compulsory. However, the disparity between annuity purchase rates in these countries makes it difficult to make an inference about the way

that the UK annuity market may evolve in the future. This will depend on a number of factors, not the least of which being the extent to which providers create innovative solutions to the new retirement landscape. This will be explored further in the second report of this series.

50. Warshawsky (2012); Rocha, Vittas & Rudolph (2010); OECD (2008)

51. Indecon and Life Strategies (2007); Rusconi (2008)



## Chapter three: how do the needs of retirees affect decisions about retirement income?

This chapter discusses the needs of individuals in retirement, the challenges they may face in meeting them and how this has changed as a result of the freedom and choice reforms.

### **Income needs can be assessed in terms of basic needs or desired levels of income**

Calculations of income needs can be divided into two main categories:

- Measures of minimum income required to meet basic needs, for example a defined poverty line or minimum income standard; and
- Measures of the income required to enable individuals to achieve their desired standard of living in retirement, for example a replacement rate relating directly to pre-retirement income which looks at whether individuals are able to maintain the same broad living standards in retirement.

### **Minimum and basic income measures provide calculations of how much income a pensioner might need to meet basic needs but exclude consideration of desired standards of living in retirement**

The most commonly used definition is to say that someone in the UK is in relative poverty if they live in a household with an income below 60% of the current median household income.

However, even those who do not experience the deprivation measured by the poverty line may have negative experiences of retirement if they experience a significant fall in income from working life to retirement.

The Joseph Rowntree Foundation calculates the minimum income standard (MIS) as a measure of the income that is required in order for individuals to achieve a minimum acceptable standard of living. In 2017, the MIS for a retired couple was around £275 per week (£360 if housing costs are included).<sup>52</sup>

52. Padley & Hirsch (2017)

### Measures based on a replacement rate of working life income or on average consumption can give an indication of how much income pensioners might need in order to achieve desired standards of living in retirement

The levels of income needed by pensioners will generally vary during retirement as needs, expectations and spending preferences change. A typical pensioner might:

- Spend more money on recreation and leisure in early retirement;
- Decrease spending around age 75 as they become less mobile;
- Increase spending once again around the age of 85 as a result of disability or health needs; and
- Potentially decrease spending in their 90s as mobility is reduced further.

### Theories of the way that retirement will impact spending patterns differ

There are four common theories about the way in which spending patterns in retirement compare to spending patterns during working life:

- **Individuals will spend less:** Individuals will adjust spending habits in order to compensate for reduced levels of income in retirement.
- **Individuals will spend more:** Individuals will spend more on leisure, social activities and holidays as a result of increased leisure time now that they are no longer in employment.
- **Individuals will spend the same amount:** According to the life-cycle model of consumption, individuals should distribute consumption across their lifetime in order to maximise lifetime welfare. This means that they should plan for periods of lower income, for example retirement, by consuming less when income is higher (during working life).
- **Individuals will allocate spending differently:** Even if the total level of an individual's expenditure does not change in retirement, they might allocate their spending across different goods.<sup>53</sup>

### Income from private pensions and other savings and assets can help individuals stay out of poverty in retirement

The State Pension is an important component of individuals' retirement income. However, individuals who receive income only from State Pension and/or State benefits in retirement may only be able to afford to meet their basic needs (though some individuals may forgo some 'necessary' expenditure in favour of discretionary spending). However, individuals who only receive income from State Pension and/or State benefits may be unable to afford all 'necessary items' if, for example, they do not claim the means-tested benefits they are entitled to, or if they have needs for higher than average spending because of needs arising from location, household structure or health problems. Despite the provision of Pension Credit, around 1.9 million pensioners (16% of total pensioners) currently live on incomes below the relative poverty line.<sup>54</sup>

Individuals who have additional income from private pensions and other assets and saving are less likely to be in poverty and may be able to afford higher levels of discretionary spending, though many will use at least some portion of their extra income for meeting basic needs as well (for example, food, housing or care).

### Individuals who have additional income from private pensions and other assets and savings are less likely to be in poverty and may be able to afford higher levels of discretionary spending

53. NEST (2014)

54. Pensioners in poverty (2017)

## Income from private pensions and other savings and assets can help individuals recreate working life living standards

Pensioners who were on a high income during working life might use income from private pensions and other savings and assets to fill the gap between State Pension income levels and a level of income which will allow them to recreate working life living standards.

The level of income that individuals will need from other savings and assets to achieve desired standards of living will depend on the level of income that the State provides. Income from State Pension in the UK gives individuals on average a replacement rate of 29%.<sup>55</sup> The Pensions Commission suggested that benchmark replacement rates could range from 50% for high earners to 80% for low earners.<sup>56</sup> Individuals in the UK may need to generate a substantial proportion of their working life income in retirement from private pensions and other savings and assets in order to recreate working life living standards.

Replacement rates have been brought into question by the removal of constraints to how individuals can access their Defined Contribution (DC) savings.

## Individuals must consider a number of risks when making decisions about accessing private pension savings

The main risks that are associated with accessing private pension savings are:

- **Longevity risk:** the risk that individuals could run out of money before their death.
- **Inflation risk:** the risk that individuals' income may lose value relative to the price of goods and services.
- **Investment risk:** the risk that market fluctuations or poor investment strategies will deplete a fund's capital.
- **Risk of missing out on investment growth:** the reverse of investment risk, withdrawing retirement savings from investment means that individuals forgo the opportunity for their pot size to increase.
- **Time-of-purchase risk:** the risk, especially relevant to lifetime annuities, that one is locked into a product with poor returns because rates are unfavourable at the time of purchase. This risk could also apply to income drawdown, if an income drawdown

product is bought at a time of poor market performance.

- **The risk of changes in need or personal circumstances:** the risk that retirement income may not be flexible enough to meet the individual's needs as they evolve during retirement (e.g. as health deteriorates).

Nevertheless, it should be recognised that for many people, the main retirement income related risk is the risk of having insufficient savings in retirement to have an adequate standard of living. This may result from decisions made during the accumulation stage of retirement planning, for example by not saving, not saving enough or making poor investment choices. However, since the introduction of pension freedoms, decisions made at and during retirement have become increasingly important.

## Individuals look for varying levels of flexibility in accessing and using their pension savings

Alongside protection from risk, individuals look for varying levels of flexibility from their pension savings. For the majority of individuals, the primary purpose of saving in a pension fund will be to provide themselves with an income in retirement. However, some individuals place a high value on having flexibility regarding:

- When they access their pension savings (before and during retirement);
- How much income they are allowed to withdraw;
- Whether they are able to continue to grow their savings during retirement; and
- Whether they are able to leave any remaining savings to dependents as inheritance after their death.

The level of flexibility associated with a particular method of accessing pension savings can be measured by examining the extent to which the method allows people control over:

- **Level of withdrawal:** choice in the amount of money withdrawn.
- **Growth:** potential to grow the capital.
- **Bequest:** potential to leave money as inheritance.

55. OECD (2017)

56. DWP (2012)

There is generally a trade-off between flexibility and risk, the more flexibility a method allows, the more the individual is generally exposed to income related risks during their retirement.

However, in a post-pension freedoms landscape, there may be scope to look at how elements of both might be combined to create more flexible solutions to better meet individuals’ needs.

Box 4: what types of financial decision-making (relevant to long-term saving) might people approaching retirement need to make?

