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# Freedom and Choice in Pensions: the minimum pension age



**Introduction**

At Budget 2014 the Chancellor announced that, from April 2015 onwards, restrictions on accessing private Defined Contribution (DC) savings from age 55 would be removed. Further to this, the Government published a consultation document *Freedom and choice in pensions* providing details on how these proposals might work in practice.

In this consultation document, the Government proposes increasing the age at which individuals can access their private pension saving, known as the minimum pension age, in line with planned increases to State Pension Age (SPA). To enable people to plan for this change, the Government has announced its intention to wait until 2028, when the SPA will increase to 67, to increase the minimum pension age from 55 to 57. The consultation document also seeks views around whether the difference between the SPA and the minimum pension age should be decreased further in future so that, for example, it is only 5 years lower than the SPA.

This Briefing Note considers the rationale for increasing the minimum pension age in line with the SPA. It then explores the extent to which the current minimum pension age influences saving and retirement behaviour, the differences in minimum pension ages and SPAs between the UK and other countries, and some practical implementation issues that might arise as a result of future increases to the minimum pension age.

**Background**

The minimum pension age is one element of a private pensions system that aims to ensure that pension savings are used to provide income and security in retirement while also incentivising pension saving. Therefore, the minimum pension age is designed not to be set so low that private pension saving acts like other easy to access tax-advantaged savings vehicles, such as ISAs, and does not contribute to individuals having an adequate retirement income. At the same time, it is designed not to be set so high that it deters people who may have concerns about not being able to access their savings when they need it because it is locked up in a pension.

This issue is complicated by retirement increasingly being a gradual or phased process rather than a single cliff-edge event that takes place around their SPA.

The current minimum pension age was increased from 50 to 55 in 2010. Any withdrawals before age 55 are now subject to a 55% rate of income tax. This means that men can currently access their private pension income up to 10 years before they can receive their state pension. The difference is smaller for women (around 7 years) but will eventually be the same as for men. However, schemes are still able to pay out benefits to a member under the age of 55 on the grounds of ill-health.

Until April 2015, individuals are required to use any pension pots accessed between the ages of 55 and 60 to purchase an annuity or enter income drawdown, after they have taken 25% of this as a tax-free lump sum. Trivial commutation rules, however, only apply from the age of 60 onwards. These rules allow individuals with total private pension pots worth up to £30,000 to withdraw their entire pension pot as a lump sum. In addition, up to three small pension pots worth no more than £10,000 each can be taken as a lump sum from age 60 onwards.

From April 2015 all restrictions on accessing private Defined Contribution (DC) savings from age 55 will be removed. This means that, in the future, reaching the minimum pension age at 55 will allow individuals full access to their private pension DC savings without any tax penalty.

Early access to private pension DC savings has previously been suggested as a way to provide flexibility for individuals facing financial hardship before they reach retirement. However, in 2011, the Government concluded that early access to pension saving should not be considered at the time

as there was not sufficient evidence that this would increase overall pension contributions or provide significant help to individuals in financial hardship.[1]

In addition, early access to pension saving might not be consistent with the Department of Work and Pensions' objective of people remaining in paid employment for longer. However, for most people, starting to receive private pension income and retiring from employment do not happen at the same time. Data from the English Longitudinal Study of Ageing (ELSA) found that, between 2004 and 2011, around two thirds of people were in work immediately prior to accessing their DC pension, and only 45% of this group left work when they first started to draw their pension income, with the remainder continuing to work.[2] Many individuals may therefore wish to access their DC pension in a more flexible way that allows them to take a partial income or gradually phase in their retirement.

**Rationale for increasing the minimum pension age in line with the SPA**

Increases to the SPA are intended to reflect changes in the life expectancy of the general population. As life expectancy increases, the state pension would be paid to people for an increasing number of years if the SPA remained unchanged, and so planned increases to the SPA are intended to ensure the state pension system remains sustainable. Delaying the age at which individuals can first access their state pension has a direct impact on the amount paid out by the state to individuals over the course of their retirements but may also encourage individuals to work and save for longer before they retire.

The relationship between any increase to the minimum pension age and sustainability of the state pension and means-tested benefits in retirement is less direct. The minimum pension age sets an age at which individuals have the option to access their own private pension savings, should they choose, which in some cases may include drawing income some years before SPA. While it might be assumed that, the earlier the minimum pension age, the greater the risk that some individuals may exhaust their private pension savings before they die, some will still choose only to their access their private pension savings at, or even after, reaching SPA.

