

PENSIONS POLICY INSTITUTE

PPPI

Would allowing  
early access to  
pension savings  
increase retirement  
incomes?



## Would allowing early access to pension savings increase retirement incomes?

Introduction	1
Summary of conclusions	3
1. Background to early access	6
2. Analysis of policy options	17
3. Policy model one – Loans	22
4. Policy model two – Permanent withdrawals	34
5. Policy model three – Feeder funds	41
6. Policy model four – Early access to lump sums	45
Appendix	51
Acknowledgements and contact details	55
References	56

A Discussion Paper on work in progress by  
Daniela Silcock, Sean James and Adam Steventon

Published by the Pensions Policy Institute

© November 2008

ISBN 978-1-906284-07-7

[www.pensionspolicyinstitute.org.uk](http://www.pensionspolicyinstitute.org.uk)

This research has been commissioned by B&CE Benefit Schemes and Legal & General. The PPI is grateful for their support.





## Introduction

The UK pension system is currently undergoing reform as a response to the challenges posed by an ageing population and widespread undersaving.

Some stakeholders<sup>1</sup> have argued that allowing early access to pension saving, for example, for a first-home or in circumstances of financial hardship, could encourage more people to save in a pension. Early access may especially incentivise younger people (ages 20-29), women, and men and women in low income groups; who have traditionally been amongst the groups least likely to be saving enough for their pensions.

For the purposes of this analysis, 'early access' refers to withdrawing money from a pension fund before a defined older age. In the UK, people cannot currently access any portion of their pension funds before the age of 50 (rising to 55 from 2010).

This paper has been commissioned by B&CE Benefit Schemes and Legal & General as an initial, independent assessment of a potential policy of early access to pension saving in the UK. The report is intended as a contribution to the debate in this area. It examines the policy options for early access to pension saving and considers the potential trade-offs between making pension saving more attractive to encourage greater saving levels, but discouraging excessive access which could leave less money available for retirement.

Chapter 1 considers the potential advantages and disadvantages of allowing early access to pension funds within the UK.

Chapter 2 explores the possible implications that allowing a US 401(k) policy model of early access might have on the aggregate size of pension funds and individual levels of pension saving in the UK.

Chapter 3 explores the possible implications that allowing a New Zealand (KiwiSaver) policy model of early access might have on the aggregate size of pension funds and individual levels of pension saving in the UK.

Chapter 4 examines the potential impact of a feeder fund model of early access on individual's pension savings.

Chapter 5 examines the potential impact of an early access to lump sums model on individual's pension savings.

Chapter 6 compares and analyses the policy options examined in the paper and looks at the implications for policy.

<sup>1</sup> Conservative party (2005), B&CE Benefit Schemes (2008), Baroness Hollis (2008)

## Summary of conclusions

The Government is reforming the pension system in an effort to increase the number of people in the UK saving in a pension. Some stakeholders have suggested that allowing early access to pension savings, for example, for first-home purchase or in situations of financial hardship, could further increase the number of people saving into a pension fund and the total amount saved.

The arguments for and against allowing early access to pension savings centre around a trade-off between making pension saving more attractive to encourage greater saving levels, but discouraging excessive access which could leave less money available to provide an income in retirement.

### Advantages and disadvantages of early access

Permitting early access to pension saving could appeal to women, men and women on low incomes and younger people, who are amongst the groups most at risk of not saving enough to provide themselves with an income in retirement that they would consider adequate. Permitting early access to pension savings may encourage more people to save in pension funds and may encourage people to contribute higher percentages of their income.

Early access has the potential to reduce individual's income in retirement, depending on:

- Whether the funds accessed are taken as a loan or a withdrawal;
- The timing of any withdrawal or loan taken;
- Whether, if the funds are taken as a loan, individuals continue to contribute to their pension fund whilst repaying their loans;
- Whether individuals contribute greater percentages of their income to their pension fund as a result of being allowed early access to their pension fund.

However, permitting early access to pension funds could also increase the scope for tax avoidance and generate greater complexity in pension fund administration which could lead to higher management charges.

This paper examines the potential effects of four different policy models of early access to pension savings:

- The 'loans and withdrawals' model is based on the 401(k) model of early access to pension savings that is used in the US. In the 'loans and withdrawals' model people are permitted to take loans from their own pension funds, which they must then pay back with interest. In cases of hardship they can also take permanent withdrawals from their pension funds.

- The ‘permanent withdrawals’ model is based on the KiwiSaver model of early access to pension savings that is used in New Zealand. In the ‘permanent withdrawals’ model people can withdraw funds permanently under certain circumstances with no obligation to repay.
- The ‘feeder funds’ model is a combination of a pension fund and an individual savings account. Any contributions a saver makes to their feeder fund go first into the liquid/savings element of the account and when that reaches a fixed limit any subsequent contributions divert into the pension fund. Therefore people saving into a pension fund also have access to a certain amount of liquid savings.
- The ‘early access to lump sums’ model permits early access to 25% of people’s pension pot at any age if the pot size is above a pre-set floor amount and below a pre-set ceiling amount. This model is based on the existing provision for people to access 25% of their pension savings tax free from the age of 50 (55 after 2010).

#### Allowing early access and pension policy

The most appropriate policy option to adopt will depend on what is the Government’s policy objective. If the policy objective is to increase the amount that individuals save for retirement, then allowing loans might be the most appropriate choice as it seems to offer the greatest scope for a positive impact on individual’s retirement income.

If the policy objective is to minimise the potential reduction in the value of individual pension funds, then allowing loans, feeder funds or early access to lump sums seems to have less potential for reduction in individual pension fund size than allowing permanent withdrawals does.

Overall, whilst allowing loans has slightly more potential for increasing individual pension pot sizes than allowing feeder funds or early access to lump sums, if people do not repay their loans then allowing loans could put individual’s pension funds at risk.

Allowing early access to pension saving could increase or decrease the aggregate size of pension funds under management in the UK. The overall effect will depend on the extent to which allowing early access encourages individuals to save more and the extent to which individuals actually exercise their right to withdraw funds early. A ‘loans and withdrawals’ model seems to offer greater scope for a positive overall impact on levels of pension saving than a model which permits permanent withdrawals only.

It has not been possible to model the aggregate impact of allowing feeder funds or early access to lump sums models on the total size of pension funds due to the lack of data on how individuals may respond to these policies.

There are a few policy options for potentially mitigating the reduction on savings levels that early access could cause:

- A minimum, mandatory contribution level of 1% above the standard rate could be required from people who wish to use early access options (i.e. 5% minimum employee contribution rather than the 4% that will be required for those auto-enrolled into pension saving after 2012). There could be a condition that people pay the increased contribution for a period of at least five years before they access their pension fund.
- Conditions for withdrawals, or a minimum length of contributions to qualify for access.
- The setting up of an advice system able to inform people of the risks posed by early access.
- A system for ensuring the majority of loans are repaid, if the 'loans and withdrawals' model is adopted.
- A penalty tax on withdrawals or limiting withdrawal conditions to severe financial hardship.



## Chapter 1: Background to early access

This chapter considers the arguments for and against allowing early access to pension funds within the UK.

### **Pension reform**

In response to the challenges posed by an ageing UK population<sup>2</sup> the Government set up the Pensions Commission in 2002. The Government used the Commission's proposals to form the basis of a consultation with the public and with stakeholders and to produce the Government's proposals for pension reform.

The state pension reforms were enacted in the 2007 Pensions Act and will:

- Raise the State Pension Age (SPA) to 68 by 2046.
- Extend the coverage of Basic State Pension (BSP) for people reaching state pension age from April 2010, by reducing the number of qualifying years required for a full BSP to 30 for both women and men.
- Replace the existing system of Home Responsibilities Protection with a new system of more inclusive, weekly, positive credits for Basic State Pension and State Second Pension (S2P).
- Restore the indexation of the BSP to increases in national average earnings rather than prices at some point between 2012 and 2015.

The Government introduced a Pensions Bill in 2007 which is currently undergoing scrutiny in Parliament. The Pensions Bill 07/8 proposes to:

- Automatically enrol most employees into saving into a pension from 2012. Individuals will have the option to opt out of pension saving but the default position will be that they are automatically enrolled into pension saving.
- Introduce a compulsory employer contribution in respect of employees who remain opted-in.
- Introduce a new low-cost national pension savings scheme, currently called personal accounts, for people without access to an existing high-quality work-based pension scheme.

Employees who are auto enrolled in to a pension scheme and remain opted-in will have to contribute at least 4% of a band of earnings between £5,035 and £33,540 (in 2006 earnings terms). Employers will be compelled to contribute at least 3% of this band and the state would contribute at least 1% of this band through tax relief.

Currently, around seven million people in the UK are not saving enough to provide themselves with an income in retirement that they would consider adequate.<sup>3</sup> The reforms in the Pensions Bill 07/8 are part of the

<sup>2</sup> Between now and 2050 the percentage of UK population over 50 will almost double, Pensions Commission 1<sup>st</sup> report

<sup>3</sup> DWP (2006b)

Government's attempt to address undersaving for retirement. The reforms aim to overcome the following barriers to saving:

- Procrastination and inertia<sup>4</sup> - through auto-enrolment into pension saving for most employees<sup>5</sup> from 2012.
- Lack of matching contributions – contributions from employers will be mandatory from 2012<sup>6</sup> and will be complemented by Government tax relief.
- Low supply of pension products appropriate for those on low to moderate incomes<sup>7</sup> – personal accounts will provide a low-cost scheme that will be accessible to all employees.

The Government is hopeful that auto-enrolment and the new pension reforms will address these barriers to save and they expect their reforms to result in 6 to 9 million more people saving into a work based pension scheme.<sup>8</sup>

However some potential savers in the UK have cited a lack of early access options as another barrier to saving. In the Association of British Insurer's 'State of the Nation's Savings' Survey,<sup>9</sup> 4% of respondents cited the lack of early access options as their reason for not taking out a pension (ranked 12<sup>th</sup> out of 13 possible responses) and 7% said they would save more in their current pension if they were allowed to withdraw money early (ranked 6<sup>th</sup> out of 7 possible responses).<sup>10</sup>

A recent survey indicated that, in most cases (74%), the lack of early access options made no impact on decisions to save. However, results indicated that early access options might have some impact on a minority of people's decision making. 12% thought that the lack of early access options make saving in a pension seem less attractive. 42% of respondents who already contribute to a pension scheme said that they would be likely to increase their payment if early access to pension saving was allowed and 42% of people who do not currently contribute to a pension said that they would be likely to consider saving in a pension if early access options were allowed. However, 10% thought that the lack of early access options make pension saving seem more attractive.<sup>11</sup>

Affordability is most commonly cited as the reason people do not pay into pensions (53%).<sup>12</sup> It is possible that allowing early access to pension saving could make pension saving seem more affordable to people as

<sup>4</sup> See The Pensions Commission 2005 for evidence of procrastination and inertia being reasons for people putting off saving

<sup>5</sup> Excepting those employees who are: under age 22; over State Pension Age; or earning under £5,033 p.a.

<sup>6</sup> Mandatory employer contributions of 1% (rising to 4% by 2016) of band earnings

<sup>7</sup> DWP (2006a) p. 43, Most private pension providers market themselves to high earners

<sup>8</sup> DWP (2008)

<sup>9</sup> ABI (2007)

<sup>10</sup> ABI (2007)

<sup>11</sup> BMRB (2008)

<sup>12</sup> ABI (2007)

their money would be available if they needed it in times of financial crisis.

It is important to note that some savers might find pension saving attractive *because* their money is locked away until they retire and the decision over whether or not to access it early is taken out of their hands.

The Government has not included options for early access to pension saving within their reforms, which have been designed around the “*key goal of increasing pension savings*,”<sup>13</sup> though the potential benefits of early access were extensively debated in the Lords pension bill committee session.<sup>14</sup> In the Government’s view, allowing early access options would be at odds with their policy objective because: “*Tax relief on pension contributions is provided so people can save for an income in retirement, not for other purposes.*”<sup>15</sup>

However, the Government is launching a separate short-term saving account scheme in 2010 that will be available to people on low incomes. This scheme, The Savings Gateway, will be available to people on specific benefits.<sup>16</sup> They will be able to contribute to an account for two years and will receive matching Government contributions up to a certain cap. The Government intends, through the Savings Gateway and other means, to encourage people to save in liquid accounts *as well as* their pension funds; so that people will have access to savings in emergencies or difficult times and to reduce the need for people to have early access to their pension savings.<sup>17</sup>

The rest of this chapter runs through the advantages and disadvantages of early access.

Early access could:

- Lower opt-out rates post 2012;
- Encourage higher rates of contribution;
- Incentivise ‘undersaving groups’ to save;
- Assist with home buying;
- Assist with job training and education;
- Appeal to behavioural economics;
- Provide cash-flow advantages to savers.

However, early access could also:

- Reduce the aggregate size of pension funds;
- Create extra tax and administrative issues;

<sup>13</sup> Lord McKenzie, House of Lords, Hansard, 23 June 2008, Column 1281

<sup>14</sup> House of Lords, 23 June 2008, Lord’s Debate – Pensions Bill, Hansard

<sup>15</sup> Quote from page 5 in IR (2002)

<sup>16</sup> For a full list of qualifying benefits, see: [www.hm-treasury.gov.uk/budget/budget\\_08/documents/bud\\_bud08\\_saving.cfm](http://www.hm-treasury.gov.uk/budget/budget_08/documents/bud_bud08_saving.cfm)

<sup>17</sup> Lord McKenzie, House of Lords, Hansard, 23 June 2008, Column 1280

- Result in higher fund management charges;
- Pose a risk to individuals of making the wrong decisions;
- Be difficult for Defined Benefit schemes to incorporate.