- When should I leave work and how (flexible transition vs. cliff edge etc.)? What will leaving work at that time, and in that way, mean for supporting retirement?
- How could longevity, inflation, market turbulence and the need for care affect both my need for, and sources of, income?
- What methods should I use for accessing my pension savings? What will these mean for the level of tax I will pay? What might be the other implications?
- How will I use my pension savings and other savings in retirement?
- How do market and financial products work?
- What will different choices mean for future income needs and for leaving a bequest (if desired)?
- How and when should I access the State Pension?
- How will eligibility for means-tested benefits interact with my pension saving choices?
- How can I differentiate between fraudsters and genuine providers?
- What are the implications of accessing savings at particular ages or transferring DB entitlement into DC schemes?
- If I have DB savings, are these sufficient to support me? Do I need supplementary savings?

Many people have not given much consideration to how they will access their retirement savings in order to fund their retirement

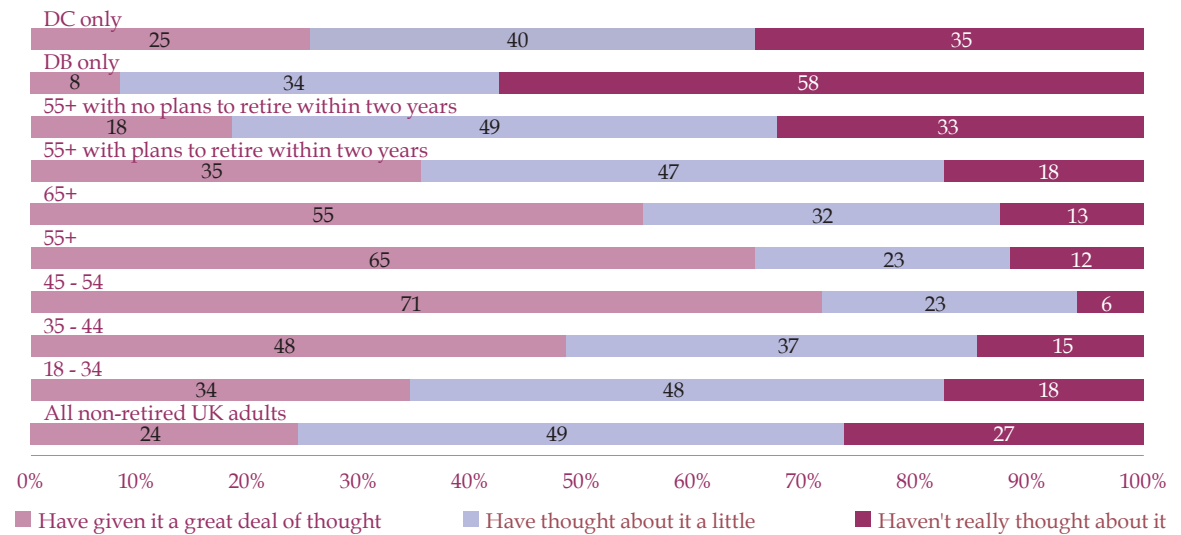
Among non-retired adults, more than two-thirds (76%) have either ‘not really thought about’ plans for retirement or ‘have thought about it a little’. People aged over 55 who intend to retire within the next two years are more likely (35%) to have ‘given it a great deal of thought’ than those aged over 55 with no plans to retire within the next two years (18%) (Chart 11).

Only a third of people aged over 55 who intend to retire within the next two years have given ‘a great deal of thought’ to how they will fund their retirement

Chart 11<sup>57</sup>

Three quarters of non-retired adults have not thought much about plans for retirement

Thought given towards planning for retirement (by age and situation) (%)



57. FCA (2018)

## Individuals priorities when making decisions about accessing retirement savings have shifted somewhat, but provision of an income for life is still considered the most important factor

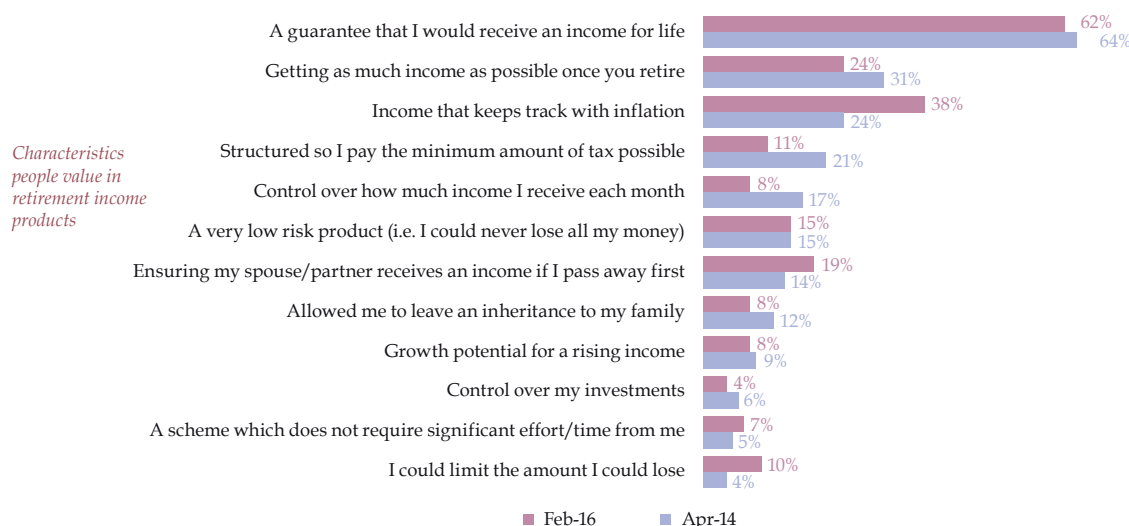
The majority (64%) of individuals consider a guarantee of an income for life to be a vital feature of any retirement option. This has remained largely unchanged since before the freedoms were introduced (62%). Flexibility

is ranked as less important, with 17% in 2014 and 8% in 2016 considering control over monthly income levels to be a desired feature of a retirement income product (Chart 12). However, this does not appear to be the case in practice, with a greater number of individuals choosing to purchase drawdown, and therefore prioritising flexibility (although not necessarily realising this is what they are doing), rather than an annuity which will provide a guaranteed income for life.<sup>58</sup>

Chart 12<sup>59</sup>

### People still value a guaranteed income for life

Desired features from retirement income products April 2014 (pre-freedom and choice) and February 2016 (post-freedom and choice)



So far people who have accessed their DC pots since 2015 generally report being happy with the new pensions freedoms, whether they have chosen to utilise them or not. Some people feel that their retirement outcomes have improved as a result of increased freedom of access, while others who have not used the freedoms also agree that the freedoms can be positive for others. More than one in three (35%) say the reforms have directly improved their retirement prospects, while just one in twenty (5%) say they have made them worse off.<sup>60</sup> However, the full impact of retirement income decisions made under the new freedoms will not become clear for some time.

## Understanding and engagement with pensions is low, even among people who have already made decisions about how to access their retirement savings

A quarter (25%) of people who have accessed a Defined Contribution pension pot in the last two years report that they have purchased a retirement income product or taken a cash lump sum but are not sure how this works.<sup>61</sup> Self-reporting of decisions made about how to access DC pension savings differ from market data on the way that people have actually accessed their pots (Chart 13), which suggests that some people are making decisions without fully understanding them.