**The impact of the current minimum pension age of 55 on behaviour**

The minimum pension age is only one of the factors that may influence the age at which an individual draws their private pension income. The normal retirement age for workplace pensions, usually 60 or 65, appears, as might be expected, to have an impact on the age at which individuals start to draw down their private pension income. Defined Benefit (DB) workplace pension schemes, in particular, can incentivise individuals to work until the scheme's normal retirement age and then retire, as benefits continue to accrue up until this age and then are generally capped at a maximum number of years of accrual.[3]

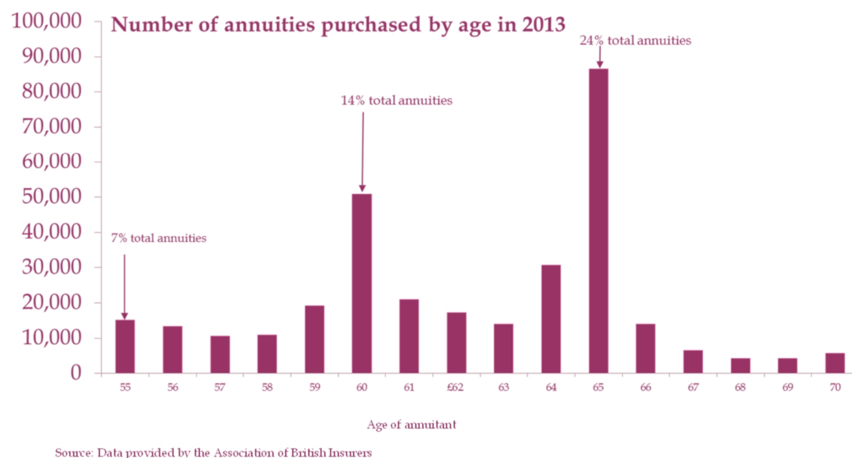
**Impact on age that individuals currently access pension funds**

Chart 1 shows the number of annuities purchased in 2013 by the age of the annuitant, based on data collected by the Association of British Insurers (ABI). This shows how the number of annuities purchased peaks at 65 and 60, in line with the normal retirement age for many workplace pensions schemes and, to a lesser extent, at 55, the minimum pension age.

The chart shows that many annuities are purchased by people under SPA, suggesting that private pension income may be used to provide income during the period between individuals stopping paid work, or reducing their hours of paid work, and receiving the state pension.

Of annuities purchased in 2013, 24% were purchased by an individual aged 65 while 14% were purchased by an individual aged 60. This suggests that factors other than the minimum pension age have influenced their decision. However, there is also a smaller peak at age 55, with 7% of annuities purchased by individuals of this age, suggesting that the minimum pen-

## Chart 1: Purchase of annuities peaks at ages 60 and 65 and, to a lesser extent, 55




Source: Data provided by the Association of British Insurers

sion age has an impact on the behaviour for some people.

The peak at age 55 is slightly higher for annuities purchased with smaller pots—for instance, 9% of pots up to the value of £10,000 that were used to purchase annuities in 2013 were for by an individual aged 55.[4] If the total value of an individual's funds was less than £18,000, they would have been able to withdraw their entire pension as a lump sum if they had waited until the age of 60 to access their funds under the trivial commutation rules up until March 2014.

As annuity rates offered to individuals with small pension funds are generally lower than those offered to individuals with larger funds,[5] purchasing an annuity may not have been the best course of action for some individuals in this group. It may be that some individuals chose to purchase an annuity in order to access the 25% tax-free lump sum. However, the data does not allow us to observe the wider circumstances of this group in terms of their other assets and income. Some of the smaller value annuities, for example, may have been bought from Additional Voluntary Contributions (AVCs) alongside a DB scheme.

While the removal, from April 2015, of limits to amounts that individuals can draw down will mean that individuals will no longer need to annuitise their funds just to gain access to their lump sum, this suggests that the minimum pension age does have an impact on the behaviour of some individuals. It also suggests that some individuals may wish to, or may feel that they need to, access their pension funds as early as possible.

**Understanding around life expectancy**

One of the concerns around the new flexibilities is that individuals might exhaust their sources of retirement income before they die. This risk is exacerbated by the fact that people tend to underestimate their own life expectancies (by 2 years for men and 4 years for women aged 50-60) compared to the official estimates.[6]

While, under the current system, life annuities can remove this risk by guaranteeing a secure income for life, individuals may be exposed to this risk if they manage their own sources of retirement income. Increasing the minimum pension age may decrease the average number of years to be funded by individuals' retirement income if it prevents some individuals from accessing their pension at younger ages. However, some may choose instead to take more income in the early years of their retirement.

