Defined Capability

Pensions, financial capability and decision-making among retirees

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Alongside this report, the Strategic Society Centre simultaneously published a discussed paper entitled 'Default Reform', to provide accompanying policy analysis and discussion.

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Executive Summary

This report describes the results of quantitative research into the characteristics and financial capability of individuals in the UK above or just below retirement age who have 'Defined Contribution' (DC) pension savings or receive an income from a life annuity.

The principal driver for the study was the UK government's announcement at Budget 2014 of a change in the taxation of DC pension savings from April 2015 - removing the obligation for individuals to convert DC savings into a secure pension income at retirement.

The outcomes resulting from the changes implemented in April 2015 will ultimately depend on the behaviour, choices and financial capability of individuals with DC pension savings from the age of 55, right through to the end of their life.

There has historically been limited detailed, quantitative evidence on financial capability among DC savers, nor on how financial capability changes over the life course.

This study comprises secondary analysis of data from Wave 3 of the Wealth and Assets Survey (WAS), which covers the period 2010-2012, and uses data from Wave 1 and 2 of WAS where appropriate The research explored the characteristics of three specific groups:

- DC pre-retirees - individuals aged 55 to 64 with DC pension savings;
- DC retirees - individuals aged 65 and over with DC pension savings or a DC pension income;
- Low-income DC retirees - individuals aged 65 and over with DC pension savings or a DC pension income whose equivalised household income is below the median.

To provide context for these groups and to understand how different aspects of financial capability vary over the life course, the research also explored variations in characteristics by 10-year age band for the whole adult population.

Understanding DC retirees

The majority of DC pre-retirees and DC retirees are male and married. Two-thirds (64%) of DC retirees report a longstanding illness, disability or infirmity, rising to 70% of low-income DC retirees.

Income and assets

Although 91% of DC retirees own their home, 32% of the low-income DC retiree group rent, as do 15% of DC pre-retirees.

Among DC pre-retirees, median net property wealth is £180,000, and 5% have a buy-to-let investment.

The median (average) level of net financial assets is £40,000 among DC pre-retirees, £30,000 among DC retirees and £8,000 among low-income DC retirees. However, distribution is skewed: 25% of DC pre-retirees have at least £320,000, and 5% of low-income DC retirees have at least £345,000, suggesting some could annuitise their financial wealth to increase their income if they wished.

Interestingly, although financial wealth declines with age, the financial wealth individuals have in their current account actually increases.

Use of financial products

The most common financial products found across the population are savings accounts and ISAs, although one quarter (23%) of DC pre-retirees and one-third (34%) of low-income DC retirees have neither. Among DC retirees, 20% have fixed-term investment bonds and 8% have unit or investment trusts, dropping to 12% and 2% for low-income DC retirees.

Across all age groups, general insurance is the most common product recently taken out, followed by an investment product among older age groups, for example, 15% of DC retirees, albeit dropping to just 6% of low-income DC retirees.

However, many individuals have not personally taken out any new financial products during the last two years, with over half of retirees falling in this group, 40% of DC pre-retirees and 57% of low-income DC retirees.

Financial decision-making

Among individuals who have personally taken out a financial product during the preceding two years, the study explored what information and advice was most influential in making a choice.

The most influential sources of information and advice among older people (cited by 21%) was information from product providers themselves, including websites. However, the most influential source of information and advice across all age groups was ‘best buy information’ cited by 33%, although influence falls steadily from 40% of the 25 to 34 age group, to 15% of those aged 75 to 84.

Across all age groups, the next most influential source of information in choosing financial products – around 12% - was friends or family. In contrast to other information sources, the influence of friends or family across age groups is U-shaped, i.e. high among those aged 16 to 24 (22%) before dropping to 7% of 45 to 64, before rising to 20% of those aged 85%.

Conversely, just over one in five of the 65+ age group say they did not collect any information in choosing a financial product, with the prevalence rising steadily from the age of 55 to 64 (13%) to 85+ (33%). Among DC retirees, 17% did not collect any information, rising to 24% of low-income DC retirees.

Financial management and budgeting

Two-fifths (41%) of DC retirees check their current account just once a month or less, rising to 47% of low-income DC retirees, and 68% of the 85+.