58. Opinium (2017)

59. Opinium (2017)

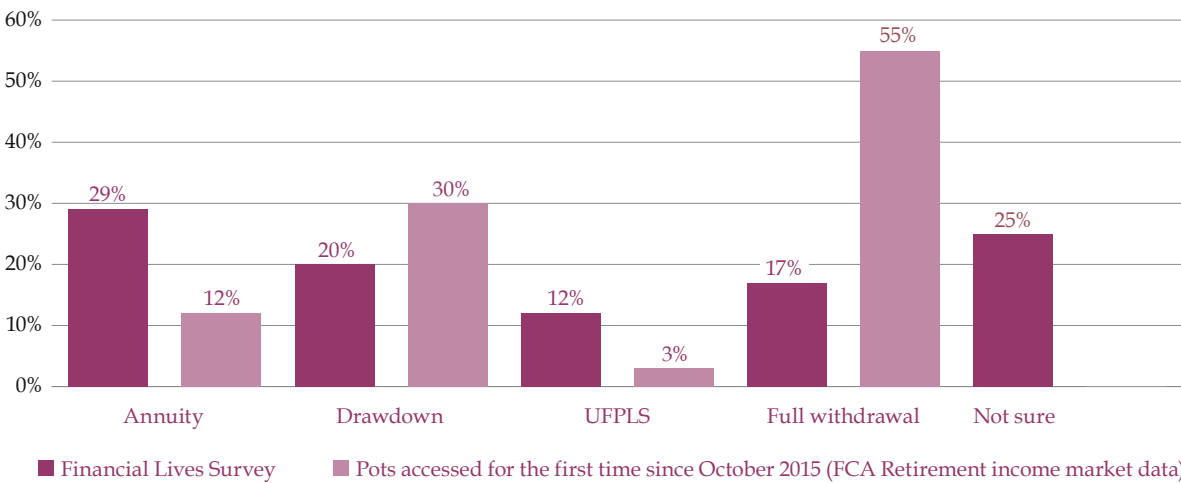
60. Citizens Advice (2016)

61. FCA (2018)

Less than 20% of people in the FCA's Financial Lives Survey report that they have fully withdrawn their pot, when market data shows that more than half of pots accessed have been fully withdrawn

Chart 13<sup>62</sup>  
**Self-reporting of the way that people have accessed their pots differs from market data**

Comparison of retirement income decisions since pension freedoms – consumers vs pots accessed



If individuals make sub-optimal decisions about how to access their retirement savings this could negatively impact them in a number of ways:

- They could run out of pension savings sooner than anticipated;
- Individuals could end up paying more in tax and/or charges than they would otherwise have done;

- Individuals may be unable to utilise the most suitable investment strategy;
- They may not be able to access their pension savings as and when it suits them; and
- They may lose valuable benefits, for example guaranteed annuity rates.

62. FCA (2018)



## Chapter four: what combination of assets do people use to fund retirement and how will this evolve in the future?

This chapter investigates the way in which individuals' wealth is split across different forms of assets and income, including Defined Contribution (DC) savings, Defined Benefit (DB) entitlement, housing wealth and other financial assets. This chapter then explores how this is likely to evolve in the foreseeable future and how this may impact individuals' decisions about to access their retirement savings.

### Box 5: modelling assumptions

In order to explore the distribution of individuals' retirement savings, this chapter uses PPI's Dynamic Model and data from the English Longitudinal Study of Ageing (ELSA) and the Wealth and Assets Survey (WAS) to explore the portfolios of pension saving and entitlement that people will be reaching State Pension age (SPa) with today and over the next ten to fifteen years. These people, currently aged 50 to SPa are aged to their individual SPa's and then their pension and other saving portfolios are considered. This chapter defines different segments within this group and explores the level of risk faced by these different segments. The segment groups are separated by level (25th percentiles) of DC savings, then further divided by level of DB entitlement to create 12 separate segments. These segments are then compared to levels of other wealth, assets and income.

The modelling projects forward assumptions about continued earning and saving among people aged 50 to SPa, and assumes that anyone eligible for automatic enrolment is automatically enrolled, does not opt-out, makes pension contributions along with their employer and receives tax relief. Those already in a pension scheme are assumed to continue contributing at their current percentage.

The PPI's Dynamic Model<sup>63</sup> uses data collected on over 10,000 respondents (selected to be representative of the English population aged 50 and over) and assess their earnings and existing pension arrangements. As this is a relatively large sample, any analysis based on the whole sample is likely to be robust and, as a result, it is possible to generalise from these findings to the population of individuals in England aged over 50. However, more detailed analysis on smaller groups should only be treated as illustrative of how outcomes might differ between individuals.

The analysis uses short-term economic assumptions for Retail Price Index (RPI), Consumer Price Index (CPI) and annual earnings growth in line with Office for Budget Responsibility projections. It has also assumed expected investment returns of 6% in nominal terms, before charges, corresponding to a mixed equity/bond fund in the ratio of 60% equities, 40% bonds. However, this could overstate investment returns if the older workers are placed in more bond heavy, lower risk funds as they approach retirement.

The modelling makes certain assumptions about the rate and impact of DB scheme closure in the private sector. A number of factors have increased the cost of providing DB schemes<sup>64</sup> and, as a consequence, over 85% of DB schemes in the private sector are now closed either to new members or to both new members and new accruals (from existing members).<sup>65</sup> As a result, the future UK private sector workplace pension landscape is likely to be dominated by DC schemes.

Previous PPI analysis indicates that if an average of 15% of all people opt-out of being auto-enrolled (and given certain economic and labour assumptions), the value of total private sector workplace DC assets in the UK could become greater than the total value of private sector workplace DB assets in around 2036 at £540 billion.<sup>66</sup>

The analysis in this report assumes that people who are currently active members of DB pension schemes remain so and continue to accrue DB pension up until their retirement. That assumption may overstate the amount of DB pension held by individuals at retirement. However, if we were to make the assumption that people in this age group experience an end of their DB accrual at the average rate of scheme closure, then we have two problems to overcome; we must arbitrarily choose people whose DB accrual ceases, and we may be overstating the closure for this particular age group, which may be more likely to remain active in schemes that are closed to new members but still offer accrual for existing members. For these reasons, the assumption made is that employees currently in DB pension schemes continue to accrue pension in their existing scheme.

Measures of retirement income adequacy suggest that individuals will need to be able to provide themselves with an income of around £7,000 per year in order to achieve adequacy targets when combined with income from the State Pension. The modelling in this chapter segments individuals' DB entitlement by:

- **No DB entitlement**
- **Some DB:** yearly DB entitlement below £7,000
- **Considerable DB:** yearly DB entitlement above £7,000

63. See Annex 1 for more detail

64. See PPI Briefing Note 86 *Defined Benefits: Today and Tomorrow* for more information

65. PPI analysis of TPR data (2016)

66. PPI (2014)



## Box 6: measures of retirement income adequacy

Among those who have DB entitlement, the median yearly amount is £10,100. When combined with the new State Pension, individuals with this level of DB entitlement would have a yearly income of around £18,600. The median weekly earnings of individuals aged over 50 is around £450, or £23,400 annually. At this salary level, the Pension Commission target replacement rate is two thirds, which gives a weekly target income of around £300. When the new State Pension is taken into account, this leaves around £140 per week to be funded by private pension in order to achieve target replacement rates. Because this report is primarily concerned with individuals who may be at risk of suffering sub-optimal retirement outcomes, a lower threshold is used to segment individuals by DB entitlement.

Taking into account income from the new State Pension, a weekly target income of £300 would mean that, on average, individuals would have to have an annual income of £15,600, including around £7,250 from private pensions in order to achieve their target replacement rate.

The PLSA suggests that in order to achieve a 'modest retirement', individuals would need an annual income of around £15,000, or a weekly income of £290. In order to achieve this level of income, individuals would need £6,700 annually from private pensions.