#### Early access could lower opt-out rates

The Government is anticipating an opt-out rate from those auto-enrolled in 2012 of between 20% and 45% with a central estimate of 25%,<sup>18</sup> (in New Zealand's new auto enrolment scheme, around a third of those auto-enrolled have opted-out.)<sup>19</sup>

Allowing early access to pension saving may be a way of lowering opt-out rates. Some studies have indicated that more people would be willing to save in a pension if they were allowed to access their savings early. 4% - 42% of UK survey respondents who do not currently contribute to a pension have indicated that the presence of early access options may make them more likely to save in a pension.<sup>20</sup>

It is important to note, however, that a 0% opt-out rate is not necessarily the ideal scenario. Pension saving may not be suitable for some people, for example, those with significant amounts of personal debt or those who cannot afford the contributions. Some people may be likely to receive a low return on their saving as a result of the interaction with means tested benefits in retirement.<sup>21</sup> However a relatively low opt-out rate is essential to the success of the auto-enrolment scheme.

#### Early access could lead to higher rates of contribution

Some studies indicate that allowing early access to pension saving might encourage savers to contribute higher percentages of their income<sup>22</sup> even if they do not necessarily intend to withdraw money. If early access resulted in higher contribution rates then this may minimise the reduction access to savings could have on pension fund size if people withdraw their money and may even increase the aggregate size of pension funds.

#### Early access could incentivise 'undersaving groups' to save

The Government's pension reform proposals are particularly targeted at getting more men and women in low income groups, women, and younger people to save because these groups are amongst those most at risk of not saving enough to provide themselves with an income in retirement that they would consider adequate.<sup>23</sup>

<sup>18</sup> DWP (2008)

<sup>19</sup> Generally around 34%. Figures sourced from New Zealand government information website: [www.kiwisaver.govt.nz/](http://www.kiwisaver.govt.nz/), for a more detailed comparison of KiwiSaver and the proposed personal accounts scheme please see PPI Briefing Note 41 - *Are there lessons from KiwiSaver for the UK?* (Updated July 2008)

<sup>20</sup> ABI (2007), BMRB (2008)

<sup>21</sup> For a more detailed analysis of why certain individuals could lose out as a result of auto-enrolment please see PPI (2006) *Are Personal Accounts Suitable for All?*

<sup>22</sup> ABI (2007)

<sup>23</sup> DWP (2006b)

Early access might appeal to people with limited incomes. In US pension plans which offer an early access ‘borrowing’ option, where people can loan themselves money from their own funds, people on low incomes tend to be more likely to take loans than people on mid to high incomes.<sup>24</sup> (The US system of early access will be further explored in Chapter 3.) However, further research is needed in the UK to determine how men and women on low incomes might react to early access options.

Women might find early access options attractive. 54% of men vs. 37% of women were found to have additional pension savings as well as contributing to the state pension and the state second pension (or mandatory private equivalent).<sup>25</sup> Qualitative research on women’s attitudes to pensions suggests that this could be because women often prioritise their family’s needs over saving for a pension.<sup>26</sup> The research found that women also experience more income turbulence throughout their lifetime than men due to breaks in employment for caring and as the result of divorce and relationship changes. If women were able to access funds early for family needs or for times of hardship (such as relationship breakdown) they may be more likely to save in a pension.<sup>27</sup> However, whilst early access may encourage women to save in a pension fund, it could put them in danger of lowering their income in retirement. For instance, if a woman withdraws from her fund after a divorce when she has lost some rights to her husband’s pension, she may be further lowering her income in retirement by withdrawing from her own fund.

Younger people may be reluctant to have their money locked away in a pension fund as they are many years away from retirement. However, keeping pension savings locked away could be advantageous for younger people as their investment returns would have the chance to compound for a long period of time and substantially increase the size of their pension fund at retirement. A recent DWP survey found that many younger people felt that they could not afford to save in a pension and that any spare funds they had would be best used for immediate needs such as purchasing a first home or, for some respondents, university.<sup>28</sup> Early access options could allow younger people to start saving for a pension whilst addressing their fears of locking their money away and allowing them to save for a home or for education.

However, the DWP research also found that many younger people approved of plans for auto-enrolment and did not intend to opt out of personal accounts if they were enrolled in 2012.<sup>29</sup> The savings landscape

<sup>24</sup> US GAO (1997)

<sup>25</sup> Price (2006), p. 47

<sup>26</sup> Sykes, Hedges, Finch, Ward & Kelly (2005)

<sup>27</sup> Sykes, Hedges, Finch, Ward & Kelly (2005)

<sup>28</sup> MORI, DWP (2007)

<sup>29</sup> MORI, DWP (2007)

will most likely change after reform, as a new market of savers becomes engaged in pension saving. These new, younger savers may require different features of savings products to encourage them to remain opted in.

Because early access could be useful to men and women on low incomes, women, and younger people, allowing early access to pension saving could bring larger numbers from these target groups of people (who may not otherwise have begun saving) into pension funds.

#### Early access could assist with home buying

Depending on the way that an early access model is operated, it could be used as a way of assisting people to get on to the housing ladder by providing an alternative way to save for a deposit. This could be an attractive way to save for a home deposit because of employer contributions and a guaranteed minimum length of saving before money could be accessed.

However policy makers would have to think carefully about introducing early access policies aimed at assisting people to purchase their first homes. Any policy designed to promote house purchases would need to take into account the housing shortage within the UK and the potential for such policies to promote house price inflation thereby making it more difficult for people with low incomes to buy a house.

#### Early access could assist with job training and education

The Leitch review<sup>30</sup> recommends that the UK commit to raising the number of people in the UK with a degree (or vocational equivalent) from 29 per cent (in 2005) to 40 per cent (by 2020), in order for the UK to achieve its skills agenda and become '*a world leader in skills*'.<sup>31</sup> Allowing early access to pension saving may enable more people to fund higher education or periods of vocational training.

Providing a means of educational funding through early access to pension saving would also fit in with the Leitch review's recommendation that '*the costs must be shared between the Government, individuals and employers*'<sup>32</sup> because the Government would contribute through tax relief, the employer through matched contributions, and the individual through their own contributions.

#### Working with behavioural economics

Early access to pension saving could appeal to tentative savers of all ages who are reluctant to have their savings locked away until they reach the age at which they can access pension saving (currently age 50). Many

<sup>30</sup> HMT (2006)

<sup>31</sup> HMT (2006), p.3

<sup>32</sup> HMT (2006), p.58

people may not actually take up the option of withdrawing money early.<sup>33</sup> However, knowing that an early access option is available may incentivise people, who would otherwise save their money in an alternative savings vehicle, to invest in a pension.

Many people attempt to smooth consumption over their lifetimes.<sup>34</sup> Allowing early access to pension saving may enable them to do so more effectively by letting them save when they can afford to as well as giving them the opportunity to use part, or all, of their savings when faced with difficulties or when buying their first home. For people who have plans to purchase homes within the next five to ten years, an early withdrawal or loan option may incentivise them to save their deposit up in a pension fund, thereby starting their pension saving earlier than they might have done if they had deferred pension saving till after their first home purchase.

**Early access could provide cash-flow advantages to savers**  
Borrowing money from pension savings could be easier financially for many people than taking a commercial loan. The interest on a pension loan may be lower than it would be on a commercial loan and the repayments would not count towards an overall 'loss', as they would be re-invested in people's pension funds. People could also use pension fund loans to pay off high interest debts already acquired, thereby freeing up more capital for living expenses or an increase in pension contributions.

**Early access could risk a reduction of the aggregate size of pension funds**

Withdrawing money early from a pension fund could reduce the size of that fund in retirement, though it would not *necessarily* do so if the saver contributed at a higher rate as a result of early access options. Depending on the rules applied to fund withdrawals the reduction in size of the fund could be great or small. For instance:

In a fund in which withdrawals are allowed with no obligation to repay, the eventual size of the fund at retirement would be reduced by:

- The amount of the initial withdrawal,
- The amount of investment return the money would have generated if it had remained in the fund,
- Any matching employer contributions or government tax relief that are required to be returned upon withdrawal to the employer or government respectively.

<sup>33</sup> Norman & Clark (2004)

<sup>34</sup> Though lifetime spending tends to track income as well as following conventional economic theories of consumption smoothing, DWP (2006a) p. 42

In a fund in which withdrawals are repaid, the eventual size of the fund at retirement would be reduced by:

- Accrued investment return the money would have generated if it had remained in the fund (less any interest on the loan repayments<sup>35</sup>),

In some cases, allowing early access could reduce a pension fund to below the trivial commutation limit, thereby allowing people to use early access as a way of having to avoid buying an annuity. If people avoid buying an annuity with their pension funds, this could seriously reduce the amount of income they would have in retirement. It would be important to consider the potential for annuity avoidance when designing an early access policy.

Other factors may also reduce pot sizes as a result of allowing early access to pension saving. As is discussed in the following section, early access options could give rise to greater complexity in pension administration. This in turn could lead to higher management charges being applied to pension funds. Higher management charges could reduce the size that a saver's pot will be when he or she reaches retirement.

#### Tax and administrative issues with early access

The Government currently provides tax relief on contributions that individuals make to their pension funds through allowing contributions to come from pre-tax income (though income received from pension savings are taxed). If the Government were to allow early withdrawals from pension funds then this could extend the scope for some individuals to use pension saving as a tool for tax avoidance. This is because people might make their pension contributions when they are being taxed at one rate of income tax and then withdraw the money from their pension funds when they are being taxed at a lower rate. The UK already uses a penalty tax (of up to 55%) on pension funds which exceed the lifetime allowance (currently £1.5 million). The Government might want to extend this mechanism to cover un-repaid pension fund loans as well or introduce an alternative penalty tax on withdrawals.

A penalty tax on withdrawals could reduce the scope for people to use early access as a method of tax avoidance but could also be disadvantageous for people on lower incomes, who may end up paying higher taxes as a result.

As well as receiving tax relief on contributions, some pension funds receive additional contributions from employers. If options for early access to pension saving were introduced in the UK the Government would need to decide whether people would also be allowed early access

<sup>35</sup> On the whole, interest paid on pension fund loans is lower than the amount of investment return that would have been accrued if the money had remained in the fund. See US GAO (1997) p.11, for further discussion.



to the contributions that their employers and the government have made to their fund.

The Government may also wish to limit early access to certain qualifying events such as financial hardship, disability or unemployment in order to minimise the reduction that early access may have on the aggregate size of pension funds.

What the above discussion highlights is that if the Government were to allow early access to pension funds in the UK they would need to carefully design how withdrawals, loans, taxes and charges would be handled. This could entail greater levels of complexity in administering pension funds.

**Early access could result in higher fund management charges**  
Schemes that are more complex could cost more to run and higher running costs could lead to higher management charges. Therefore, one of the results of allowing early access to pension saving in the UK pension system could be higher management charges for savers, though it is important to note that there is little data on the potential magnitude of an increase in charges. The effect that allowing early access to pension saving would have on aggregate management charges would depend on how an early access policy was designed and whether charges were split amongst all fund holders, or just those wanting to take loans or withdrawals.

Higher management charges may not necessarily impact on people's decisions to save, but could reduce the size of an individual's pension pot at retirement. As an illustration: a rise of 0.1% in annual management charges could cost a saver around 2% of their total pension fund over 40 years.<sup>36</sup> However, it is important to remember that an increase in contribution rates as a result of early access options could compensate for the reduction that higher management charges might have on levels of the aggregate size of pension funds.

**Early access could pose a risk to individuals**  
Allowing early access to pension saving could expose individual savers to more risk of making the wrong decisions than less flexible systems. If savers are allowed early access to their pension funds they could be faced with making complex choices which might negatively impact on their future levels of retirement income. For example, by today's regulations people are allowed to access 25% of their pension fund as a tax free lump sum when they are 50. The FSA has found that in many cases people have made decisions to withdraw their lump sums without being properly informed of the impact this would have on their final pension

<sup>36</sup> PPI (2007b)

pot size. This has put them at risk of *'having less than they expect to live on in retirement.'*<sup>37</sup>

Because of this risk, early access options may need to be accompanied by a system of financial information (or possibly regulated advice) to educate people about the implications of accessing pension savings early. Such an information system could be an added expense as it is not currently part of the Government's considerations for the design of personal accounts, though the Government is attempting to ensure that a comprehensive system of generic information is available to all individuals. Private pension providers and workplace providers can choose whether to make financial information and advice available to members of their pension schemes and some do, but others provide only generic information in an effort to keep management charges low.

**Early access could be difficult for Defined Benefit schemes to incorporate.**

Contributions in most Defined Benefit schemes are pooled into one investment fund, which means it could be difficult for Defined Benefit schemes to offer early access.

- In a Defined Benefit scheme it could be difficult to determine the value of an individual's accrued benefits, which are in part based on future earnings.
- Taking money early from a Defined Benefit fund could reduce the value of the whole pooled fund, and potentially have an adverse effect on other scheme members.
- There is the potential for a run on a Defined Benefit pension fund if people respond to rumours of trouble with the fund by wanting to access their fund early.
- In the public sector, most Defined Benefit schemes are unfunded and allowing early access in these schemes could represent a cash-flow cost to the Government.

Because of the potential difficulties for early access to pension savings in Defined Benefit schemes, early access in other countries is often only permitted in Defined Contribution schemes.

**Could early access form a part of pension policy?**

In summary, introducing early access options could encourage more people to save, existing savers to contribute in higher amounts and could appeal to women, younger people and men and women on low incomes.