However, the proportion of the population who describe themselves as very organised rises steadily with age, as does the percentage of each age group who report that they are keeping up with bills and credit commitments. Similarly, the proportion of individuals who report they never run out of money before the end of the month rises from 33% of the 16 to 24 age group to 87% of the age 85+ age group.

Individuals are also more likely to report their income is adequate as they age, including 82% of DC retirees and 65% of low-income DC retirees. Retirees were much more likely to report they could cope for 12 months or more with a one-quarter drop in their income level, including over 60% of DC retirees. For low-income DC retirees, just 29% reported they could cope for 12 months or more.

Savings, risk and financial position

Many older people deliberately save from their income. Indeed, despite being above retirement age, 49% of the 65+ population reported saving during the preceding two years, rising to 56% of DC retirees. By far the most common motivation for saving was against unexpected expenditure. Looking ahead, 44% of the 65+ population report they are likely to save money during the next 12 months, rising to 50% of DC retirees, but dropping to 38% of low-income DC retirees.

Across most age groups, unexpected expenditure was significantly the most cited motivation for such planned saving.

‘Accidental’ saving - i.e. unspent income in your current account at the end of the month - is highest among DC retirees (62%) and increases overall with age. Over half of retirees report that they leave money left over at the end of the month in their current account. One in five DC retirees leave the money in a savings account, and 12% move it from a current account to savings account. Interestingly, among all the groups studied, low income DC retirees are most likely to keep left over money in a current account.

As individuals age, they are significantly more likely to report they always have money saved for a rainy day.

People’s attitudes to investment risk are consistent across age groups, with DC retirees particularly likely to agree that it is better to play it safe with your savings and investments. However, a hardening of attitudes against investment risk is observable as individuals age. Nevertheless, most individuals accept that a good return on investment is associated with risk, although people are less likely to agree with this as they age, and agreement is lower among low-income DC retirees.

Financial engagement

The main economic trend that individuals keep an eye on is changes in interest rates, including 50% of DC pre-retirees. Around one in three DC pre-retirees and DC retirees keep an eye on changes in inflation, although again, overall propensity declines with age. Less than one quarter of low-income DC retirees monitor inflation.

Just 16% of the 65+ age group keeps an eye on changes in the stock market. Although once more, propensity again declines with age, it is higher (25%) among DC pre-retirees and DC retirees, albeit very low (11%) among low-income DC retirees. Less than one in 10 (8%) of the 65+ population report keeping an eye on financial product best buy tables. Once more, propensity declines with age, is higher (13%) among the DC retiree group, but lower (4%) among the low-income DC retiree group.

Conversely, nearly 30% of DC pre-retirees and DC retirees do not keep an eye on any economic trends, rising to 39% of all individuals aged 65+ and 41% of low-income DC retirees. More widely, the propensity to not monitor any economic or financial changes rises with age to 57% of the 85+ group.

1.Introduction

1.1. Background to the study

This report describes the results of quantitative research into the characteristics and financial capability of individuals in Great Britain above or just below retirement age who have 'Defined Contribution' (DC) pension savings or receive an income from a life annuity.

The research comprises original, secondary analysis of a nationally representative, large-sample social survey.

The principal driver for the study was the UK government's announcement in Budget 2014 of a change in the taxation of DC pension savings - removing the obligation for individuals to convert DC savings into a secure pension income at retirement.

Following implementation, individuals with DC pension savings over the age of 55 will be able to withdraw as much of their DC pension savings as they wish, with withdrawals taxed at their marginal income tax rate rather than the previous deliberately punitive rate of 55%.

In this way, the government effectively scrapped the rule requiring the compulsory conversion of DC pension savings into a secure retirement income – which for most DC savers meant purchasing an annuity. This rule reflected the so-called 'annuities deal' that had formed the basis of UK pensions policy since the Finance Act of 1921.

The outcomes resulting from the changes announced in Budget 2014 will ultimately depend on the behaviour of individuals with DC pension savings from the age of 55, right through to the end of their life, rather than just at the point of retirement.

Recognising this significant increase in personal responsibility, the government also announced a 'guidance guarantee' – subsequently branded 'Pension Wise - a free, generic information and guidance session for individuals with DC pension savings aged 55 and over to help inform and direct their retirement income decisions.