Among people currently aged between 50 and SPa who have DC savings, the median amount is around £24,400. The individuals are categorised by quartile as:

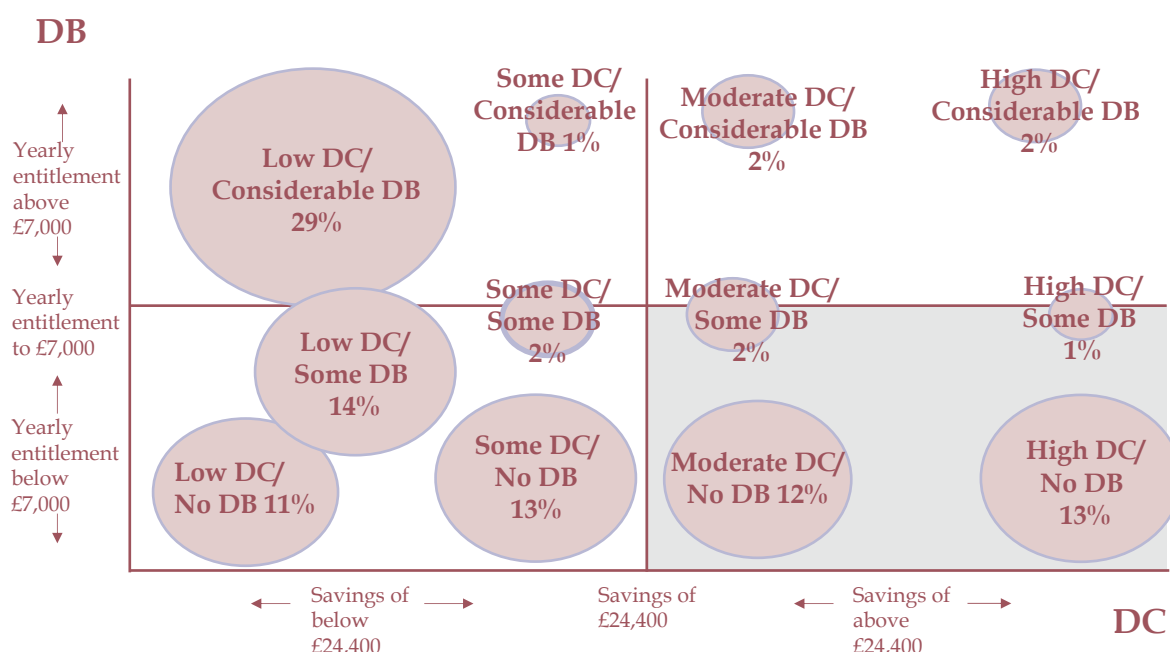
- **Low DC:** DC savings of less than £9,500
- **Some DC:** between £9,500 and £24,400 in DC savings
- **Moderate DC:** between £24,400 and £63,600 in DC savings
- **High DC:** DC savings of more than £63,600

### The majority of DC savers aged between 50 and SPa have low levels of DC savings

Of people aged between 50 and SPa who have DC savings, more than half (54%) have relatively low levels of savings of less than £9,500 (2018 earnings terms) (Chart 14). A pot of this size or less is unlikely to provide a substantial level of income through retirement, though it could make a significant difference for someone on a relatively low income.

Chart 14

**People with low levels of DC saving and considerable DB entitlement are currently the largest group**



## Half of people currently aged between 50 and SPa with pension savings will have £9,500 or less in DC savings by the time they reach their SPa, including some with no DC savings

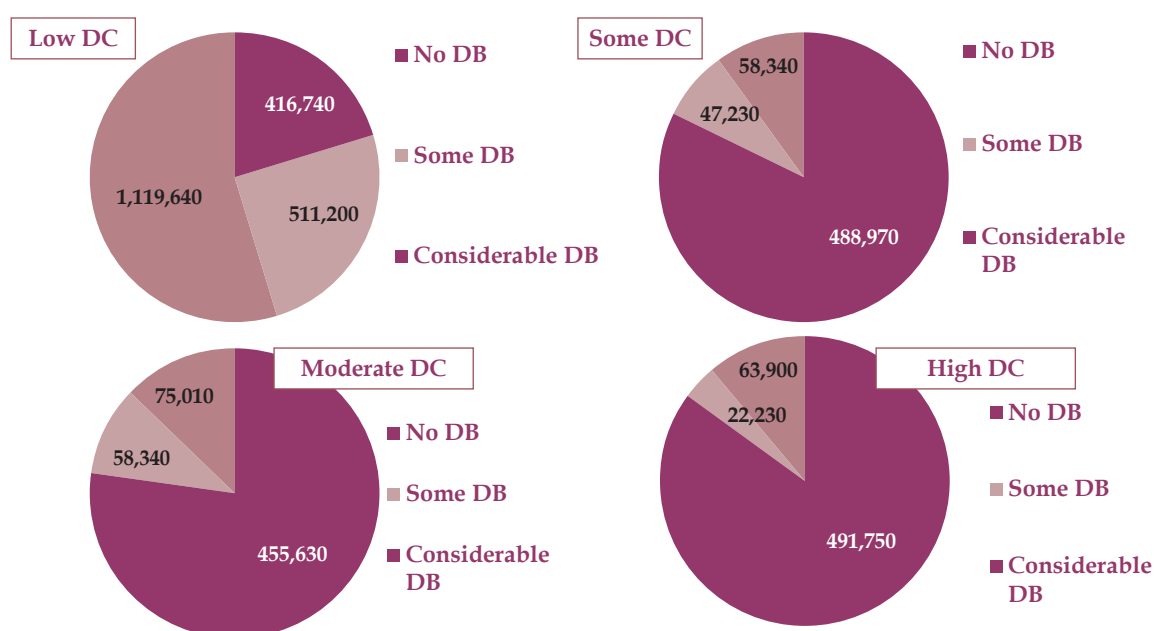
In England, around 3.8 million people currently aged between 50 and SPa will have some private pension savings or entitlement at their

SPa. Around half of these people will have DC pots of £9,500 or less, including those who will have no DC savings. Around 80% of this group will have DB entitlement. The other half of individuals in this age group will have DC pots of more than £9,500, and less than a quarter of this half will have DB entitlement (Chart 15).

Chart 15

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

Groups divided by 25<sup>th</sup> percentiles of DC savings and shaded by level of DB entitlement (people aged 50 to SPa in 2018 at their individual SPa's)



### People aged between 50 and SPa in 2018 have higher average levels of DB entitlement than DC savings

Current average levels of DB entitlement for those aged 50 to SPa would provide a higher income than the average levels of DC savings could provide. More than two-thirds (70%) of people in this age group have DC savings of less than £24,400 (in 2018 earnings terms), which could purchase a level annuity of around £110 per month, well below the amount required in order to achieve target replacement rates.

More than two-thirds of people currently aged between 50 and SPa have DC savings of less than £24,400

People in the “Low DC/No DB” group, accounting for 11% (around 416,750) of people currently aged between 50 and SPa, are more likely than those with either higher levels of DC or DB to:

- Be in a low socio-economic class, with half (50%) of this group in the bottom 40% of income and half (51%) working in semi routine and routine occupations;
- Have lower levels of non-pension savings, with almost half (46%) in the bottom 40% for other savings and assets;
- Score lower on proxy indicators of financial skill and engagement; and
- Have slightly higher levels of non-mortgage debt than those with similar levels of DC savings and some or considerable DB entitlement.

This group may be classified as lower risk in the sense that they are more likely to rely mainly on the State Pension and State benefits in retirement. These are fairly low-risk sources of income which escalate to protect against inflation. For individuals in this group, the risk of making sub-optimal decisions about how to access their pension savings is unlikely to have a significant impact. However, as mentioned earlier in this chapter, even a small income could make a significant difference for someone on a relatively low income.

**Although DB provision is progressively declining among younger cohorts, around a third of people currently aged between 50 and SPa have yearly DB entitlement above £7,000**

More than two thirds (68%) of individuals currently aged between 50 and SPa have less than £7,000 yearly DB entitlement, with half (49%) having no DB entitlement. However, the largest single segment includes individuals with low levels of DC savings (less than £9,500) and considerable DB entitlement of at least £7,000 per year, accounting for 29% (around 1.2 million people).