Despite this, like the SPA, the minimum pension age may be used as a signal of expected increases in life expectancy and the need for private pension savings to support longer retirements.

**Incentivising pension saving**

One of the objectives of the pensions system is to incentivise pension saving. If a low minimum pension age were an effective incentive to pension saving, this might support keeping it at age 55. However,

## Chart 2: Features in countries with different annuitisation levels

| | State pension | Minimum age for accessing private retirement income | Early withdrawal allowed from private pension fund |
|---|---|---|---|
| Australia | Means-tested only<br>Paid from 65 increasing to 67 by 2024 | Between 55 and 60, depending on individual's age | Yes - health, financial hardship, changing employer after age 60 |
| Ireland | Yes<br>Earnings-related and means-tested<br>Paid at 66 increasing to 68 | 60 | Yes - health, if worked in particular occupation, leaving employer after 50 |
| Chile | Means-tested only<br>Paid from 65 | 65 for men, 60 for women | Yes - if fund has a sufficient balance accumulated, if worked in particular occupation |
| New Zealand | Yes, based on number of years of residency<br>Paid from 65 | 65 (or after 5 years, whichever is later) | Yes - health, purchase first home, financial hardship, emigration |
| USA | Earnings-related only<br>Paid from 65 (though available on a reduced basis from 62) increasing to 67 by 2027 | 59.5 | Yes - medical expenses, disability-related, changing employer after age 55 |

there is very little evidence around the impact of the minimum pension age on incentives to save. In addition, other factors may be more important—for instance, employer contributions are a key factor in take up of pension saving among eligible employees.[7] As more employees become eligible for employer contributions as a result of automatic enrolment, this factor, and the returns they expect to see on their contributions, may become more important for a growing number of employees. Building up more substantial pension pots may also change how choose to use those pots to support them in their retirement.

**Relevant changes in the UK pensions landscape**

The single-tier state pension will be introduced in April 2016 and will be set at a rate above the Guarantee Credit which is £148.35 in 2014-15. It is designed to help lift pensioners out of means-tested benefits and, in particular, Pension Credit. This has implications for the interaction of how individuals access their private pensions with means-tested benefits in future.

**Pension systems in other countries**

Chart 2 shows state pension ages and the ages at which individuals can access their private pension savings for five countries, as well as some other attributes. These countries have been selected because their pension ages and the interaction of these with other attributes provide some insight into the differences in approach around setting the minimum pension age.

**Differences between state pension ages and ages at which individuals can access private pension saving**

Unlike the UK, in Chile[8] and New Zealand[9], the age at which pensioners can access state support (65) is the same as the age at which individuals can access their own private pension income (65, although women in Chile can still access retirement savings at the age of 60).

Like the UK, rules in Australia[10], Ireland[11] and the United States[12] allow individuals to withdraw their private pension income at an earlier age than they first qualify for the state pension. However, the difference between the ages is smaller in these countries than the ten year difference that is proposed for the UK.

For instance, while the age at which individuals in the United States can access their full state pension is increasing from 65 to 67 by 2027, the age at which they can first access their private pension income is 59.5. In contrast the Treasury consultation document outlines a proposal for the UK where the SPA will increase to 67 while the minimum pension age increases to 57.

However, all of these countries under consideration allow early withdrawal from pension funds for a wider range of reasons than in the UK, where this is limited to the grounds of ill-health. While it is difficult to estimate how the different policies of a younger minimum pension age versus wider grounds for early access influence retirement outcomes, this is something to take

into account when making international comparisons. A number of countries (Australia, Ireland and the United States) also allow access when an older worker changes employer, which may mean in practice that many older workers do access their private pension savings sooner.

**Patterns of behaviour around withdrawals**

While it is possible to observe certain patterns around withdrawals of lump sums from pensions in the UK, the high level of annuitisation, partly due to the tax and regulatory framework, means that only limited conclusions can be reached. In contrast, in New Zealand, individuals are able to access the whole of their pension funds accumulated under KiwiSaver.

While the funds accumulated under KiwiSaver tend to be relatively small (as KiwiSaver was only introduced in 2007), observed behaviour in New Zealand provides some interesting insights. The first KiwiSaver members who were 65 years of age became eligible to withdraw their savings in 2012. Research estimated that, around three quarters of KiwiSaver members will have made a full withdrawal within five years.[13] In addition, members with lower levels of Kiwisaver savings were more likely to have made a full withdrawal at the time of the research. Similarly, members with higher levels of other savings and investments were more likely not to have withdrawn any of their KiwiSaver savings.