1.2. Aims and objectives

Although the historic changes announced in Budget 2014 represented a significant increase in personal responsibility for decision-making around DC pension savings, there has historically been limited detailed, quantitative evidence on financial capability among DC savers, nor on how financial capability changes over the life course.

Given the absence of such evidence, the Strategic Society Centre undertook original quantitative research to fill this gap in partnership with NatCen Social Research, and made possible by the support of the Joseph Rowntree Foundation (JRF).

The research aimed to answer a number of questions, including:

- Who are DC pension savers and what are their characteristics, both before and after the age of 65?
- What are the characteristics of low-income retirees with DC savings or income, for whom the marginal impact of poor decisions around their DC savings will be the greatest?
- To what extent do DC retirees display aspects of financial capability relevant to the Budget 2014 changes – such as using 'best buy tables' or monitoring changes in inflation – and how do these aspects of financial capability vary over the life course.

1.3. Overview of research

The research explored the characteristics of three specific groups:

- **DC pre-retirees** - individuals aged 55 to 64 with DC pension savings;
- **DC retirees** - individuals aged 65 and over with DC pension savings or a DC pension income;
- **Low-income DC retirees** - individuals aged 65 and over with DC pension savings or a DC pension income whose equivalised household income is below the median.

To provide context for these groups and to understand how different aspects of financial capability vary over the life course, the research also explored variations in characteristics by 10-year age bands for the whole adult population.

In this way, the research provides:

- Descriptive information on the actual characteristics and behaviour of individuals with DC pension savings or income;
- A dynamic understanding of how these characteristics and behaviour vary over the life course, particularly in late old age.

1.4. Defined Capability: Pensions, financial capability and decision-making among retirees

In the next chapter, the policy context and themes of the research are described, exploring how different themes of the research relate to policy development. **Chapter 3** reviews the academic literature relevant to the study, including previous research on financial capability, while the fourth chapter sets out the methodology and data employed in the analysis. **Chapter 4** set outs the methodology and data used in the study

Chapter 5 describes the core characteristics to understand DC retirees and other groups, while **Chapter 6** looks at the income and assets of the various groups examined. **Chapter 7** explores use of financial products among the different groups examined in the study, while

Chapter 8 explores their financial decision-making, and **Chapter 9** examines their financial management and budgeting. Chapter 10 examines attitudes to savings, risk and financial position, while **Chapter 11** looks at variations in financial engagement.

2.Policy context and issues

2.1. Background: The 'annuities deal' and UK pension policy

To ensure that pension savings are used to fund a pension income – i.e. an income guaranteed until the end of a person's life – successive UK governments coupled voluntary participation in private pension saving with compulsory conversion of these savings into a secure pension income at retirement.

The so-called 'annuities deal' had its origins in the Finance Act of 1921, which introduced the "mandatory annuitisation of pension funds".[1] Under the annuities deal, UK private pension savings benefited from exceptional levels of tax-relief compared to other types of saving product. However, in return, individuals were expected to convert their pension savings into a secure pension income that protects their income in retirement from longevity risk, i.e. uncertainty over how long they will live for and the risk of running out of money.

Under the annuities deal, most UK workers with defined contribution (DC) pension savings converted these savings into a secure pension income by purchasing an annuity, which is an insurance product that pays out a guaranteed income for the rest of someone's life in return for an upfront lump sum payment from a worker's pension pot.

For many years, the annuities deal was policed in relation to DC pension savings by punitive tax charges: although in theory individuals could take their pension pot at retirement wholly as cash, beyond the first 25% of its value (the 'tax-free lump sum'), individuals were charged punitive tax-rates of 55% of the money withdrawn. As a result, very few individuals exercised this option.

2.2. Problems with the UK annuity market

Although a foundation stone of UK pensions policy for nearly a century, in recent years several factors have contributed to growing public disquiet and hostility toward the compulsory annuitisation framework for DC pension savers. These factors include:[2]

- Declining 'gilt' rates – the average income paid by annuities ('annuity rates') has fallen in recent years, reflecting changes in the underlying capital market instruments that insurance companies invest in to pay annuity incomes, especially long-term governments bonds ('gilts'). To a significant extent, falling gilt rates result from the policy of 'quantitative easing' pursued by central banks in the wake of the 2008 financial crisis and subsequent global economic downturn;
- Increasing longevity – continued increases in average life expectancy have extended the number of years during which annuities are expected to pay an income, thereby increasing the uncertainty (risk) facing annuity providers, further depressing annuity rates;

[1] Finance Act (1921), quoted in HM Treasury (2014) *Freedom and choice in pensions*, London
[2] For a more detailed review of these issues, see FCA (2014) *Thematic Review of Annuities*, London

- Inadequate competition – despite efforts to encourage workers retiring with DC pension savings to shop around for an annuity via the 'open market option' in order to secure the best income available, particularly given their individual circumstances and characteristics (for example, a longstanding health condition), many individuals continued to default to the annuity offered by their pension saving provider, which has sometimes represented poor value for money.