People in the “Low DC/Considerable DB” group are more likely than those with similar levels of DC and low levels of DB to:

- Be in a high socio-economic class, with more than a quarter (28%) of this group in the top 20% of income and two thirds (63%) working in managerial and professional roles;
- Have higher levels of non-pension savings, with a third (31%) in the top 20% for other savings and assets, compared to 19% of people with low DC and no DB;
- Score higher on proxy indicators of financial skill and engagement; and
- Have slightly lower levels of non-mortgage debt than those with similar levels of DC savings and low or no DB entitlement.

This group, as well as others with considerable DB entitlement, may also be classified as lower risk because they are likely to rely mainly on a combination of the State Pension and DB entitlement for their income in retirement. These are fairly low-risk sources of income which escalate to protect against inflation.

However, individuals with DB entitlement are able to transfer their money out of the scheme, and since the introduction of the

pension freedoms, DB transfers have become more common as people value the flexibility in accessing DC savings. This means that even individuals with significant levels of DB entitlement may be at risk of making decisions about how to access their pension savings which will lead to sub-optimal retirement outcomes.

**Groups that are most at risk of making sub-optimal decisions that could have a significant negative impact on their retirement outcomes are those with moderate to high levels of DC savings and no or low DB entitlement**

Around a quarter of individuals currently aged between 50 and SPa have moderate to high levels of DC savings (more than £24,400) and either no DB entitlement or entitlement below £7,000 per year. Individuals in this group have DC savings of such a level that they have the potential to have a significant impact on individuals’ retirement outcomes, however this also means that they have the potential to negatively impact outcomes if individuals make sub-optimal outcomes. These individuals do not have much, if any, DB income to fall back on if they do make sub-optimal decisions about how to access their retirement savings (although they do have State Pension entitlement), and so are likely to experience a significantly poorer outcomes if they make sub-optimal decisions.

**While these at risk groups are currently relatively small, they will grow in the future**

The groups identified as being at greater risk of making sub-optimal decisions that could have a significant negative impact on their retirement outcomes (those with moderate to high DC savings and low or no DB entitlement) are currently relatively small compared to those with low levels of DC savings but considerable DB entitlement. However, these at risk groups will grow steadily in the future.

In the next five to ten years, the number of people reaching retirement with both low levels of DC savings and low or no DB entitlement may increase as those who have not been offered DB provision and have been automatically enrolled later in their working life reach retirement.

However, as millennials approach retirement, the groups identified as most at risk will increase in number, as future cohorts will have been automatically enrolled for much of their working lives and are unlikely to have much, if any, DB entitlement.

**The changing patterns of pension saving among younger cohorts means that these segments will shift away from DB towards DC in the foreseeable future**

Future retirees will be unlikely to reach retirement with the same combinations of pension savings and other assets as today's retirees. There are many reasons for this, the most significant in relation to pension savings being:

- The shift away from DB provision; and
- The introduction of automatic enrolment.

Typical retirement income levels and living conditions are at an all-time high compared to retirement outcomes of previous cohorts. This progress has been underpinned by growth in private wealth accumulation and access to DB schemes. These trends are in decline and will therefore have less of an impact on retirement outcomes of younger cohorts. In spite of this, analysis suggests that people currently aged between 18 and 37 will fare at least as well as today's retirees.<sup>67</sup>

However, it is likely that the combination of wealth and assets held by future retirees will differ considerably from that held by today's retirees, with a greater reliance on DC savings rather than DB entitlement, as well as less housing security than previous cohorts. This will mean that future retirees will face different and more complex decisions at and during retirement in using their savings and assets to secure an adequate retirement income and standard of living.

**It is likely that the combination of wealth and assets held by future retirees will differ considerably from that held by today's retirees**

For people currently aged 22 to 34 only 1.9 million (25%) have any DB accrual, compared to 6.3 million (36%) of those aged between 35 and 64.<sup>68</sup> For those currently aged between 50 and 64, around half will reach retirement with some DB entitlement, while a third will have a yearly DB entitlement of at least £7,000 (Chart 14).

Individuals with DB entitlement are more likely to achieve their target replacement rates than those with only DC savings. Among those with DB entitlement, 93% will more likely than not achieve their target replacement rate, compared to 3% of people with only DC savings.<sup>69</sup> However, this may change as DC savings levels grow.

**Automatic enrolment is likely to lead to improved retirement outcomes for future retirees**

Millennials (individuals born between 1982 and 1995) make up around 40% of the eligible target group for automatic enrolment. In 2015/16 workplace pension participation among eligible 22 to 29 year olds was 72%, compared to 36% of those aged 22 to 29 in 2011/12 (before the introduction of automatic enrolment).<sup>70</sup>

Because millennials generally entered the workforce shortly before or during the initial implementation of automatic enrolment, they may be the first cohort to spend their entire working life contributing to pension schemes into which they were automatically enrolled.<sup>71</sup>

As minimum automatic enrolment contribution levels increase, the number of individuals choosing to opt-out may also increase, which would reduce the potential for improved outcomes. However, there is unlikely to be a large increase in opt-out rates.

67. Resolution Foundation (2017a)

68. PLSA (2016)

69. PLSA (2016)

70. DWP (2017)

71. See PPI Briefing Note 105 *The impact of the introduction of automatic enrolment on future generations* for more information

## Levels of home ownership are high among people currently aged between 50 and SPa

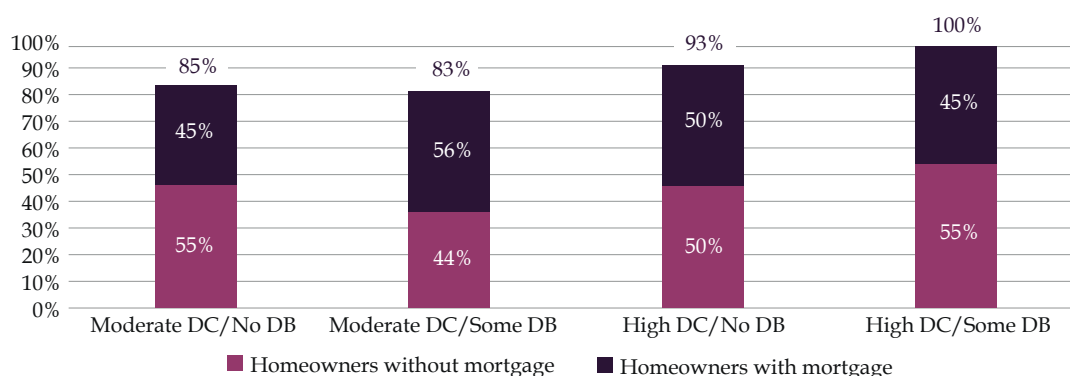
Among the entirety of people currently aged between 50 and SPa, levels of home ownership are high at around 90%, with nearly two

thirds (62%) of those who own homes doing so outright (i.e. without a mortgage). Among the groups identified as “at risk”, home ownership is also relatively high, between 83% and 100%, with around half owning their home outright (i.e. without a mortgage) (Chart 16).<sup>72</sup>

Chart 16

### Individuals in these at risk groups have relatively high levels of home ownership

Percentage of individuals currently aged 50 to SPa who own their own home, with and without mortgage, by pension savings



## Around half of homeowners currently aged between 50 and SPa own their home outright (without a mortgage)

### People with lower levels of pension savings are more likely to have low levels of non-pension savings

Among people with moderate to high levels of DC savings, non-pension savings and assets, which may be used alongside pension savings to support retirement income, vary.