However, people accessing their pension savings early risk lowering the size that their pension pot will be on retirement (though this risk could be mitigated by the increase in savings that providing early access options might generate). Introducing early access could lead to a greater complexity in the management of pension funds. This greater complexity

<sup>37</sup> FSA (2006), p.1

could lead to higher management fees which, in their turn, could contribute to reducing the size of the pension pot that savers receive on retirement.

There are many different models of early access to pension savings, some of which are used internationally, and each model carries different advantages and disadvantages. The rest of this paper focuses on drawing out the lessons which different early access models offer and looks at the potential policy implications for designing a model which mitigates some of the risks posed by early access.

## Chapter 2: Analysis of Policy Options

This paper examines the potential effects of four different policy models of early access to pension savings:

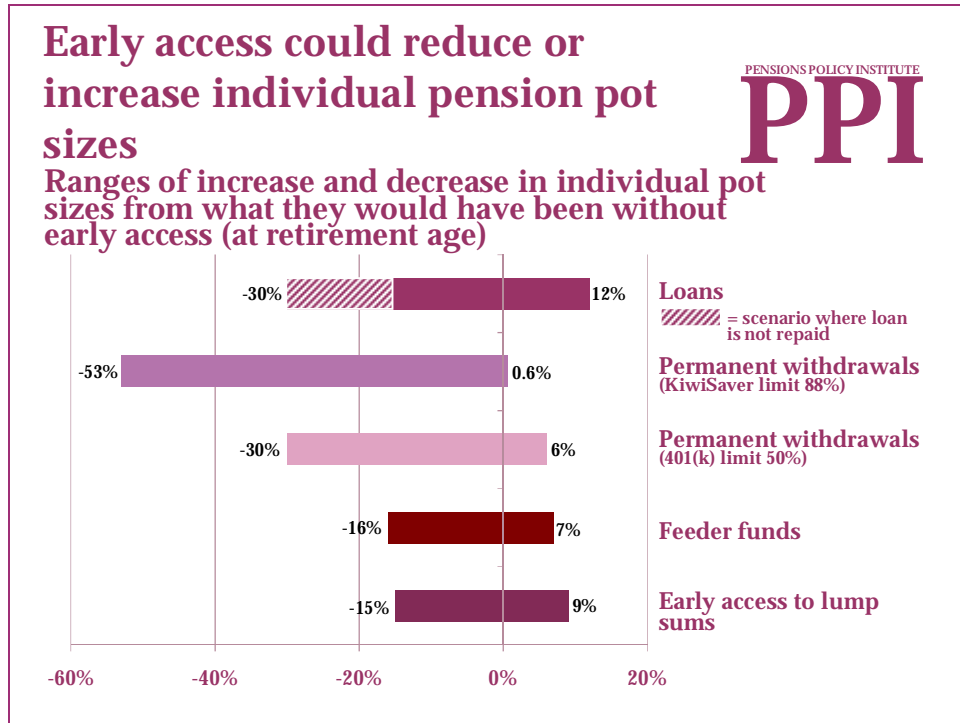
- The 'loans and withdrawals' model is based on the 401(k) model of early access to pension savings that is used in the US. In the 'loans and withdrawals' model people are permitted to take loans from their own pension funds, which they must then pay back with interest. In cases of hardship they can also take permanent withdrawals from their pension funds.
- The 'permanent withdrawals' model is based on the KiwiSaver model of early access to pension savings that is used in New Zealand. In the 'permanent withdrawals' model people can withdraw funds permanently under certain circumstances with no obligation to repay.
- The 'feeder funds' model is a combination of a pension fund and an individual savings account. Any contributions a saver makes to their feeder fund go first into the liquid/savings element of the account and when that reaches a fixed limit any subsequent contributions divert into the pension fund. Therefore people saving into a pension fund also have access to a certain amount of liquid savings.
- The 'early access to lump sums' model permits early access to 25% of people's pension pot at any age if the pot size is above a pre-set floor amount and below a pre-set ceiling amount. This model is based on the existing provision for people to access 25% of their pension savings tax free from the age of 50 (55 after 2010).

### **Allowing early access can affect individual pension pot size**

All four different policy models of early access have the potential to increase or decrease individual pension pot sizes.

- The model which has the potential for decreasing individual pension pot sizes the most, and with the least potential for increase, is the 'permanent withdrawals' model. However, the extent of decrease can be reduced by limiting the amount available for withdrawal.
- The 'loans' model has the most potential for increase in individual pension pot sizes in the most optimistic scenarios; however, if individuals don't repay their loans then it has the potential to decrease the size of individual pension pots at retirement age by around 30% in the most pessimistic scenarios.
- The 'feeder funds' and 'early access to lump sums' models have the least variation in outcomes, with potential reductions in individual pot sizes at retirement age limited to around 15% and potential increases of up to 9%, in the most optimistic scenarios regarding higher contribution rates.

Chart 3<sup>38</sup>



If the Government’s overriding policy objective is to implement the early access policy model with the most potential for increasing the amount that individuals save for retirement, then the ‘loans’ model might be the most appropriate choice as it seems to offer the greatest scope for a positive impact on individual’s retirement income.

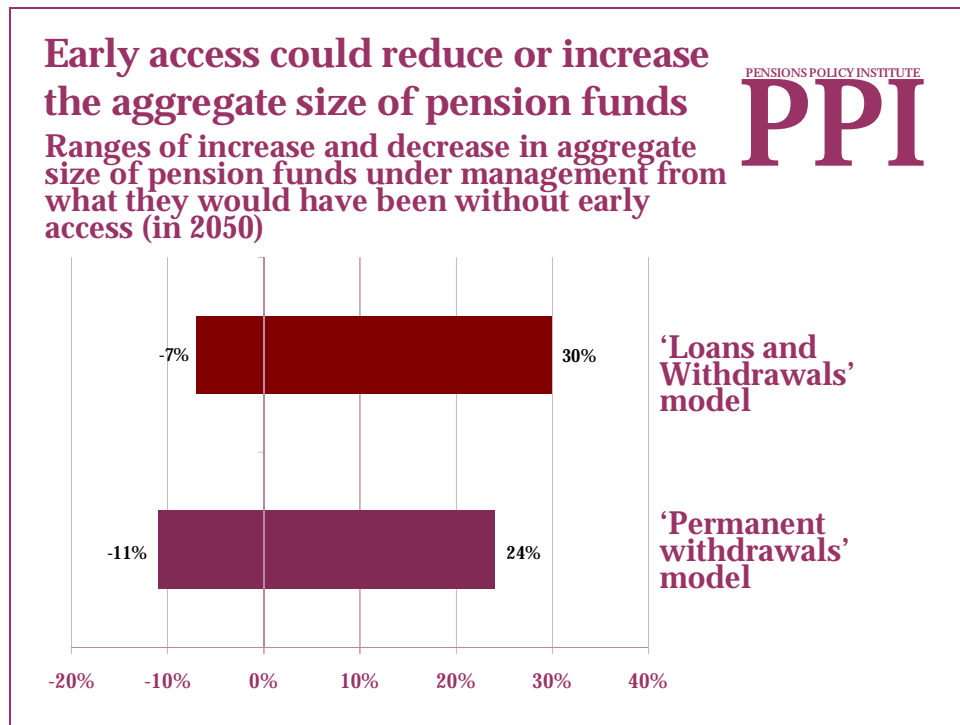
If the overriding policy objective is to implement the early access policy model which has the least potential for a negative impact on individual’s pension pots then either the ‘loans’, ‘feeder funds’ or ‘early access to lump sums’ models might be the most appropriate choice as all three models have less potential for reductions than the ‘permanent withdrawal’ model. However, if people do not repay their loans then the ‘loans’ model could put individual’s pension funds at risk of reductions similar to the levels seen in the ‘permanent withdrawals’ model.

**Early access effects on the aggregate size of pension funds**  
 Implementing a ‘loans and withdrawals’ model of early access could potentially increase the aggregate size of pension funds up to 30% by 2050, around £400 billion (in 2008 earning terms) in the most optimistic scenario regarding additional participation and contribution rates. However, if people stop contributing whilst repaying their loans, then a ‘loans and withdrawals’ model of early access could decrease the aggregate size of pension funds by up to 7%, a decrease of around £70 billion.

<sup>38</sup> PPI Modelling

Implementing a ‘permanent withdrawals’ policy model could potentially increase the aggregate size of pension funds by around 24%, around £300 billion, in 2050 (in 2008 earnings terms) in the most optimistic scenario regarding additional participation and contribution rates. However, implementing a ‘permanent withdrawals’ policy model also has the potential to reduce the aggregate size of pension funds by 11%, around £100 billion, in the most pessimistic scenario.

Chart 4<sup>39</sup>



The early access model which seems to have the most potential for increasing the aggregate size of pension funds (when accompanied by higher contribution levels), and the least potential for decreasing the aggregate size of pension funds, is the ‘loans and withdrawals’ model, based on the US’s 401(k); though the ‘permanent withdrawals’ model also has some potential to increase the aggregate size of pension funds when accompanied by higher contribution levels.

Therefore, if the overriding policy objective is to increase the aggregate size of pension funds, and an early access model is implemented in the UK, then the ‘loans and withdrawals’ model might be the most appropriate choice. The ‘loans and withdrawals’ model still runs the risk of reducing the aggregate size of pension funds, however, if people do not contribute more to their funds as a consequence of being allowed

<sup>39</sup> PPI Modelling

early access to their pension saving, or if they cease to contribute to their funds whilst repaying their loans, or do not repay their loans at all.

It is important to remember that the illustrations of the 'loans and withdrawals' and 'permanent withdrawals' policy models use data from the US on participation and contribution rates. Implementing a similar model of early access in the UK may produce very different outcomes. If, for instance, people in the UK repaid their loans at a higher or lower rate than seen in the US, or did not contribute a higher percentage of their salary to their pension fund, then the aggregate size of pension funds could be higher or lower than seen in some of these illustrations.

It should also be noted that this paper does not give an analysis of the potential effects of the 'feeder fund' and 'early access to lump sums' models on the aggregate size of pension funds. This is due to data limitations. More research on the possible effects of implementing these models in the UK would need to be done in order to determine whether these models have the potential to reduce or increase the aggregate size of pension funds to greater or lesser degrees than seen in the 'loans and withdrawals' and 'permanent withdrawals' models.

#### Policy implications of early access

What the illustrations in this paper indicate is that permitting early access to pension saving could reduce *or* increase the aggregate size of pension funds. Because of the potential for early access to decrease savings, it would be important for Government to think very carefully about how any early access policies were designed.

In order to attempt to minimise the reduction that an early access model could have on the aggregate size of pension funds the following options may be worth considering:

- A possible minimum, mandatory contribution level, for people whose plans offer early access options, of 1% above the standard rate (i.e. 5% minimum employee contribution rather than 4%) could mitigate the potential reduction in the aggregate size of pension funds which early access could cause. Alternatively, there could be a requirement that people contribute at 1% over the standard rate for a period of time (e.g., 5 years) before being allowed early access to their fund.
- Conditions could be placed on the circumstances in which a loan or withdrawal would be allowed, for instance, loans or withdrawals might only be permitted in the case of financial hardship, unemployment or disability. This could limit the access most people have to their pension funds and prevent unnecessary use. Conditions could also be placed on the length of time an individual would have to save in order to be allowed early access, thereby

ensuring that a certain level of savings is built up before any loan or withdrawal is taken.<sup>40</sup>

- A system of financial advice could be set up to help people understand the implications that accessing their money early could have for their income in retirement. This might prevent some people from making decisions about early access which would be wrong for their particular financial situations, though a system of financial advice may have a cost attached for the Government or for providers.
- In order to ensure that as many loans were repaid as possible (if a 'loans and withdrawals' policy model is used) a system for ensuring repayment of loans could be implemented that did not negatively impact on people with low incomes or people experiencing financial hardship. One possibility could be mandatory deduction of loan repayments from salaries once a person reaches a certain income level.

It may also be worth considering some policy options for dealing with the tax issues that are thrown up by early access:

- Applying a penalty tax, as is done in the US, could prevent people from using early access to avoid paying taxes, but may impact heavily on people with lower incomes.
- One potential way to overcome the tax issues with early access would be to take pension contributions out of post tax income (as in New Zealand) however this would not be possible without major pension reforms.
- Another option would be to limit withdrawals very strictly to situations of financial hardship where tax evasion is most likely not going to be an issue, and to write off a certain small level of tax revenue.
- A third option would be to only allow early access through loans, and automatically deduct repayments from people's wages after they reach a certain income level. This could negate the need for taxing withdrawals, though some people on very low incomes may not ever repay their loans or pay extra taxes on the money withdrawn.

### Next Steps

The background research for this paper highlighted a dearth of data on how early access options would be perceived and responded to in the UK. Before any decisions are made regarding permitting an early access to pension saving within the UK, it would be useful to conduct in-depth research on employer, employee and pension providers attitudes towards early access and what their likely responses would be.

More extensive data on employer, employee and provider attitudes and responses would make it easier to accurately model the potential impact of permitting early access to pension saving in the UK.

<sup>40</sup> Baroness Hollis, House of Lords, Hansard, 23 June 2008, Column 1275



## Chapter 3: Policy model one - loans

This chapter uses stylised scenarios to explore the possible implications that allowing a 401(k) policy model of early access might have on the size of individual pension pots and the aggregate size of pension funds in the UK.