As a result of these multiple factors, annuities progressively experienced growing criticism from UK consumers, politicians and the media, with some stakeholders questioning whether they should continue to be the default 'at-retirement' product for most DC pension savers.

2.3. Budget 2014

In this context, Budget 2014 effectively scrapped the annuities deal for DC savers by downgrading the tax-rate for withdrawals from pension pots from April 2015, for individuals aged 55 or over, from 55% to a person's marginal income tax rate, i.e. treating withdrawals from DC pension pots as simply a form of taxable income for the year it is received.

Budget 2014 therefore imposed a radical change on UK pensions: from April 2015, DC pension savers were completely released from any requirement to obtain a secure pension income with their pension savings and can, if they wish, withdraw their entire pot to spend on leisure items, holidays and bequests, etc.

As stated by the government at the time of the announcement, the Budget 2014 change to pension taxation reflects two distinct beliefs that represent a departure from the previous regime associated with the 'annuities deal'.

First, individuals are better placed than the state to understand their own retirement income needs and priorities, and manage their savings accordingly, so should be free of requirements as to how they use their DC pension savings. HM Treasury noted:

> "With the right consumer guidance, advice and support, people should be able to make their own choices about how to finance their retirement. Everybody's circumstances are unique and it should not be for the State to dictate how someone should have to spend their savings."
>
> HM Treasury (2014) *Freedom and choice in pensions*, London

Second, if individuals choose to spend down all their pension savings before they die, that is their prerogative, but this is not a 'negative' outcome given the availability of the higher, flat-rate 'New State Pension' for individuals retiring from 2016 as an 'income floor' for pensioners. In short, if individuals choose to entirely deplete their DC pension savings on short-term luxuries – such as expensive cars - the New State Pension will prevent them falling into poverty.

Following Budget 2014, the outcomes resulting from the UK's DC pensions policy, and the retirement income and welfare of millions of UK retirees with DC pension savings, ultimately hinges entirely on the decision-making and financial capability of individuals approaching - and beyond - retirement age.

In recognition of this significant increase in personal responsibility for financial welfare in old age, the government announced a 'guidance guarantee' at the time of Budget 2014 – subsequently named Pension Wise - free, semi-personalised information and guidance for individuals aged 55 and over with DC savings. However, in the absence of evidence from piloting, the government was unable to set out how many individuals would be likely to take up the offer of the guidance guarantee before its launch, nor the influence this guidance would have on the decisions of individuals, leading some stakeholders to question its long-term effectiveness.[3]

2.4. Options for retirees

The April 2015 changes give DC pension savers several options as to how to use their DC pension pot:

- Annuity - purchase an annuity with some or all of their fund, whether from their pension scheme provider or via the 'open market option';
- Cash - full or partial crystallisation of the pension pot as cash, with receipt of the cash value of the pot subject to a person's marginal income tax rate for the year it is received;
- Drawdown – leave the pension pot invested, but draw down in stages.

Up to 25% of a person's DC savings can be taken tax free if individuals opt to crystallise ('cash-in') and take their entire pension pot. Alternatively, if individuals draw down their fund in stages, the first 25% of these lump sums will be tax free.

If individuals do opt to draw on their pension savings – whether as cash or drawdown - individuals have several options:

- Investment - invest their savings, for example in property, equities or other investments;
- Consumption - spend their savings, whether on everyday outgoings, holidays, leisure activities or home adaptations;
- Bequests - gift their savings to a child or other family member;
- Savings - leave their pension savings in an accessible, 'liquid' form, such as a current account, savings account or tax-incentivised ISA.