Half of those with high DC and some DB entitlement have more than £155,000 in non-pension savings. However, only 16% of those with moderate DC and no DB entitlement have savings of this level. A quarter of people in this group have less than £1,000 in non-pension savings. (Chart 17 and Chart 18).

## A quarter of people with moderate levels of DC savings and no DB entitlement have less than £1,000 in non-pension savings.

72. For data on other groups, see Appendix two



Chart 17  
**People with higher levels of pension savings are more likely to be in the top quintile for non-pension savings**

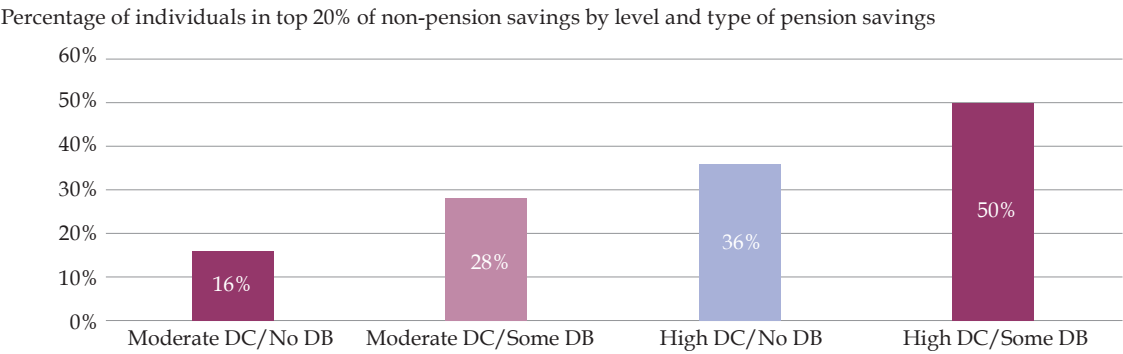


Chart 18  
**A quarter of those with moderate DC and No DB/Some DB have less than £1,000 in non pension savings**

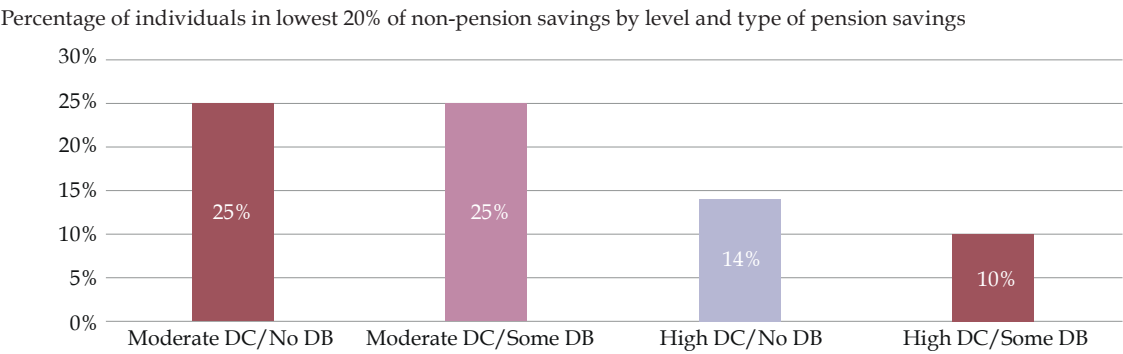
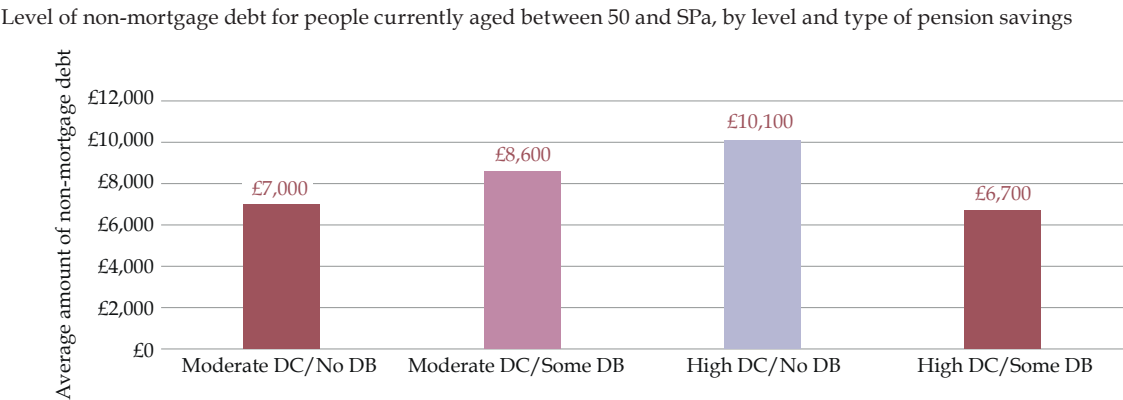


Chart 19  
**Levels of non-mortgage debt vary between these “at risk” groups**



**Non-mortgage debts can effectively reduce retirement income levels**  
Levels of non-mortgage debt, which can have a negative impact on retirement income levels, are around average for the groups identified as

“at risk”, although those with high levels of DC savings and no DB entitlement have slightly higher levels of non-mortgage debt at £10,100, compared to an average of around £8,000 (Chart 19).

## Future retirees' non-pension savings and assets will differ from those of today's retirees

It is likely that future retirees will have less housing security than previous cohorts because fewer people will reach retirement owning their

own home. Since 2000, home ownership has been in decline overall and for all age groups except those aged over 65 (Table 1).

Table 1: home ownership by age group 2000-2017<sup>73</sup>

	Age					
	25 – 34	35 – 44	45 – 54	55 – 64	65+	All
2000	45%	68%	75%	75%	65%	57%
2017	25%	53%	64%	72%	75%	52%

The average age of individuals buying their first home has gradually increased, from 23 in the 1960s to 30 in 2016, with only 26% of current 20 to 39 year olds projected to become homeowners by 2025.<sup>74</sup> If this trend continues, there are likely to be more people reaching retirement either renting or still paying off their mortgage. This will increase their living costs and therefore the amount of income they will require to achieve an acceptable standard of living in retirement.

**Only a quarter of those currently aged between 20 and 39 are projected to own their own house by 2025**

## Changing combinations of savings and wealth will affect the way that individuals make decisions about how to fund retirement

People in the future, who will reach retirement with different combinations of saving and wealth to today's retirees, will face more complex decisions about how to access their retirement savings and how to convert them into an income that will support them throughout their retirement. The extent to which individuals will be able to achieve positive retirement outcomes under the new pension freedoms will depend on the success of policy makers and industry in providing:

- Financial education, advice and guidance; and
- Innovative product solutions to evolving retirement income needs.

73. Resolution Foundation (2017b)

74. Halifax (2017); PWC (2015)





# Appendix one: technical annex

## Dynamic Modelling

The PPI Dynamic Model projects retirement cashflow outcomes for individuals taken from the most recent English Longitudinal Study of Ageing (ELSA) wave 7 (2014-2015) dataset. For this project, it has been used with a deterministic retirement approach, assuming that individuals retire at their State Pension age. Economic assumptions are derived from those published by the Office for Budget Responsibility (OBR) in their Economic and Fiscal Outlook and Fiscal Sustainability Report. The model is capable of projecting variations of the current pension system framework and behavioural assumptions.

The projection of an individual takes in:

- Private pension accrual to State Pension age (SPa).
- Retirement income from private pension.
- Retirement income from State Pension.
- Means-tested benefits in retirement, including Pensions Credit.
- Individual taxation.