**The United States' 401(k) – Early access through loans and withdrawals**  
Around 30 years ago the US Government passed an Act stipulating that individual pension contributions could be taken out of pre-tax income<sup>41</sup> and that employees could elect to have their contributions taken directly out of their salaries. The relevant regulations were contained in section 401(k) of the Act and led to the new breed of pension plans taking the name '401(k)'.

Today, 401(k) plans are available to private sector employees and self-employed people<sup>42</sup>. It is up to the discretion of individual companies whether to offer their employees a 401(k) plan (and whether to auto-enrol new employees) but many private companies have chosen to offer a 401(k) plan.

Many 401(k) plans offer early access options in the form of loans and hardship withdrawals, though it is left to individual plan providers to decide whether they will offer these options. Loans taken from 401(k) accounts are not taxed, but the capital must be repaid with interest.<sup>43</sup> People are also able to take permanent 'hardship withdrawals' from their funds, but if they do so the withdrawal is taxed as new income and a 10% penalty tax is applied on top.<sup>44</sup>

In the US, the Government does not distinguish between employee and employer contributions but allows access to US\$50,000 or 50% of fund, whichever is lower.

<sup>41</sup> Though it was possible for employees to receive tax relief using certain pension plans before this legislation was passed

<sup>42</sup> Self employed people can open single-participant 401(k) plans

<sup>43</sup> Interest rates are set by plan providers

<sup>44</sup> In certain 'emergency' circumstances such as (but not limited to) disability, medical debt or court-ordered child support payments, people may be forgiven the 10% penalty tax

**Table 1: Early access to 401(k) – Main features**

	<b>Loan</b>	<b>Hardship Withdrawal</b>
<b>When can savings be accessed early?</b>	<p>If plan allows loans: At any time as long as individual is still working for company which provides plan.</p> <p>Some plans only allow loans to be taken for specific purposes such as home deposits.</p>	<p>If the plan allows withdrawals: At any time as long as individual is still working for company which provides plan.</p> <p>If the plan does not allow withdrawals: When individual leaves company providing plan.</p>
<b>What can be accessed?</b>	No distinction between employee/employer contributions or accrued interest when loans and withdrawals are taken.	No distinction between employee/employer contributions or accrued interest when loans and withdrawals are taken.
<b>How much can be accessed?</b>	50% of pot or US\$50,000, whichever amount is lowest	<p>If penalty is paid: full amount of pot or any portion that member determines.</p> <p>If qualifying for a penalty-free withdrawal: amount determined by Internal Revenue Service to suit purpose of withdrawal.</p>
<b>Does it have to be paid back?</b>	Loans must be paid back within five years to avoid a penalty charge. Loans for home down-payment are given up to 15 years for repayment. Exact length of time is up to plan provider.	Withdrawals do not need to be paid back.
<b>Are there any tax or penalty charges?</b>	<p>If loan is repaid within time allowed (5-15 years) then no taxes or penalty charges. Interest is applied.</p> <p>If loan is not repaid in time or individual leaves company before repaying loan then balance will be treated as a withdrawal (see box on right).</p>	<p>Withdrawals are taxed at regular rate of income tax and a 10% penalty tax is applied on top.</p> <p>If individual qualifies for a penalty-free withdrawal they are charged at regular rate of income tax but no 10% penalty tax.</p>

**401(k) loans are currently taken up by about 18% of people whose plans offer them<sup>45</sup> and hardship withdrawals are taken up by about 4%<sup>46</sup> of individuals whose plans offer them, however plan providers have reported that hardship withdrawals may be on the rise due to the downturn in the US economy.<sup>47</sup>**

<sup>45</sup> Figures differ slightly between studies, but the general pattern seems to be about 18% from 1996, Holden (2005), TCRS (2008)

<sup>46</sup> Data for number of participants taking a withdrawal since joining plan is 4% , and for a year (2007) is 1.5%: ICI (2000), Vanguard (2008)

<sup>47</sup>Nessmith & Utkus (2008)

### **401(k) account activity – loans and withdrawals**

People are much more likely to borrow money from their 401(k) plans than to permanently withdraw money. This could be due to people prioritising pension saving over short-term consumption or it could be as a result of the penalties imposed on un-repaid withdrawals. But whatever the reason, the result is that given the choice, most 401(k) members are choosing the early access option which results in the least reduction of pot size.

In 401(k) plans which offer an early access borrowing option, people on low incomes tend to be more likely to take loans than people on mid to high incomes.<sup>48</sup> Similar numbers of women and men tended to borrow from their 401(k)s; 19% of women participants in 401(k) plans have an outstanding loan in comparison to 18% of men participants.<sup>49</sup> However, women tend to have larger outstanding balances than men (16% for women vs. 12% for men as a proportion of 401(k) balance).<sup>50</sup> This indicates that people with low incomes and women find accessing their funds early to be a useful option, even if the money has to be paid back.

### **Participation and contribution levels in 401(k) plans**

Though early access to 401(k)s could reduce pot sizes, there is evidence that people who save in 401(k) plans with early access options voluntarily contribute from 0.6% to 3% more<sup>51</sup> of their salaries to their pension fund than those in plans without early access options. There is also evidence that all things being equal, participation is from 0% to 6% higher in plans which offer early access options.<sup>52</sup> This is an average for the whole plan and includes people who do not subsequently take advantage of early access options.

This implies that people in plans with early access options may be contributing more overall to their funds, and more people may be saving as a result of early access options. Increases in the amounts of people saving and the amount that people contribute could help to increase the aggregate size of pension funds, though loans or withdrawals may work towards reducing it.

### **What if early access is allowed in the UK using loans and withdrawals?**

The following scenarios explore what could happen to the aggregate size of pension funds in the UK if people are allowed to access their funds early through a 401(k) style model of 'loans and withdrawals'. These are stylised scenarios; if early access options were introduced in the UK then the 401(k) model may not be used. The projections in this paper are derived from the PPI's Aggregate Model.

<sup>48</sup> US GAO (1997)

<sup>49</sup> Evidence from Vanguard plans quoted in Utkus (2005)

<sup>50</sup> Evidence from Vanguard plans quoted in Utkus (2005)

<sup>51</sup> Munnell, Sundén & Taylor (2000), US GAO (1997), Holden, S., and VanDerhei, J., (2001)

<sup>52</sup> US GAO (1997), Mitchell, Utkus, Yang (2005)

The 401(k) model is used because it is the international system of early access with the most comprehensive data on saver behaviour. It is important to remember that this is not a like-for-like comparison. The US and the UK have very different policy contexts and applying a US type model in the UK could result in different outcomes than seen in the US and would probably require a different regulatory framework.

For example, the US uses a 10% penalty tax on hardship withdrawals<sup>53</sup> to discourage early withdrawals and to deal with the potential for tax avoidance. If a system of loans and withdrawals is instituted in the UK, and a similar penalty tax is levied, the penalty charge might need to be altered to reflect the levels of taxes applied in the UK.

However penalties for un-repaid loans could impact heavily on those with low incomes, who are more likely to turn to their pension savings if they are in a financial crisis.<sup>54</sup>

**How could pension provision evolve without early access?**

This paper will compare possible outcomes from early access policies against a baseline that assumes the reforms in the Pensions Bill 07/8 are introduced, including auto-enrolment, but without early access options. The 'no early access'<sup>55</sup> scenario assumes that employers act in line with a survey conducted by Deloitte<sup>56</sup> of employers reported likely responses to the reforms. The 'no early access' scenario assumes that:

- 12% of employers with DB schemes and 31% of employers with DC schemes maintain current contribution levels.
- The remaining employers with DB and DC schemes either: limit eligibility, reduce contributions, and/or close current schemes to new members.
- Employers who do not currently offer a pension scheme enrol employees into personal accounts and contribute the minimum amount required.

In this scenario, enacting the pension reforms (without permitting early access to funds) would result in the value of the aggregate size of pension funds being about £1200 billion (in 2008 earnings terms) in 2012 and about £950 billion in 2050.<sup>57</sup>

**Uses and limitations of scenario analysis**

Scenarios are useful to explore outcomes on the basis of certain assumptions (i.e. to answer questions like: *What would happen if this*

<sup>53</sup> Early withdrawals that are not repaid are taxed at an individual's current rate of income tax + a 10% penalty tax, (though some extreme hardship withdrawals are exempt from the penalty tax)

<sup>54</sup> US GAO (1997) loans and withdrawals were more often taken by people with low incomes

<sup>55</sup> Please see Appendix A and PPI (2007a) p. 20-22 'modelled employer response scenario' for full explanation of modelling assumptions for the baseline scenario

<sup>56</sup> Deloitte 2006a

<sup>57</sup> Reduction from 2012 due to gradual reduction in contribution levels as reported by Deloitte survey, and projected closures of DB schemes

*amount of people accessed their pension savings early?*). These scenarios are intended as illustrative rather than as forecasts. We do not estimate the likelihood of each scenario occurring.

The projections illustrated in this paper should not be taken as forecasts. The analysis seeks to illustrate the potential impact of a *range* of possible scenarios and is not intended to imply that any of the scenarios are more likely to occur than the others. If a forecast of the effect of early access on the aggregate size of pension funds under management were to be produced, it would need to allow for factors that are not allowed for in this paper.

It would also be necessary for the baseline scenario to allow for the possibility that individuals in personal accounts contribute more than the minimum 4%, or that some employers who use a pension scheme to attract and retain employees increase their contributions under the reforms in order to maintain the differential they currently have over their competitors. It would also be necessary to allow for the proposed phased introduction of the reforms, rather than assuming immediate introduction of the reforms from 2012.

The paper does not cover the potential distributional impacts of early access to pension savings, nor does it look at whether the use of early access might decrease or increase the aggregate need for means-tested benefits in retirement. This is because the model used for scenario analysis is not sophisticated enough to make these types of projections. If early access policies were to be introduced it would be important for information on potential distributional impacts and impact on need for means tested benefits to be made available.

The scenario below is based on the premise that all of the assumptions in the baseline scenario take place, i.e. that the reforms in the Pensions Bill 07/8 are introduced and that employers react to the reforms in line with survey responses from the Deloitte survey described above.<sup>58</sup> However it also assumes that early access options have been introduced alongside the reforms in the Pensions Bill.

In this scenario it is assumed that savers cannot access money saved before 2012 because, from a policy perspective, there is limited rationale for allowing early access to past saving (since this brings the risk of lower retirement incomes but without the upside of greater levels of participation). In practice allowing access to only a portion of savings may bring administrative complications.

The 'loans and withdrawals' policy model of early access which is applied in this scenario allows early access under the following conditions:

<sup>58</sup> Also see: Appendix A and PPI (2007a) 'modelled employer response scenario'

- People are allowed to take loans from their DC and personal pension funds (including personal accounts) without paying income tax on the loan amount but loans must be repaid within a period of five years. (Loans are assumed to be repaid at an interest rate that is below the investment return people would have received on their pension saving if they had not taken the loan.<sup>59</sup>)
- People are allowed to permanently withdraw funds from their savings in amounts of up to 50% of total pot size.

In practice, individual providers might have the choice about whether to offer early access options, but for the sake of illustration it is assumed that all Defined Contribution and personal pensions (including personal accounts) offer early access through loans and withdrawals. It is assumed that Defined Benefit plans do not offer early access options because there is little international data on how early access would work in Defined Benefit plans.

This scenario uses data on the behaviour of 401(k) participants as the basis of assumptions on how the presence of early access could affect the behaviour of savers in the UK. It explores what the effects on the aggregate size of pension funds could be if savers reacted at the high end, low end or centre of the observed range of data on reactions of 401(k) participants. It assumes that:

- The presence of early access options increases the level of participation in pension fund savings and motivates people to voluntarily contribute in greater amounts to their pension fund throughout their whole working life.
- People react to the presence of early access options by taking loans and withdrawals at the same rate as seen in the US amongst 401(k) participants. Any un-repaid loans are counted as withdrawals.
- People with a loan outstanding make the same level of pension contributions that they would have made if they had not taken out a loan, on top of their loan repayments, except in the most pessimistic scenario, which assumes that 50% of people stop making new contributions to their pension funds whilst they are repaying their loans.