Individuals with no other savings or lower levels of other savings were more likely to spend their KiwiSaver savings or use them to pay off their mortgage or other debt. In contrast, individuals with savings/ investments of higher worth were more likely to reinvest them. This suggests that some individuals who access their KiwiSaver savings do so because they have immediate financial needs and lack the other assets to meet these.

It is not possible to make a direct comparison with what behaviour might be seen in the UK as the two countries have different characteristics including a lower relative state pension in the UK and a stronger legacy of DB and DC private pensions. However, this could suggest that, as a result of the flexibilities, there might be higher levels of full withdrawal from pension funds at the minimum pension age or at individuals' workplace retirement age, particularly for those with smaller funds and limited other assets.

Retaining the ten-year (or greater) difference between the minimum pension age and the SPA may mean that individuals will use their private pension to provide income during the period between individuals stopping paid work, or limiting their hours of paid work, and receiving the state pension. Similarly, it is possible to foresee cases where it may be financially beneficial for individuals to be able to access some or all of their fund at a younger age. For instance, if individuals are able to pay back their mortgage or other debt at age 55 or 57 this could result in savings to the individual in terms of interest payments to financial institutions that they are no longer required to make. However, any savings would need to be measured against the expected investment interest foregone on their pension funds.

**Interaction with means-tested benefits**

In Australia, where there are no restrictions on how individuals access their private pension savings, combined with a means-tested state pension, it is reported that some individuals draw down their private pension savings in a way that maximises their ability to access social security.[14] If the risk of moral hazard were considered to be significant in the UK pensions system, this might support the argument to increase the minimum pension age to reduce the number of years over which an individual can run down their private pension saving.

The UK state pension is different to the Australian system in that, while there are means-tested benefits for pensioners such as Pension Credit, Housing Benefit and

Council Tax Support, the state pension is contributions-based. The Government expects the new single-tier pension to prevent pensioners falling back on the state in future. However, as previous PPI research has shown, even individuals in receipt of a full single-tier pension may still in some circumstances fall back on the state for Guarantee Credit (including couple and disability elements), Housing Benefit, Council Tax Reduction and other means-tested benefits. There are still therefore some risks of moral hazard, particularly for people with relatively low amounts of private pension saving who are close to these thresholds.

**Practical issues around changes and future increases to the minimum pension age**

Many individuals have savings in contract– or trust– based pension schemes which may include rules around when individuals will access their funds. In some cases this may be linked to certain elements of protected or guaranteed benefits to be paid at retirement. If individuals do wish to access their funds sooner, or transfer out of their DC arrangement in order to do so, they may be at risk of losing those benefits. Therefore, some individuals may face a trade-off between exercising the new freedoms and accessing their private pension at age 55 and the benefits they expect to receive. If the minimum pension age is increased in future, schemes will need to amend their processes and member communications. This could create administrative burdens, particularly if the implementation of the increases is directly linked to the incrementally phased increases that are used to increase the SPA.

**Conclusion**

While the UK minimum pension age of 55 is currently lower than those of the other countries considered in this paper, and significantly below the SPA, these countries do allow some forms of early withdrawal from pension funds for a wider range of reasons than in the UK where early access is limited to those in ill-health. The extent to which the minimum pension age acts as a signal or incentive for individuals to access their private pension saving at an early age is not clear, though it is apparent from the available data that some groups will choose to access their saving as early as they can, and that they will have greater opportunities to do so with the new flexibilities in place.

One consequence of the removal of restrictions on how individuals can access their DC pension savings is that there will no longer be an incentive for individuals to purchase an annuity at age 55 just in order to access their tax-free lump sum, regardless of whether an annuity is in their long-term interest. This may improve retirement outcomes for some individuals.

However there is also a concern that an earlier minimum pension age would lead to some individuals exhausting their private pension savings too soon and living on reduced incomes or falling back on the state later in retirement. Even under the single-tier reforms there will be some groups who can still become eligible for elements of Guarantee Credit, Housing Benefit and Council Tax Support.

1 HM Treasury (2011) *response to its call for evidence on early access to pension savings*
2 IFS (2010) *Employment, retirement and pensions*
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5 Financial Conduct Authority (2014) *Thematic Review of Annuities*
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9 www.enz.org/new-zealand-pension.html
10 www.amp.com.au
11 www.irishlife.ie/uploadedFiles/Retail/body/products/Pensions/retirement-options-booklet.pdf
12 www.irs.gov/taxtopics/tc558.html
13 Inland Revenue (2013) *Results of a telephone survey of KiwiSaver members eligible to withdraw savings for retirement purposes*
14 Deloitte (2013) *Dynamics of the Australian Superannuation System*

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