## Private pension accrual to State Pension age

The individuals' current pension wealth is taken from the ELSA dataset and projected to their State Pension age. For Defined Contribution (DC) entitlement, this is subject to economic assumptions taken from OBR and an assumed portfolio composition as well as deductions from charges (assumed Annual Management Charge at 0.5%). Further benefit accruals are based upon current contribution data from ELSA where savers are assumed to continue to contribute at their current rate, based upon income.

For those who do not currently make pension contributions they are assumed to join an automatic enrolment workplace pension scheme, subject to eligibility criteria. This is projected at the legislated minimum levels of contributions based upon band salary.

Individuals are assumed to continue working and saving until their SPa, and the accrued funds are subject to the same assumptions as existing pension wealth from the dataset.

## Retirement income from private pension

It is assumed that the individuals do not access private pension saving until SPa. For those with Defined Benefit (DB) entitlement they are assumed to convert 25% of their benefit into a lump sum.

For those with a DC benefit who retire before 6th April 2015, they are not eligible for freedom and choice and are assumed to take 25% of their pension in the form of a tax-free lump sum and purchase a single life level annuity. For those who reach SPa after 6th April 2015, they are eligible for freedom and choice and have more options around access to their pension savings, subject to behavioural assumptions.

## Retirement income from State Pension

Individuals receive their State Pension at their SPa as currently announced and legislated for. The two tier State Pension system is in place for those reaching SPa until 2016, thereafter, the single tier pension is introduced for those reaching SPa after that date.

The State Pension may be uprated by the 'triple lock' assumption, as applicable to the policy scenario, throughout the projection period or linked to alternative uprating approaches.

It is assumed that the individuals qualify for a full single tier pension if they retire after April 2016. A foundation pension based on bSP and additional pension as set out above is calculated for those who reach SPa after the introduction of the new State Pension (nSP). If the foundation amount is greater than the nSP level, the individual is assumed to receive a CPI linked "protected amount".

## Segmentation of individuals

Individuals aged from 50 years old to their State Pension who have accumulated private pension rights have been segmented to analyse the proportion of the population at risk through their dependency upon DC savings. Those who were judged to be very dependent on DC savings were determined to have higher levels of risk because they must make more complex decisions about how to access their retirement

savings and generate an income throughout retirement. Risk level was mitigated by other factors such as whether they had substantial enough DC savings to afford the risk, whether they were more likely to use independent advice, and whether they were likely to have higher numerical ability, or score well on proxy indicators of financial skill and engagement.

Individuals who have either DB or DC pension rights have been segmented based upon the relative value of these private pension rights. DB rights have been split at a level of £7,000, which combined with a new State Pension, would give a retirement income around £15,000. The PLSA has suggested this is a minimum amount required for a modest retirement income. It is also around two thirds of the median earnings level for older workers, which would represent a target retirement income for a typical worker using Pension Commission suggested replacement rates.

## Descriptive statistics of segments

The analysis in this report uses other variables from ELSA to consider the distribution of individuals and couples by certain characteristics. The following data variables were taken from the ELSA dataset for this purpose. Many questions are not asked within each wave of interviews and where the questions were not asked of a respondent in wave 7, data for individuals has generally been taken from the preceding datasets.

- **Benefit unit income quintile** - This variable is based on the ranking of benefit units (either a couple or a single person) by their equivalised incomes from earnings, State benefits, investments, pensions in payment. It uses the income distribution of all the respondent households in ELSA, so includes those in retirement.
- **Socio-economic class (NS-SEC5)** - This measure of socio-economic group is based on in employment occupation, split into 5 categories in accordance with the Office for National Statistics groupings.
- **Numeracy** - An assessment is made of a respondent's numerical capacity through a number of questions. The number of correct responses informs the numeracy score of the respondent.

The numeracy questions consisted of three initial questions:

1. A sofa costs £300. How much would it cost in a half-price sale?
2. How many of 1000 people would be expected to get a disease if the chance is 10%?
3. A car is on sale at £6000, two-thirds of the cost new. What was the cost new?

The results of these first three questions then decided which route the numeracy test would take. If the first three questions were answered incorrectly question 4 was asked, then the numeracy test was over:

4. How much change would you get from buying an 85p drink with a £1 coin?

If at least one of the first three questions was answered correctly, the following question was asked:

5. How much would 5 people get with winning lottery numbers and a prize of £2 million?

If at least one of questions 2, 3 or 5 was answered correctly the following question was asked:

6. How much would you have in an account from £200 after 2 years if the account pays 10% interest a year?

The respondent is then allocated a score. Credit for question 4 was given to those who were asked questions 5 and 6.

- Educational qualification - highest level of educational qualification achieved.
- Investments held – The ELSA data contains information about the assets held by respondents. The report does not distinguish

between the amounts of the assets held as it is being used as a measure of familiarity, whereas amount is more likely correlated with opportunity.

These investments were grouped into the categories used in the report as follows.

1. Bank account - bank current account
  2. Basic savings – savings account, premium bonds, national savings products
  3. More advanced savings – ISAs (Individual Savings Accounts), TESSAs (Tax-Exempt Special Savings Accounts) and PEPs (Personal Equity Plans)
  4. Direct market investment – holdings in equities, bonds/gilts, unit/investment trust, share clubs and also included were any share reward schemes from their employer.
- Pension scheme information sources – respondents to ELSA were asked to identify the sources of information that they had used when making decisions about their pension savings.
  - Housing status and mortgage - the data contains information upon housing tenure and the amount of debt secure against the main residence. Mortgage levels have not been projected to State Pension age, as repayment schedules are unknown and may be impacted by the accessibility of pension funds.
  - Non-mortgage debt – this includes credit card debt as well as other forms of private debt and loan arrangements.



## Appendix two: supplementary charts

Chart 20

### Most people currently aged between 50 and SPa own a house and of those less than half have a mortgage

Percentage of individuals currently aged 50 - SPa who own their own home, with mortgage and without, by pension savings

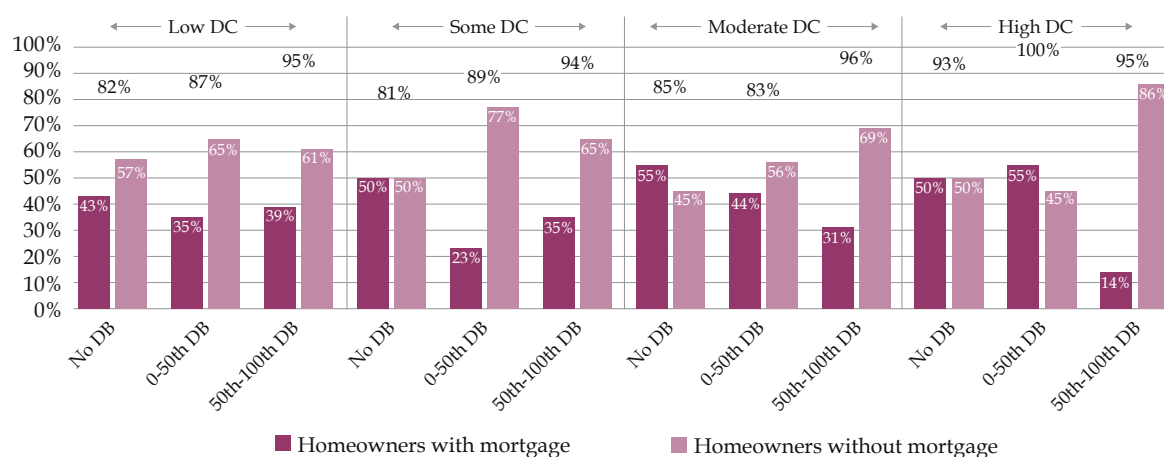


Chart 21

Levels of non-mortgage debt are highest among those in the “High DC/ Considerable DB” group