<sup>59</sup> Interest on loan repayments assumed to be price inflation + 2% a year, whereas investment returns on pension savings are assumed to be price inflation + 3.5% a year

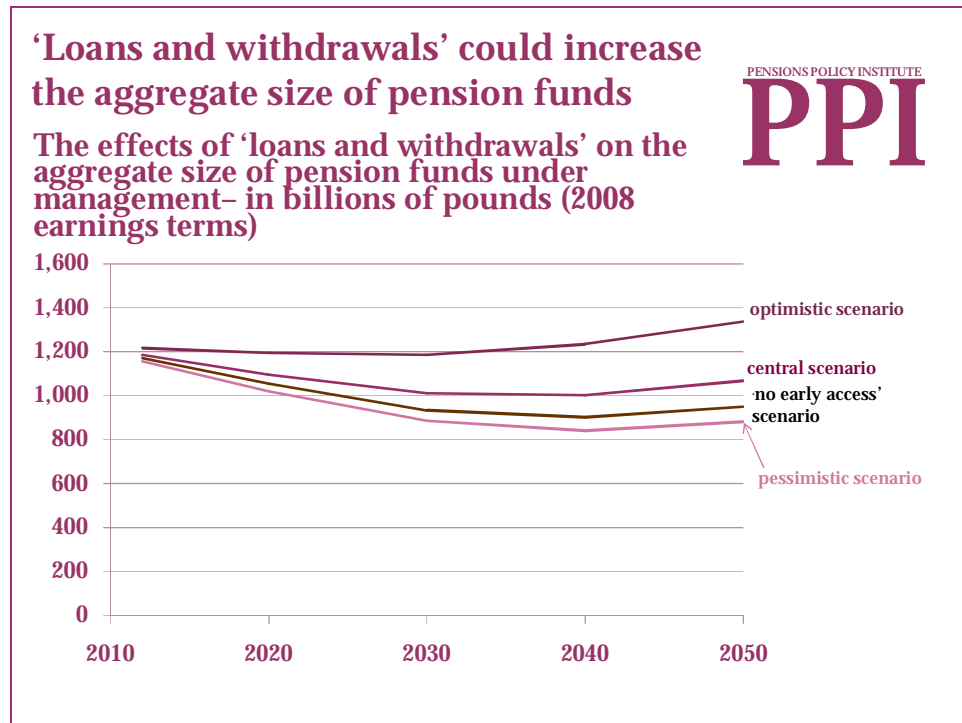
**Table 2:<sup>60</sup> Range of 401(k) participant’s behaviour in schemes with early access options – based on US data on 401(k) participant behaviour**

Saver Behaviour	Pessimistic	Central	Optimistic
Increase in participation rates	0%	3%	6%
Increase in contribution rates	0.6%	1%	3%
Loans outstanding in any one year	25%	18%	10%
Proportion of pension scheme assets withdrawn permanently each year	0.2%	0.1%	0.05%

The effects of ‘loans and withdrawals’ on the aggregate size of pension funds

If a policy model of ‘loans and withdrawals’ is introduced in the UK, and people react in a similar way to 401(k) participants in the US, (Table 2 and Appendix 1) then the aggregate size of pension funds in the UK could be increased by around 30% by 2050, an increase of around £400 billion (in 2008 earnings terms) and could be decreased by up to 7%, a decrease of around £70 billion.

**Chart 5<sup>61</sup>**



<sup>60</sup> See appendix 1 for full set of data and sources

<sup>61</sup> PPI Modelling data

### Loans and individual pension fund size at retirement

This chapter uses three hypothetical case studies to illustrate the effects that early access through loans might have on an individual's pension pot size. Each hypothetical individual is assumed to borrow 50% of their pension fund balance which is the maximum amount possible for the loans scenario (the loan limit for 401(k)s is 50% or US\$50,000 whichever is lower).

The individual case studies do not take into account the potential cash-flow advantages of borrowing from a pension fund rather than taking a commercial loan. However, the interest rates on a pension loan may be lower than those on commercial loans and could leave more money free for people to invest in their pension funds, for other savings or for spending on living costs.

This section explores the potential reactions people might have to the 'loans' model of early access:

- Taking out a loan and contributing more to their pension fund as a result of early access.
- Taking out a loan and not contributing more to their pension fund.
- Taking out a loan but ceasing contributions to their pension fund whilst repaying their loan.
- Taking out a loan and then not repaying the loan.

#### A median earning man who takes a loan at age 30

Paul is a hypothetical median-earning man who works full-time for most of his life, part time for 5 years, and is unemployed for 2 years in his twenties. Paul saves in a work-based pension fund whenever he is in work. If Paul does not take a loan from his fund, the value of his pension fund will be worth an estimated £81,700 at retirement (in 2008 earnings terms).

#### Paul: 25 year-old median-earning man

Paul is a median earning man, aged 25 in 2012.

- Paul starts working full-time from age 21, but is unemployed for two years during his twenties.
- He accesses his pension saving at age 30 to use towards a deposit for his first home.
- Between the ages of 55 and 60 Paul works part-time. He then returns to work full-time until he retires.
- When in full-time work, he earns at median age-specific earnings for men.
- Both he and his employer contribute the minimum amount to a work based pension from 2012, while he is working. He takes his pension at state pension age, at age 68 in 2055.



- At age 30 Paul takes a loan of £3,400 (in 2008 earning terms) from his fund to use towards a deposit for his first home. Paul repays his loan within 5 years.
- This results in the value of his pension fund being worth an estimated £81,400 at retirement (in 2008 earnings terms) which is £300 (0.4%) lower than it would be if he had not taken the loan.
- If Paul contributes 1% more of his earnings to his pension fund (as a response to early access options) then this results in the value of his pension fund being worth an estimated £91,500 at retirement, which is 12% higher than it would have been if he had not taken a loan.
- However, it is probable that some people who take a loan from their pension funds will stop contributing to their fund whilst they repay their loan. If it is assumed that Paul does not contribute to his pension fund whilst he is repaying his loan then the value of his pension fund will be worth an estimated £69,700 at retirement (in 2008 earnings terms) which is 15% lower than it would have been if he had not taken a loan.
- If Paul increases his contributions but does not repay his loan then the value of his pension fund will be worth an estimated £78,400 at retirement (in 2008 earnings terms) which is 4% lower than it would have been if he had not taken a loan.

Table 3:<sup>62</sup> Effects of pension fund loans on Paul's pot size (in 2008 earning terms)

	Pot size at retirement without early access or higher contributions	Pot size at retirement with early access withdrawal	Pot size at retirement with early access withdrawal + 1% higher contributions
Paul	£81,700	£81,400 (0.4%↓) <sup>63</sup>	£91,500 (12%↑)
Paul – with no contributions while repaying loan	£81,700	£69,700 (15%↓)	£78,400 (4%↓)

#### A low-earning man who takes a loan at age 40

Tony is a hypothetical low-earning man who works mainly full time with some time in self-employment and three years unemployment. If Tony does not take a loan from his fund, the value of his pension fund will be worth an estimated £41,600 at retirement (in 2008 earnings terms).

<sup>62</sup> PPI modelling data

<sup>63</sup> Change from pot size without early access

**Tony: 25-year old low earning man**

Tony is a low earning man, aged 25 in 2012.

- Tony starts work at the age of 21, working full-time until age 40 except for three years of unemployment in his twenties.
- When Tony is 40 he becomes self-employed and accesses his pension saving to fund his business start-up costs.
- Tony does not contribute to his pension fund when he is self-employed.
- When he is 48 he returns to employment,<sup>64</sup> working full-time until he retires.
- When in full time work he earns at low<sup>65</sup> age-specific earnings for men.
- Both he and his employer contribute the minimum amount to a work-based pension from 2012, while he is employed. He takes his pension three years before state pension age, at age 65 in 2052.

- At age 40 Tony takes a loan from his fund of £7,700 (in 2008 earning terms). Tony repays his loan within 5 years.
- This results in the value of his pension fund being worth an estimated £40,800 at retirement (in 2008 earnings terms) which is £800 (2%) lower than if he had not taken the loan.
- If Tony contributes 1% more of his earnings to his pension fund then this results in the value of his pension fund being worth an estimated £45,900 at retirement, which is 10% higher than it would have been if he had not taken a loan.

**Table 4:<sup>66</sup> Effects of pension fund loans on Tony’s pot size (in 2008 earning terms)**

	Pot size at retirement without early access or higher contributions	Pot size at retirement with early access withdrawal	Pot size at retirement with early access withdrawal + 1% higher contributions
Tony	£41,600	£40,800 (2%↓)	£45,900 (10%↑)

**A low earning woman who takes a loan at age 50**

Malika is a hypothetical low earning woman who takes two caring breaks and works both full and part time. When she is 50 she takes a 5 year break from work to care for her elderly mother who is disabled. If Malika does not take a loan, the value of her pension fund will be worth an estimated £27,000 at retirement (in 2008 earnings terms).

<sup>64</sup> A study in 2000 found that on average a spell of self-employment lasts almost 8 years, Knight and McKay (2000)

<sup>65</sup> Earnings in the 3<sup>rd</sup> decile of the distribution of age specific earnings for men employed full-time in the UK in 2008

<sup>66</sup> PPI modelling data

**Malika: 25-year old woman with modest caring and part-time work**

Malika is a low earning woman, aged 25 in 2012.

- Malika starts work at the age of 21, working full-time until age 28.
  - She has a career break to care for her two children for six years.<sup>67</sup>
  - She returns to part-time work for five years.
  - She then works full-time until she takes another career break for 5 years at age 50 to care for her elderly mother.<sup>68</sup>
  - At age 50 Malika withdraws money from her fund to make modifications to her home so it will be more accessible for her mother.
  - She returns to full-time work at age 55, and stays in work until she reaches state pension age.
  - When in full-time work, she earns at low age-specific earnings for women.
  - Both she and her employer contribute the minimum amount to a work-based pension scheme from 2012, while she is working. She takes her pension at state pension age, at age 68 in 2055.
- At age 50 Malika takes a loan of £6,800 from her fund (in 2008 earning terms).
  - If Malika repays her loan within 5 years, then this results in the value of her pension fund being worth an estimated £26,400 at retirement (in 2008 earnings terms) which is £600 (2%) lower than if she had not taken the loan.
  - If Malika contributes 1% more of her earnings to her pension fund then this results in the value of her pension fund being worth an estimated £29,600 at retirement, which is 10% higher than it would have been if she had not taken a loan.
  - However, if Malika is unable to repay her loan whilst she is caring, then her pension fund will be worth an estimated £18,900 at retirement and an estimated £21,300 if she increases her contributions by 1%, a decrease of 30% and 21% respectively of what her pot size would have been without taking a loan. (If Malika is required to pay a penalty tax because she does not repay her loan, it is assumed that she pays this tax out of the loan amount and that the charge does not affect the size of her pension fund.)

<sup>67</sup> She qualifies for state pension credits during this period

<sup>68</sup> During this period she receives no carer benefits or credits

**Table 5:<sup>69</sup> Effects of pension fund loans on Malika's pot size (in 2008 earning terms)**

	Pot size at retirement without early access or higher contributions	Pot size at retirement with early access withdrawal	Pot size at retirement with early access withdrawal + 1% higher contributions
Malika	£27,000	£26,400 (2%↓)	£29,600 (10%↑)
Malika – no repayment of loan	£27,000	£18,900 (30%↓)	£21,300 (21%↓)

**Effects of loans from pension funds**

In these scenarios:

- Taking loans from pension funds, without increasing contributions by one percent, reduces individual pot sizes by between 0.4% and 2% of what they would have been without early access.
- Pot sizes in funds where loans have been taken but individuals also contribute one percent more, are higher by 10% to 12% than the pot sizes in funds where there are no early access options and contributions are not increased.
- In the scenario in which Malika does not repay her loan, her fund size is reduced by 30% of what it would have been without early access, and by 21% if she increases her contributions by one percent while in work.
- In the scenario in which Paul stops contributing whilst repaying his loan, his final pot size is reduced by 15% of what its value would have been without early access.
- Even if Paul contributes 1% more during his lifetime, ceasing contributions whilst repaying his loan still reduces his final pot size by 4% of what its value would have been without early access or higher contributions.

If people contribute a higher percentage of their earnings to their pension fund because they are allowed early access to pension saving then, even if they take a loan at some point, their pot sizes in retirement could be significantly higher than if there is no early access option. However, if people stop contributing to their pension account during the loan repayment period, or do not repay their loans then the reduction in final pot size can be quite substantial (15% - 30% in these scenarios).

<sup>69</sup> PPI modelling data

## Chapter 4: Policy model two – Permanent withdrawals

This chapter looks at New Zealand's model of early access to pension savings and explores the implications that applying a similar model in the UK would have for individual's pension savings.

**New Zealand's KiwiSaver – Early access using permanent withdrawals**  
In July 2007 KiwiSaver was launched in New Zealand as a response to low levels of household saving amongst New Zealanders.<sup>70</sup> Like personal accounts, KiwiSaver is a national pension saving scheme that uses automatic enrolment but allows people to opt-out.

KiwiSaver members can access their funds early for: down payment on their first home; serious illness; significant financial hardship, or; permanent emigration (Table 4). Depending on circumstances, members can have early access to their own savings, their employers' contributions, 'tax credits' paid by the Government and the NZ\$1,000 kick-start they receive from the Government when joining. For members who are withdrawing funds for a first home purchase there is a subsidy of up to NZ\$5,000 paid by the Government.<sup>71</sup>

KiwiSaver members are not required to repay their withdrawals; in fact there is no facility for repayment even if people wished to do so. This reflects a difference in approach to pension policy between New Zealand and the UK. New Zealand's KiwiSaver was designed with the intention of promoting household saving levels amongst New Zealanders, whereas the pension reforms in the UK have been designed with the objective of increasing pension savings.<sup>72</sup>

One crucial way in which the pension system operates differently in New Zealand from the UK is that individual's pension contributions are taken out of post-tax income.<sup>73</sup> This makes the regulation of early access much simpler for the New Zealand Government because withdrawals do not need to be taxed as new income and the New Zealand Government does not need to apply penalty taxes to prevent tax avoidance.

<sup>70</sup> NZ Treasury (2005)

<sup>71</sup> To qualify for the subsidy members must have been contributing for 3 years or more, have an income below NZ\$100,000 per year and be buying a lower-priced home

<sup>72</sup> Lord McKenzie, House of Lords, Hansard, 23 June 2008, Column 1281

<sup>73</sup> Though the government matches pension contributions with tax credits up to the value of NZ\$1,042.86 per year

**Table 6: Early access to KiwiSaver – Main features**

When can savings be accessed early?	<p>For buying first home: after 3 years of saving.</p> <p>For serious illness or significant financial hardship: at any time.</p> <p>For permanent emigration: after 1 year living abroad.</p>
What can be accessed?	<p>For buying first home: all member contributions, all employer contributions, investment returns.</p> <p>For serious illness: all member contributions, all employer contributions, investment returns, all member tax credits, NZ\$1,000 kick-start.</p> <p>For significant financial hardship: all member contributions, all employer contributions, investment returns.</p> <p>For permanent emigration: all member contributions, all employer contributions, investment returns, NZ\$1,000 kick-start.</p>
How much can be accessed?	All funds available
Does it have to be paid back?	No, there is no facility for repayment.
Are there any tax or penalty charges?	No

It is too early to say how many people will take up early access options in KiwiSaver. However, 10% of people cited early withdrawal options for a home down-payment as their reason for joining (or staying in) KiwiSaver,<sup>74</sup> and 16% gave this as their reason for thinking about joining.