Importantly, the experience of other countries with voluntary annuitisation systems consistently shows very low levels of annuity purchase when annuitisation is voluntary. An extensive field of academic research has developed over the last fifty years into this so-called 'annuity puzzle', which is reviewed in the next chapter.

2.5. Financial decision-making and policy outcomes

The outcomes that result from the historic change to UK pensions policy announced at Budget 2014 will ultimately be determined by the financial decision-making of millions of individuals with DC pension savings. Indeed, it is important to note that these decisions will not be limited to the period around retirement age: those individuals who choose not to annuitise, withdraw their DC pension savings and manage or spend this wealth in other ways,

[3] For example, see Eley J (2014) *Guidance will be offered, but will savers take it?*, Financial Times, London

will potentially be required to go on making decisions about their DC savings until the end of their life, which can be 30 to 40 years after retirement.

In this context, it is important that UK policymakers, financial services providers and other stakeholders have the best possible evidence base available to understand the characteristics of DC retirees and how they are likely to behave over coming decades.

Defined Capability therefore improves this evidence base by exploring different aspects of 'financial capability' broadly defined, such as use of different financial products, attitudes to investment risk and engagement with economic trends such as changes to interest rates and the performance of stock markets.

3.Literature review

3.1. Background

Defined Capability maps different aspects of the 'financial capability' of DC retirees and other groups in the UK, in order to inform subsequent policy development in the context of the UK's transition from a system of near-compulsory annuitisation to a system of voluntary annuitisation.

Across financial services policy and associated research, 'financial capability' is an umbrella concept, that is used to mean different things in different contexts – for example, household budgeting, shopping around for financial products - and has been the subject of previous research of varying types.

With a particular focus on older people, this chapter therefore briefly reviews the literature on:

- Financial capability;
- Financial decision-making and retirement;
- Cognitive function and ageing;
- Annuitisation choices in countries with voluntary annuitisation systems.

3.2. Financial capability

Previous quantitative social research in the UK has established variations in 'financial capability' among different age groups.

A 2006 study funded by the UK's Financial Services Authority (FSA) deployed a multi-dimensional measure of financial capability.[4] The study found that levels of financial capability appear to increase steadily with age, peaking in the 60 to 70-year old age group, before declining among individuals aged 70+. This has sometimes been interpreted as a 'life-stage' effect: individuals accumulate financial knowledge and experience over their lifetime, but the impact of declining cognitive ability in old age reduces financial capability.

Subsequent research undertaken by the Institute for Social and Economic Research (ISER) using data from the British Household Panel Survey (BHPS) found a statistically significant association between age and financial capability across three indices deployed in the analysis.[5] In particular, people aged below 45 have below average financial capability, while those aged 55 and over have above average financial capability.

As the inverse of financial capability, one US study looked at the incidence of financial 'mistakes' - suboptimal use of credit card balance transfer offers, mis-estimation of the value of one's house, and excess interest rate and fee payments – and how this varies among

[4] Atkinson A et al. (2006) *Levels of Financial Capability in the UK: Results of a baseline Survey*, FSA, London
[5] Taylor M et al. (2009) *Financial capability and wellbeing: Evidence from the BHPS*, FSA, London

different age groups. The study suggested that middle-aged adults make fewer financial mistakes than younger and older adults, again suggesting that the benefits of experience that accumulate with age are ultimately subverted by declining cognitive ability.[6]

More recently, a US study evaluated financial sophistication in the American population over the age of 50, finding that many older respondents are not financially sophisticated: they fail to grasp essential aspects of risk diversification, asset valuation, portfolio choice and investment fees. Subgroups with notably lower levels of financial sophistication include women, the least educated, BME groups and those aged 75 and over.[7]

3.3. Financial decision-making and retirement

A number of studies have examined the way in which individuals and couples make financial decisions around retirement, both before and after retirement age.

A qualitative study for the Department for Work and Pensions (DWP) of financial decision making by couples in the UK found that where couples had actively made financial decisions, this was often in response to 'life triggers' such as marriage or first-time parenthood, or 'financial triggers' involving a change to the household's income.[8] Discussions about possible courses of action began after this trigger took effect, usually increasing in momentum over time, and culminating in the final decision.

The study also noted that in most couples there was an 'alpha' and a 'beta' partner, with the former taking more control over financial issues, although not necessarily being financially confident or knowledgeable. In relation to pensions, the study found that couples typically perceived pensions as individual rather than joint or household products, and that even older couples discussed retirement only occasionally, and few people had been active in making provision for retirement.