Level of non-mortgage debt for people currently aged between 50 and SPa, by level and type of pension savings

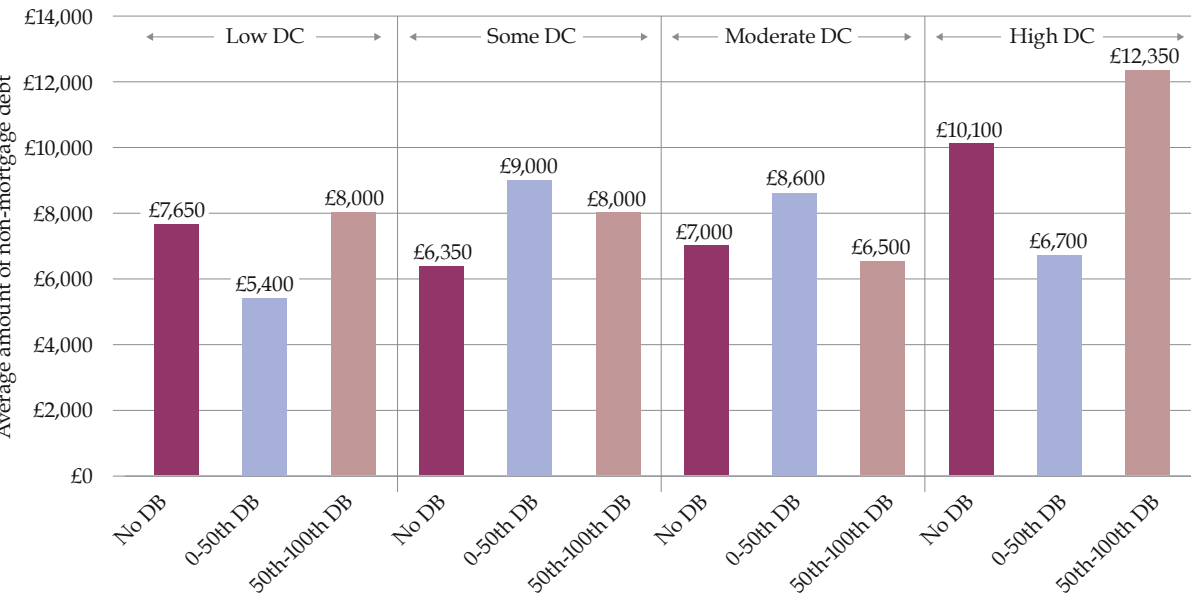


Chart 22

People with lower levels of pension savings are more likely to be in the lowest quintile for non-pension savings

Percentage of individuals in lowest 20% of non-pension savings by level and type of pension savings

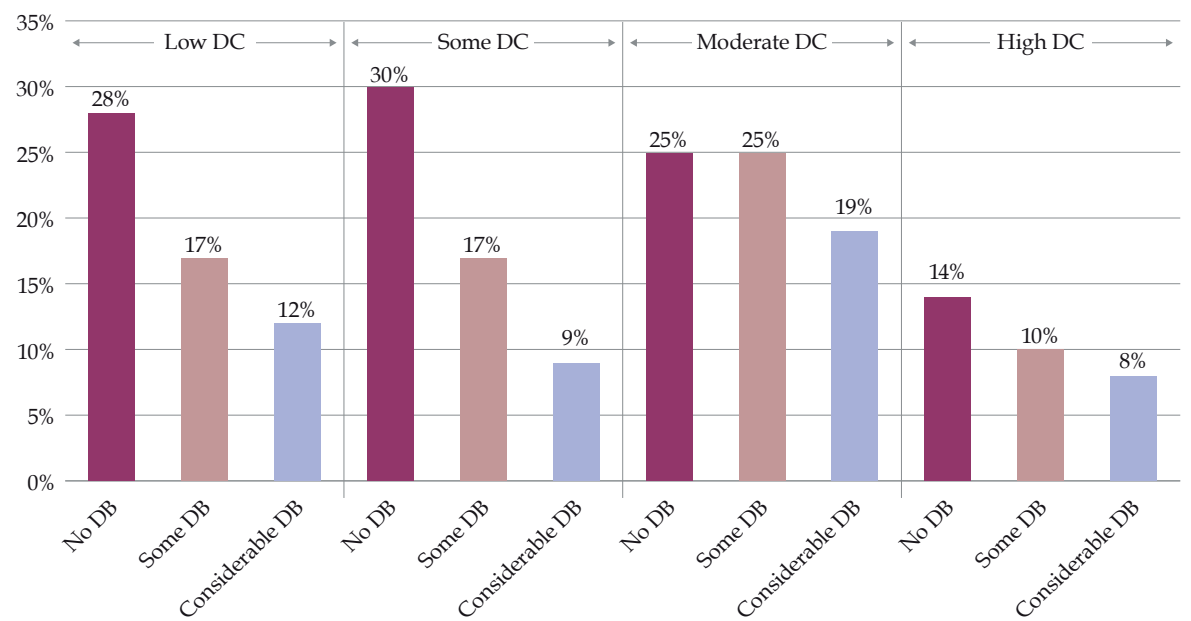
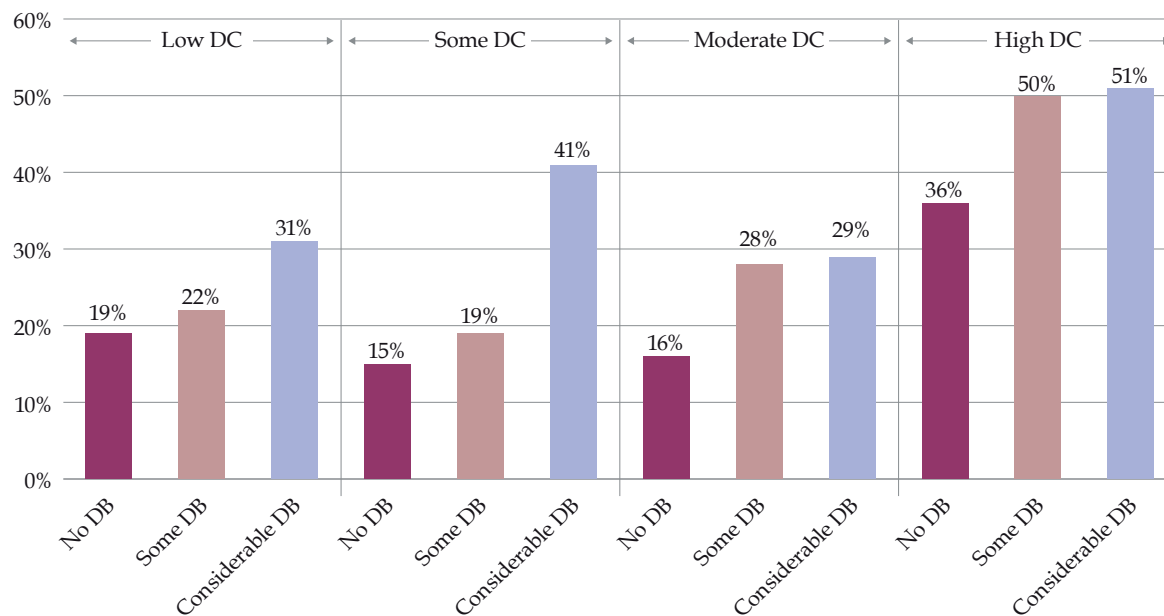




Chart 23

### People with higher levels of pension savings are more likely to be in the top quintile for non-pension savings

Percentage of individuals in top 20% of non-pension savings by level and type of pension savings





# Acknowledgements and Contact Details

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