It is important to note that the early withdrawal for home deposit option in KiwiSaver is accompanied by a subsidy of up to NZ\$5,000<sup>75</sup> (about £2000) and that this may account for a higher rate of take up than would be seen for a first home deposit early withdrawal option that did not include a subsidy.

<sup>74</sup> Evaluation Services, Inland Revenue (2008)

<sup>75</sup> A couple buying a home together could jointly qualify for a subsidy of up to NZ\$10,000

### **What if early access is allowed using permanent withdrawals?**

For illustrative purposes, the following scenarios look at what would happen if a 'permanent withdrawal' policy model of early access was introduced in the UK. It is important to remember that this is not a like-for-like comparison.

New Zealand and the UK have very different policy contexts and applying a New Zealand type model in the UK could result in different outcomes than seen in New Zealand and would probably require a different regulatory framework.

For example; pension fund contributions come out of post-tax income in New Zealand and pre-tax income in the UK. Therefore, it would be difficult for the UK Government to be able to allow such free access to pension funds as the New Zealand Government does. The UK Government might want to set up a system for applying taxes to funds withdrawn early that ensured people would not use pension withdrawals as a form of tax avoidance.

Though this scenario is based on New Zealand's 'permanent withdrawal' policy model of early access, it uses data on the behaviour of 401(k) participants as the basis of assumptions on how the presence of early access would affect the behaviour of savers. It explores what the effects on the aggregate size of pension funds would be if savers reacted at the high end, low end or centre of the range of data on reactions. It assumes that:

- The same proportion of the UK savers take permanent withdrawals from their pension funds as the proportion of people in US 401(k) plans take withdrawals *and* loans (see appendix 1).
- People take withdrawals of the same proportions of fund size as is seen in loans and withdrawals in US 401(k) plans (in 401(k) plans, people are allowed to take up to 50% of their account balance or US\$50,000, whichever is lower).
- The presence of early access options has increased the level of participation in pension fund savings and has motivated people to contribute in greater amounts, similar to the increases of participation and contribution seen in US 401(k) plans.

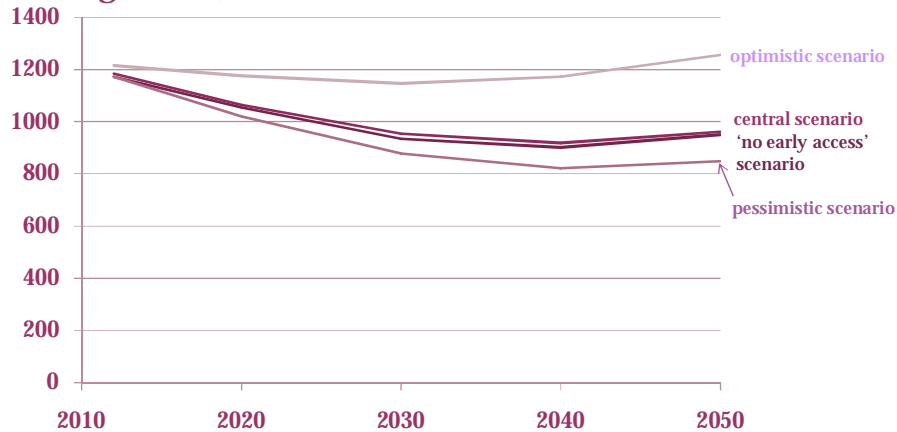
### **The effects of 'permanent withdrawals' on the aggregate size of pension funds**

If a policy model of 'permanent withdrawals' is introduced in the UK, and people react in a similar way to 401(k) participants in the US, (Table 2 and Appendix 1) then the aggregate size of pension funds in the UK could be decreased by around 11% (pessimistic scenario) and increased by around 0% to 24% (optimistic scenario) by 2050.

Chart 6<sup>76</sup>

**‘Permanent withdrawals’ could reduce or increase the aggregate size of pension funds**

The effects of ‘permanent withdrawals’ the aggregate size of pension funds under management – in billions of pounds (2008 earnings terms)



**‘Permanent withdrawals’ of 88% (KiwiSaver level) and individual pension fund size at retirement**

This chapter revisits the three hypothetical individuals to illustrate the effects that early access through permanent withdrawals may have on an individual’s pension savings. This chapter explores what would happen if people reacted to early access by contributing more to their pension funds and what would happen if they contributed in the same amount as they would have done without an early access option.

- Each hypothetical individual is assumed to withdraw the maximum amount possible for the permanent withdrawal scenario which is: the value of individual and employer contributions, plus investment returns. This is equivalent to about 88% of total fund size.<sup>77</sup>
- Tax relief (at the appropriate rate) and investment returns on tax relief are assumed not to be withdrawn.

**A median earning man who takes a withdrawal at age 30<sup>78</sup>**

- At age 30 Paul withdraws £6,000 (in 2008 earnings terms) from his fund.
- This results in the value of his pension fund being worth an estimated £73,100<sup>79</sup> (Table 7) at retirement (in 2008 earnings terms) which is £8,600 (11%) lower than if he had not taken a withdrawal.

<sup>76</sup> PPI modelling data

<sup>77</sup> Assuming that tax relief and investment returns on tax relief accounts for approximately 1/8 of fund size

<sup>78</sup> See Chapter 2 for a full description of Paul, Tony and Malika’s working histories



- If Paul contributes 1% more of his earnings to his pension fund then the value of his pension fund will be worth an estimated £82,200 at retirement, an increase of 0.6% of what it would have been without a withdrawal.

#### A low earning man who takes a withdrawal at age 40

- At age 40 Tony withdraws £13,500 (in 2008 earnings terms) from his fund.
- This results in the value of his pension fund being worth an estimated £24,400 at retirement (in 2008 earnings terms) which is £17,200 (41%) lower than if he had not taken a withdrawal.
- If Tony contributes 1% more of his earnings to his pension fund then the value of his pension fund will be worth an estimated £27,400 at retirement, a decrease of 34% of what it would have been without a withdrawal.

#### A low earning woman who takes a withdrawal at age 50

- At age 50 Malika withdraws £11,900 from her fund.
- This results in the value of her pension fund being worth an estimated £12,800 at retirement (in 2008 earnings terms) which is £14,200 (53%) lower than if she had not taken a withdrawal. This is below the trivial commutation limit and Malika could withdraw her entire pension pot (if she has no other non-state pension saving) and not purchase an annuity.
- If Malika contributes 1% more of her earnings to her pension fund then the value of her pension fund will be worth an estimated £14,400 at retirement, a decrease of 47% of what it would have been without a withdrawal.

**Table 7: Effects of permanent withdrawal on individual pot sizes (in 2008 earnings terms)**

	Pot size at retirement without early access or higher contributions	Pot size at retirement with early access withdrawal	Pot size at retirement with early access withdrawal + 1% higher contributions
Paul	£81,700	£73,100 (11%↓) <sup>81</sup>	£82,200 (0.6%↑)
Tony	£41,600	£24,400 (41%↓)	£27,400 (34%↓)
Malika	£27,000	£12,800 (53%↓)	£14,400 (47%↓)

These figures assume that the individuals withdraw the sum of individual contributions, employer contributions and investment returns on these

<sup>79</sup> Since this is more than the trivial commutation limit of £15,000, he would not be able to trivially commute. He could take a tax-free lump sum worth 25% of his pension saving of about £18,000, and would have to buy an annuity with the remainder by the time he reaches age 75.

<sup>80</sup> PPI modelling data

<sup>81</sup> Change from pot size without early access

contributions, assumed to amount to 88% of the fund. The limit on the size of withdrawals, however, could be set lower, which might limit some of the reductions in pot sizes shown in table 7.

**‘Permanent withdrawals’ of 50% (401(k) level) and individual pension fund size at retirement**

If it is assumed that individuals take permanent withdrawals of 50% of their fund total (which is the limit set on loans in the 401(k) early access scheme) instead of 88% of fund size (as in KiwiSaver), then individual pot sizes could be reduced by less. The following table illustrates how permanent withdrawals of 50% could affect individual pension fund sizes.

**Table 8:<sup>82</sup> Effects of permanent withdrawal on individual pot sizes (in 2008 earnings terms)**

	Pot size at retirement without early access or higher contributions	Pot size at retirement with early access withdrawal	Pot size at retirement with early access withdrawal + 1% higher contributions
Paul	£81,700	£76,800 (6%↓)	£86,400 (6%↑)
Tony	£41,600	£31,800 (24%↓)	£35,800 (14%↓)
Malika	£27,000	£18,900 (30%↓)	£21,300 (21%↓)

**Effects of permanent withdrawals**

In these scenarios, permanent withdrawals from pension funds of 88% (KiwiSaver level), significantly reduce the sizes of pension funds that individuals end up with. The final reductions in pot sizes range between 11% and 53% of what their value would have been without early access. The scenarios show that an increase in contribution levels of one percent could increase final pot size (by 0.6% in this scenario) if the withdrawal is taken when the saver is quite young (30 years old) but that for later withdrawals the pot size is reduced significantly even with increased levels of contribution.

If permanent withdrawals are taken at 50% of fund size (401(k) level) then the final reductions in pot sizes range between 6% and 30% of the value without early access. If the individuals increase their contributions by one percent, then Paul’s pot size is increased by 6% and Tony and Malika’s pot sizes are decreased by 14% to 21%. Limiting the amount available for permanent withdrawals to 50% ensured that final pot sizes were reduced by 23% less in these scenarios.

Tony and Malika end up with much more significantly reduced pot sizes than Paul because they withdraw from their funds closer to retirement

<sup>82</sup> PPI modelling data

age. In effect, Malika takes her retirement fund early. In practice, taking a withdrawal close to retirement could be a way to avoid having to buy an annuity (Malika is able to trivially commute her pension pot) and so an early access feature of this kind would pose problems when it interacted with the requirement of compulsory annuitisation.

## Chapter 5: Policy model three – Feeder funds

This chapter looks at the ways in which feeder funds could be used to promote pension savings and explores the implications that introducing a ‘feeder fund’ model of early access to pension savings would have for individual’s pension savings in the UK.

### Feeder funds – access to liquid savings

A feeder fund is a combination of a pension fund and an individual savings account. Any contributions a saver makes to their feeder fund go first into the liquid/savings element of the account and when that reaches a fixed limit any subsequent contributions divert into the pension fund. People can access the money in the liquid portion of the account but not the money in the pension fund. If the liquid portion of the account goes below the maximum balance, for example, after money has been accessed, any new contributions will top up the liquid portion of the account until the maximum balance is reached again and then the contributions divert into the pension fund once more.

Feeder funds are an alternative model of early access that uses existing products instead of requiring extensive changes to pension regulations. The logic behind a feeder fund is that it encourages pension saving by giving people immediate access to a certain level of liquid savings as well.

It is important to note that feeder funds might allow people to choose whether to invest their money in cash or equities (as they do in ISAs) and that this could have implications for the rate of long-term return people receive from their funds.

### Feeder funds and pension fund size at retirement

This chapter revisits the three hypothetical individuals, Paul, Tony and Malika, to illustrate the effects that a ‘feeder fund’ model might have on an individual’s pension savings.

For illustrative purposes, the following scenarios look at what would happen if individuals used feeder funds as the basis of pension fund saving in the UK. It is important to note that these are merely illustrative scenarios of what the effects of applying a ‘feeder fund’ model *might* be and cannot be taken as predictions of what would definitely occur if this policy model was applied. If a ‘feeder fund’ model was introduced in the UK it might be regulated differently than the one which is used as an example in these scenarios. There may also be differences in employee and employer behaviour that these scenarios have not accounted for.

The three scenarios below assume that a feeder fund is being used that has a maximum limit of £3,000 in the liquid element of the account. Any contributions made when the liquid element is at capacity are assumed to

be diverted into the pension fund. The two elements of the account maintain their own investment return, however, so savers may access their £3,000 savings in the liquid element of their account and any accrued investment return on that money.

Each hypothetical individual is assumed to withdraw the maximum amount allowed for in the 'feeder fund' model which is the entire contents of the liquid account plus any accrued interest. The scenarios look at what could happen if people do or do not contribute more to their funds as a response to early access options.

**A median earning man who takes a withdrawal at age 30<sup>83</sup>**

- At age 30 Paul withdraws £3,100 (in 2008 earnings terms) from his fund to use towards a deposit for his first home.
- This results in the value of his pension fund being worth an estimated £77,300 at retirement (in 2008 earnings terms) which is £4,400 (5%) lower than it would have been if he had not taken a withdrawal.
- If Paul contributes 1% more of his earnings to his pension fund then this results in the value of his pension fund being worth an estimated £87,500 at retirement, an increase of 7% of what it would have been without a withdrawal.

**A low earning man who takes a withdrawal at age 40**

- At age 40 Tony withdraws £3,300 (in 2008 earnings terms) from his fund.
- This results in the value of his pension fund being worth an estimated £37,400 at retirement (in 2008 earnings terms) which is £4,200 (10%) lower than it would have been if he had not taken a withdrawal.
- If Tony contributes 1% more of his earnings to his pension fund then this results in the value of his pension fund being worth an estimated £42,600 at retirement, an increase of 2% of what it would have been without a withdrawal.

**A low earning woman who takes a withdrawal at age 50**

- At age 50 Malika withdraws £3,700 from her fund (in 2008 earnings terms).
- This results in the value of her pension fund being worth an estimated £22,600 at retirement (in 2008 earnings terms) which is £4,400 (16%) lower than it would have been if she had not taken a withdrawal.
- If Malika contributes 1% more of her earnings to her pension fund then this results in the value of her pension fund being worth an estimated £26,000 at retirement, a decrease of 4% of what it would have been without a withdrawal.

<sup>83</sup> See Chapter 2 for a full description of Paul, Tony and Malika's working histories

**Table 9: Effects of feeder fund withdrawals on individual pot sizes (in 2008 earnings terms)**

	Pot size at retirement without early access or higher contributions	Pot size at retirement with early access withdrawal	Pot size at retirement with early access withdrawal + 1% higher contributions
Paul	£81,700	£77,300 (5%↓) <sup>85</sup>	£87,500 (7%↑)
Tony	£41,600	£37,400 (10%↓)	£42,600 (2%↑)
Malika	£27,000	£22,600 (16%↓)	£26,000 (4%↓)

**Effects of feeder funds on pension fund totals**

In these scenarios, withdrawing from a feeder fund reduces final pot sizes by about 5% to 16% of what their value would have been without early access. A 16% reduction in final pot size is quite significant. However, because withdrawals are capped at the same limit for all individuals, the bigger the account is in retirement, the less significant the relative reduction in pot size will be.

If it is assumed that the three hypothetical individuals contribute 1% more to their funds because of the presence of early access, then final pot size is increased by 2% to 7% (of what its value would have been without early access or higher contributions) in the case of Tony and Paul, but still reduced by 4% in the case of Malika who takes more time out of full-time employment.

A potential problem with the 'feeder fund' model is the limit on the amount that can be contained in the liquid element of the account. If the cap is quite low as seen in this example (£3,000) then people may not be able to access a sufficient amount of money to use in times of need, for example, the median deposit of first homebuyers is around £16,700.<sup>86</sup> Paul is only able to access about 18% of the money needed for a home deposit from his feeder fund.

However the higher the limit on the liquid element of the account is, the longer it will take a person with a low income to start saving in a pension. For example, an individual who earns £18,000 per year would need to save in a feeder fund with a limit of £3,000 for 3 years before their contributions started diverting to their pension fund. If they then withdrew all the money from their feeder fund at a later date, they would need to contribute for another 3 years before the funds diverted back into their pension savings. And if the limit is higher than £3,000, some people may spend even less of their working lives contributing to their pension

<sup>84</sup> PPI modelling data

<sup>85</sup> Change from pot size without early access

<sup>86</sup> CML Table ML2 and Scottish Widows' Graduate First Time Buyer Report 2007

**fund. In extreme cases, if people always withdrew from their feeder funds before they reached the liquid account limit, then they could face the danger of never contributing into their pension fund throughout their whole working lives.**

## **Chapter 6: Policy model four – early access to lump sums**

This chapter looks at proposals for early access to tax-free lump sums of up to 25% of the value of an individual's pension pot and explores the implications that introducing an 'early access to lump sums' model would have for individual's pension savings in the UK.

### **Early access to tax-free lump sums**

Individuals in the UK are allowed to withdraw 25% of their pension fund tax-free after the age of 50 (rising to 55 from 2010) however some stakeholders<sup>87</sup> have suggested that allowing earlier access to this lump sum may be a practical way to integrate early access into the pension system.

A potential model of an early access to tax-free lump sums model was recently raised by Baroness Hollis in the House of Lords.<sup>88</sup> Proponents for the model argued that early access was especially relevant to women who often choose not to save in a pension because they prioritise spending for their families. They argued that women tend to have lower incomes than men and more need to recourse to savings in times of financial hardship, and so may not be able to afford to save in both a pension and a separate savings vehicle.

The Government argued in response that allowing early access would be too complex for the pensions system, decrease people's retirement incomes and increase the likelihood that people will be dependent on means tested benefits.

However, it would not necessarily be the case that introducing an 'early access to lump sums' model would further complicate the system as there is already a facility for 25% lump sum payments, albeit only available to those over 50 (55 from 2010). Proponents for the model argue that allowing earlier access to the lump sum would not increase current levels of means-testing dependency nor reduce retirement income as people often use their 25% lump sum for paying off housing debts, doing home improvements and helping their children, rather than buying an annuity. Only around 14% of people currently put their tax-free lump sum towards an annuity when they retire.<sup>89</sup>

Baroness Hollis proposed one way in which an early access to lump sums model could work, which is outlined in the table below. A variant of this proposal will be used as a basis for the illustrative scenarios in this chapter. The basic tenets of her model proposal were that savers can have

<sup>87</sup> Baroness Hollis, House of Lords, 23 June 2008, Hansard, Column 1272

<sup>88</sup> Baroness Hollis, House of Lords, 23 June 2008, Hansard, Column 1272

<sup>89</sup> Prudential, YouGov (2008)



access to 25% of their pot at any age if the pot size is above the floor amount and below the ceiling amount. The floor (£20,000 in her model) is suggested in order to ensure that people have had a chance to form a savings habit before they access any of their pot. The ceiling (£80,000) is to prevent people with high incomes using the fund as a way to avoid paying taxes as people on high incomes tend to already have separate savings accounts with available funds that they can use for a 'rainy day'.

It has the potential to be a relatively simple model because it does not require tax penalties, systems for repayment or extra regulation for people with several different pots. The withdrawal limit on 25% of pot size from any fund held by an individual ensures that people will only ever be able to withdraw 25% of their total pension savings, even if they have more than one pension fund.

**Table 10: Early access to tax-free lump sum model – Main features**

When can savings be accessed early?	When pot size is over £20,000 but under £80,000
What can be accessed?	No distinction between employee, employer and government contributions.
How much can be accessed?	25% of pot or 25% of difference between size of pot at last withdrawal and new total <sup>90</sup>
Does it have to be paid back?	No, but new withdrawals cannot be taken until pot exceeds size it was before initial withdrawal
Are there any tax or penalty charges?	No

#### Early access to lump sums and pension fund size at retirement

For illustrative purposes, the following scenarios look at what would happen if an 'early access to lump sums' model was allowed in the UK. It is important to note that these are merely illustrative scenarios of what the effects of applying an 'early access to lump sums' model *might* be and cannot be taken as predictions of what would definitely occur if this policy model was applied. If an 'early access to lump sums' model was introduced in the UK, then the model may be designed differently than the one used as an example in these scenarios.

If we interpret the model just as Baroness Hollis has set it out, then neither Paul, Tony nor Malika will be able to withdraw from their pension saving at the time in which they do. If the individuals waited until they

<sup>90</sup> Baroness Hollis gives the following example in House of Lords, Hansard, 23 June 2008, Column 1275 "...It would mean that the woman could access £5,000, £20,000 or £25,000 during her working life if she needed to, but it would have to be rebuilt before she could draw any more. For example, if she took £10,000 from a £40,000 pot, she would not be allowed any more until she had rebuilt beyond that £40,000 to, say, £60,000. She could then take 25 per cent of the difference between the £40,000 and £60,000—that is, a further £5,000."

reached the £20,000 floor proposed by Baroness Hollis to withdraw their lump sums then: Paul would need to wait eight extra years (until he was 38), Tony and Malika would both need to wait eleven extra years (until ages 51 and 61).<sup>91</sup> However, in order to be able to compare individual experiences under an early access to lump sums policy with the policy options in the preceding three chapters, this illustration assumes that the floor is low enough for the withdrawals to take place.

This chapter revisits the three hypothetical individuals to illustrate the effects that an ‘early access to lump sums’ model might have on an individual’s pension savings. Each hypothetical individual is assumed to withdraw the maximum amount allowed for the lump sum model which is 25% of the total pension fund at that point in time. The scenarios look at what could happen if people do or do not contribute more to their funds as a response to early access options.

**A median earning man who takes a 25% lump sum at age 30**

- At age 30 Paul withdraws £1,700 (in 2008 earnings terms) from his fund to use towards a deposit for his first home.
- This results in the value of his pension fund being worth an estimated £79,300 at retirement (in 2008 earnings terms) which is £2,400 (3%) lower than it would have been if he had not taken a withdrawal.
- If Paul contributes 1% more of his earnings to his pension fund<sup>92</sup> then this results in the value of his pension fund being worth an estimated £89,200 at retirement, an increase of 9% of what it would have been without a lump sum withdrawal.

**A low earning man who takes a 25% lump sum at age 40**

- At age 40 Tony withdraws £3,900 (in 2008 earnings terms) from his fund.
- This results in the value of his pension fund being worth an estimated £36,700 at retirement (in 2008 earnings terms) which is £4,900 (12%) lower than it would have been if he had not taken a withdrawal.
- If Tony contributes 1% more of his earnings to his pension fund then this results in the value of his pension fund being worth an estimated £41,300 at retirement, a decrease of 0.7% of what it would have been without a lump sum withdrawal.

**A low earning woman who takes a 25% lump sum at age 50**

- At age 50 Malika withdraws £3,400 (in 2008 earnings terms) from her fund.
- This results in the value of her pension fund being worth an estimated £23,000 at retirement (in 2008 earnings terms) which is £4,000 (15%) lower than it would have been if she had not taken a withdrawal.

<sup>91</sup> PPI Modelling

<sup>92</sup> A higher rate of contribution also results in a higher amount available for 25% lump sum withdrawal.

- If Malika contributes 1% more of her earnings to her pension fund then this results in the value of her pension fund being worth an estimated £25,800 at retirement, a decrease of 4% of what it would have been without a lump sum withdrawal.

**Table 11:<sup>93</sup> Effects of 25% lump sum withdrawals on individual pot sizes (in 2008 earnings terms)**

	Pot size at retirement without early access or higher contributions	Pot size at retirement with early access withdrawal	Pot size at retirement with early access withdrawal + 1% higher contributions
Paul	£81,700	£79,300 (3%↓) <sup>94</sup>	£89,200 (9%↑)
Tony	£41,600	£36,700 (12%↓)	£41,300 (0.7%↓)
Malika	£27,000	£23,000 (15%↓)	£25,800 (4%↓)

#### Effects of early access to 25% lump sum on pension fund totals

In these scenarios, withdrawing a lump sum of 25% from a pension fund reduces the final fund amounts by 3% to 15% of what their value would have been without early access. The reduction is much higher for Tony and Malika (12%, 15%) than it is for Paul (3%) because Tony and Malika withdraw their lump sums later in life.

However, it is important to remember that people can currently withdraw 25% of their retirement fund from age 50 (rising to 55 in 2010), so the individuals in this scenario merely take their 25% lump sums early. Therefore Tony, Malika and Paul's pension funds may be reduced by similar amounts under today's system if they take their 25% lump sum at 55. Since the majority of people (around three-quarters)<sup>95</sup> take lump sums when they retire this policy would not necessarily reduce retirement *incomes* very much in terms of the returns people would receive from an annuity (Table 11). And if people increased their contributions by 1% then their retirement incomes would in fact be increased, though their overall wealth at the beginning of their retirement may be reduced.

<sup>93</sup> PPI modelling data

<sup>94</sup> Change from pot size without early access

<sup>95</sup> Prudential, YouGov (2008)

**Table 12:- Annual return from single-life, level annuity *after taking 25% lump sum* with or without early access (in 2008 earnings terms)**

	Annuity Income at retirement <i>without</i> early access withdrawal	Annuity Income at retirement with early access withdrawal	Annuity Income at retirement with early access withdrawal + 1% contributions
Paul	£4,230	£4,210 (0.4%↓)	£4,740 (12%↑)
Tony	£1,860	£1,760 (5%↓)	£1,980 (6%↑)
Malika	£1,290	£1,230 (5%↓)	£1,380 (7%↑)

An ‘early access to lump sums’ model may impact the *capital* people have in retirement. Though around three-quarters of people take a lump sum when they retire, the majority use it to invest in other forms of saving for the future (52%) or investment in stocks, shares or trusts (24%) and a large proportion of people use it for paying off their mortgage (22%) or home improvements (31%).<sup>97</sup> If people were able to access their funds early then the money may not be available in retirement to save, invest, or pay off debts like mortgages or credit card debt.

One possible drawback of the ‘early access to lump sums’ model is that younger people might not be able to accrue enough savings to make withdrawals in amounts that will truly assist them in life stage purchases such as home deposits or taking time out for studying. For example, at age 30 Paul is able to withdraw £1,700 from his pension fund. This amount is not high enough to be very helpful with a home deposit or to support oneself for a year out in full time education.

It is also when savers are younger that they may want to take time out of work to care for children, and might wish to draw on their pension savings for help during this period. However, in the 25% lump sum model, it is only when most savers are in their 40s and 50s that they accrue enough to withdraw a significant sum, though their needs for early access may no longer be so pressing.

#### Variations in implementation are possible

This chapter illustrates one potential way in which a model of early access to lump sums could be implemented, and other ways of implementing and administering early access to lump sums are possible.

For example, an alternative approach could see the pension pot ‘ring-fenced’ at the time of an early access withdrawal, with no further lump sum available from that part of pension saving. All of the remaining fund would be used to purchase an annuity or drawdown product.

<sup>96</sup> PPI modelling data

<sup>97</sup> Prudential, YouGov (2008)

**Any new pension saving would in effect be treated as a separate pension, where a further lump sum could be taken early, or left until retirement.**

**This may be easier for individuals to understand and providers to administer, and could potentially reduce the amount of lump sum available at retirement in favour of more pension income.**

## Appendix: Modelling assumptions

This appendix describes modelling assumptions used in this report. The modelling uses two models – the Individual Model and the Aggregate Model – that were developed with a grant from the Nuffield Foundation.

### Individual modelling

The modelling of the pension pot sizes of hypothetical individuals uses the PPI Individual Model.<sup>98</sup> Detailed assumptions have been made about the individuals' working and saving behaviours and these are described in the main report. Throughout, the modelling assumes:

- Future annual price inflation of 2.5%.
- Future annual earnings growth of 2% in excess of prices.
- Expected investment returns of 3.5% in excess of prices, before charges, corresponding to a mixed equity/bond fund.<sup>99</sup>
- Annual management charges of 0.5% of assets under management.

### Aggregate modelling

The modelling of the aggregate size of pension funds uses the PPI Aggregate Model. Private pension funds are modelled using a stock/flow approach. The flows into each pension fund consist of contributions and investment returns, while the flows out of each pension fund are new pensions and tax-free lump sums. More detail about the modelling methodology is available on the PPI website.<sup>100</sup>

A baseline ('no early access') scenario has been constructed assuming that the proposed Government reforms in the Pensions Bill 07/8 are introduced, including auto-enrolment, but without early access options. This has been compared to various scenarios assuming early access options are introduced.

The baseline scenario is similar to the 'modelled employer response' scenario used in the PPI's report *Will Personal Accounts increase pension saving?* published in 2007. The main change is that the Aggregate Model has been updated to incorporate the latest, 2006-based set of UK population projections published by the Office for National Statistics.

In the baseline scenario, employers are assumed to respond to the Pensions Bill reforms in line with a survey conducted by Deloitte.<sup>101</sup> Some employers are assumed to keep their current pension scheme open on current terms and others are assumed to close their scheme or reduce their contribution levels (Table A1).

<sup>98</sup> For more information on the Individual Model, see PPI (2003) *The Under-pensioned*

<sup>99</sup> This corresponds to assumed equity returns of 7.5% a year, assumed bond returns of 4.5% a year, and a portfolio of 55% equities and 45% bonds

<sup>100</sup> For more information on the Individual Model, see PPI (2005) *What will pensions cost in future?*

<sup>101</sup> Deloitte 2006a

**Table A1:<sup>102</sup> Assumptions made in the modelled employer response scenario for employers running existing exempt pension schemes**

<b>Approach taken by employers:</b>	<b>DB schemes: % of members</b>	<b>DC schemes: % of members</b>
<b>Open and grow</b> Keep scheme open for all new recruits, applying auto enrolment to the existing scheme on existing terms.	12%	31%
<b>Open and reduce</b> Keep scheme open for all new recruits but reduce contribution rates for new and existing members.	8%	11%
<b>Limit and maintain</b> Restrict eligibility so that only senior managers are able to join the existing scheme on existing terms in future. Individuals who already belong to existing schemes can continue accruing new pension rights on existing terms until they leave the company.	19%	37%
<b>Shrink and maintain<sup>103</sup></b> Close schemes altogether for new members but retain contribution rates for existing members. Individuals who already belong to existing schemes can continue accruing new pension rights on existing terms until they leave the company.	61%	13%
<b>Shrink and reduce</b> Close schemes to new members and future accruals.	0%	8%

There is limited information from the survey about whether employers would auto enrol their employees into an existing type of pension scheme or into personal accounts, whether employers would close their existing scheme, and how much their contribution would be. Some stylised assumptions have therefore been made. Half of employees who are not eligible to join existing schemes on existing terms from 2012 are assumed to instead receive combined contributions of 9% of all earnings into an existing type of pension scheme.<sup>104</sup> The other half receive a combined contribution of 8% of band earnings into a personal account.

<sup>102</sup> Based on NAPF (2006) Table 4

<sup>103</sup> Defined Benefit schemes that have already closed to new members, or that are assumed to do so before 2012, are included in this row

<sup>104</sup> This is the current average contribution rate into Defined Contribution schemes (including employee contributions, employer contributions and tax relief). ONS (2008) *Occupational Pension Schemes Annual Report: No. 15 2007 edition* p. 26

**The baseline scenario should be taken as illustrative, since there is limited evidence for how employers will react to the reforms and a significant minority are not yet aware of the proposed reforms in the Pensions Bill 07/08.**

**The assumptions adopted in the early access scenarios are described in Chapters 3 and 4. Data on the behaviour of 401(k) participants has been used as the basis of assumptions on how the presence of early access could affect the behaviour of savers in the UK (Table A2).**



**Table A2: Summary of research about the impact of early access in 401(k) plans and proposed modelling assumptions**

	Increase in participation rates	Increase in contribution rates	Loans outstanding in any one year	Proportion of pension scheme assets withdrawn permanently each year
US GAO (1997), based on SCF 1992 and IRS 1992 Forms	6%	3%	8% of all people have an outstanding loan	n/a
Munnell, Sundén, Taylor (2000), based on SCF 1998	n/a	1%	n/a	n/a
Holden and VanDerhei (2001), based on plans administered by EBRI or ICI	n/a	0.6%	Superseded by VanDerhei and Holden (2007)	n/a
Mitchell, Utkus, Yang (2005), based on Vanguard plans for those earning under \$85,000	Nil	0.6%	15% of people have a loan outstanding	n/a
VanDerhei and Holden (2007)	n/a	n/a	18% of 401(k) participants who are eligible to take a loan have an outstanding loan	n/a
Nessmith and Utkus (2008) based on Vanguard plans	n/a	n/a	n/a	0.1%
<b>Modelling assumptions</b>				
Pessimistic	-	0.6%	25% of DC savers have loan outstanding	0.2%
Central	3%	1%	18% of DC savers have loan outstanding	0.1%
Optimistic	6%	3%	10% of DC savers have loan outstanding	0.05%

Note: SCF = "Survey of Consumer Finances"

## Acknowledgements and Contact Details

The Pensions Policy Institute is grateful for input from many people in support of this paper, in particular:

Christina Barnes	Baroness Hollis
Martin Campbell	John Jory
Chris Curry	Dominic Lindley
Niki Cleal	Elaine McCauley
John Gleadall	Steven Utkus

Editing decisions remained with the author who takes responsibility for any remaining errors or omissions.

© Pensions Policy Institute, 2008

The Pensions Policy Institute is an educational charity promoting the study of retirement provision through research, analysis, discussion and publication. The PPI takes an independent view across the entire pensions system.

The PPI is funded by donations, grants and benefits-in-kind from a range of organisations, as well as being commissioned for research projects. To learn more about the PPI, see: [www.pensionspolicyinstitute.org.uk](http://www.pensionspolicyinstitute.org.uk)

Contact:

Niki Cleal, Director

Telephone: 020 7848 3744

Email: [info@pensionspolicyinstitute.org.uk](mailto:info@pensionspolicyinstitute.org.uk)

Pensions Policy Institute  
King's College  
26 Drury Lane  
3<sup>rd</sup> Floor, Room 311  
London WC2B 5RL

The PPI is grateful for the continuing support of its Platinum members:

AEGON Scottish Equitable/Origen  
Hewitt  
Prudential  
The Pensions Regulator  
Threadneedle Investments

A full list of donors is on the PPI's website. All donations are given independently of the PPI's research agenda and report content.

## References

- Association of British Insurers (ABI). (2005). *The State of the Nation's Savings 2005/06*. ABI
- Association of British Insurers (ABI). (2007). *The state of the nation's savings, 2006/07*. ABI
- BMRB Omnibus, Legal & General. (2008) *BMRB Telephone Omnibus Survey – Pension*. Legal & General
- Council of Mortgage Lenders (CML). *First-time buyers, lending and affordability, Table ML2*. [www.cml.org.uk/cml/home](http://www.cml.org.uk/cml/home). CML
- Deloitte. (2006a). *Employer pension contributions and pension reform: ABI research paper 2*. Deloitte
- Department for Work and Pensions (DWP). (2006a). *Security in retirement: towards a new pensions system*. CM 6841: TSO
- Department for Work and Pensions (DWP). (2006b). *Personal Accounts: a new way to save*. CM 7121: TSO
- Department for Work and Pensions (DWP). (2008). *Pensions Bill – Impact Assessment*. TSO
- Financial Services Authority (FSA). (2006). *Press release: FSA fines Braemar £182,000 for 'pensions unlocking' failings*. [www.fsa.gov.uk/pages/Library/Communication/PR/2006/091.shtml](http://www.fsa.gov.uk/pages/Library/Communication/PR/2006/091.shtml). FSA
- Government Actuary Department (GAD). (2006). *Occupational pension schemes 2005: Thirteenth survey by the Government Actuary*. TSO
- HM Treasury (HMT). (2006). *Leitch Review of Skills: Prosperity for all in the global economy - world class skills*. HMSO
- Holden, S. (2005). *401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2005*. Investment Company Institute, US
- Holden, S. and VanDerhei, J. (2001). *Contribution Behaviour of 401(k) Plan Participant*. ICI Perspective, Vol. 7, No. 4, and EBRI Issue Brief, No. 238, Washington, DC: Investment Company Institute and Employee Benefit Research Institute
- Investment Company Institute (ICI). (2000). *401(k) Plan Participants: Characteristics, Contributions, and Account Activity*. ICI

- Inland Revenue (IR). (2002). *Modernising Annuities: A Consultative Document*. [www.hmrc.gov.uk](http://www.hmrc.gov.uk). IR
- Knight G, McKay S. (2000). *Lifetime Experiences of Self-Employment*. DSS Research Report no. 120, Department for Social Security
- Kennickell, Arthur, and the Board of Governors of the Federal Reserve System. *Survey of Consumer Finances*. (1992). ICPSR version. Washington, DC: Board of Governors of the Federal Reserve System. doi:10.3886/ICPSR06729
- Mitchell, O. Utkus, S. Yang, T. (2005). *Turning workers into savers? Incentives, liquidity, and choice in 401(k) plan design*. National Bureau of Economic Research Working Paper 11726. [www.nber.org](http://www.nber.org)
- Ipsos MORI (MORI). Department for Work and Pensions (DWP). (2007). *Live now, save later? Young people, saving and pensions*. (MORI). (DWP). TSO
- Munnell, A. Sundén, A. Taylor, C. (2000). *What Determines 401(k) Participation and Contributions?* Center for Retirement Research at Boston College
- National Association of Pension Funds (NAPF). (2006). *More savers, more saving?: How employer decisions will determine the long-term success of pension reform. Research report 7*. NAPF
- Nessmith, E. Utkus, S. (2008). *Research Note: Hardship Withdrawals and the Mortgage Crisis*. Vanguard Center for Retirement Research
- Norman, J. Clark, G. (2004). *Towards a Lifetime of Saving*. Policy Unit, Conservative Research and Development
- New Zealand Treasury. (2005). *Memorandum to Cabinet Policy Committee: Budget 2005 Savings Package: Work Based Savings Scheme - 6 April*. NZ Treasury
- Office for National Statistics (ONS). (2008). *Occupational Pension Schemes Annual Report: No. 15 2007 edition*. ONS
- Pension Policy Institute (PPI). (2003). *The Under-pensioned*. PPI
- Pensions Policy Institute (PPI). (2004). *Property or Pensions?* PPI
- Pensions Policy Institute (PPI). (2005). *What will pensions cost in future?* ISBN 0-9548248-3-0: PPI
- Pensions Policy Institute (PPI). (2006). *Are Personal Accounts Suitable for All?* ISBN 0-9548248-8-1: PPI

Pensions Policy Institute (PPI). (2007a). *Will Personal Accounts Increase Pension Saving?* ISBN 978-1-906284-04-6: PPI

Pensions Policy Institute (PPI). (2007b). *Charging Structures for Personal Accounts*. ISBN 0-9548248-9-X: PPI

Pensions Policy Institute (PPI). (Updated July 2008). *Briefing Note 41 - Are there lessons from KiwiSaver for the UK?* PPI

Price, D. (2006). *Gender and Generational Continuity: Breadwinners, Caregivers and Pension Provision in the UK*. International Journal of Ageing and Later Life, 2006, 1(2): 31-66

Prudential, YouGov. (2008). *“Three quarters of pensioners with company and private pension schemes taking lump sums averaging £24,000”*. Prudential

Scottish Widows. (2007). *Scottish Widows' Graduate First Time Buyer Report 2007*. Scottish Widows

Sykes, W. Hedges, A. Finch, H. Ward, K. & Kelly, J. (2005). *Financial plans for retirement: women's perspectives*. Department for Work and Pensions, TSO

Transamerica Center for Retirement Studies (TCRS). (2008). *9<sup>th</sup> Annual Transamerica Retirement Survey*. TCRS

The Pensions Commission. (2005). *A new pensions settlement for the twenty-first century – The second report of the Pensions Commission*. ISBN 0-11-703602-1: TSO

US General Accounting Office (GAO). (1997). *401(k) Pension Plans: Loan Provisions Enhance Participation, but May Affect Income Security for Some*. GAO/HEHS-97-5 Washington DC

Utkus, S. (2005). *The question of loans*. Presented at 2005 US-UK Dialogue on Pensions, July 19–21, 2005, in Washington, DC

VanDerhei, J. Holden, S. Copeland, C. Alonso, L. (2007). *401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2006*. Employee Benefit Research Institute

Crown copyright material is reproduced with the permission of the Controller of HMSO and the Queen's Printer for Scotland.

Published by  
PENSIONS POLICY INSTITUTE

**PPI**

[www.pensionspolicyinstitute.org.uk](http://www.pensionspolicyinstitute.org.uk)  
ISBN 978-1-906284-07-7