The study noted that couples saw retirement planning as a process involving long-term decisions and long-term consequences: no immediate or tangible benefit was recognised as a result of beginning to contribute to a pension. Consequently, it could be difficult for momentum to build in the same way as it did for other financial decisions. The research found that couples were distracted from long-term financial planning by three different types of inertia:

- The most prevalent type, 'day-to-day inertia', stemmed from the ongoing and constant need to manage the couple's home and family;
- 'Material inertia' took effect when couples were restricted in their planning by low levels of disposable income, limiting their scope for decision making;
- 'Emotional inertia' resulted from couples' underlying fear or sense of intimidation when faced with financial products and decision making.

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[6] Agarwal S et al. (2009) *The Age of Reason: Financial Decisions over the Life-Cycle with Implications for Regulation*, Brookings Papers on Economic Activity

[7] Lusardi A et al. (2014) "Financial literacy and financial sophistication in the older population" in *Journal of Pension Economics and Finance*, available on CJO2014. doi:10.1017/S147474721400003

[8] Wood A et al. (2012) *Household financial decision making: Qualitative research with couples*, Research Report No 805, Department for Work and Pensions, London

Qualitative research undertaken after Budget 2014 with individuals aged 55 to 70 with DC pension savings, focused on those with sufficiently large pension pots such that they may prefer to leave these invested rather than withdrawing them in their entirety as a cash lump sum.[9] Key findings of the research, published by the Pensions Policy Institute, included:

- Planning horizons are short, focusing on the next year or two rather than long term income needs – making it difficult to engage savers with detailed retirement planning ahead of, or even at, retirement;
- Generally stated preferences are to take a lump sum at the start of retirement (often using the tax-free cash lump sum) and then draw a gradual income, sometimes taking more out in the early years when they expected to be most active. However it isn't always appreciated how taking a lump sum might impact on their remaining income over the course of the retirement;
- The 55-70 year olds were not confident with equity markets or making direct investments themselves and tended to invest their non-pension savings in cash-based investments such as ISAs – suggesting that pension savings accessed as one or a series of lump sums may simply be placed in "safe" or low-return investments;
- This was sometimes combined with occasional false confidence in their ability to invest in something "safe" or "better" outside of a pension. This typically included either cash investments or property but there was evidence that the tax implications of drawing down all of a pot at once had been missed by some and few had considered the associated costs and level of risk of investing in property;
- Those interviewed were initially drawn to investment options in retirement that involved them taking little or no investment risk to protect their capital and guard against losses;
- However, they lacked any understanding of how investment choices might interact with the average level of income they might receive over the course of their retirement and, in particular, how some risk might be required to deliver investment returns that can protect them against inflation.

3.4. Cognitive function

Budget 2014 changes to rules on DC pension saving principally affect those aged 55 and over. In this context, it is relevant to note research on variations in cognitive function among different older age groups.

Analysing data from the English Longitudinal Study of Ageing (ELSA), Huppert F et al. (2004) were able to identify age-related reductions in a range of cognitive performance tests relating to memory (e.g. word recall) and executive functioning (e.g. numerical ability, visual search, mental speed).[10]

A complementary study using ELSA by the Institute for Fiscal Studies (IFS) examined in detail declines in numeracy among the older population in England.[11] The findings of the analysis

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[9] Echalier M et al. (2015) *Supporting DC members with defaults and choices up to, into, and through retirement*, Pensions Policy Institute, London

[10] Huppert F et al. (2004) "Cognitive Ability" in Banks J et al. (2004) *Retirement, health and relationships of the older population in England: The 2004 English Longitudinal Study of Ageing (Wave 2)*, Institute for Fiscal Studies, London

[11] Banks J and Oldfield Z (2006) *Understanding Pensions: Cognitive Function, Numerical Ability and*

suggest a marked deterioration in the numeracy of older age groups that actually begins when individuals are aged 50-60, i.e. significantly ahead of retirement.

3.5. Annuitisation behaviour under voluntary annuitisation systems

The April 2015 change to DC pension rules transition the UK from a system of near-compulsory to voluntary annuitisation. However, across multiple different countries with voluntary annuitisation frameworks for DC pension savings, an extensive academic literature exists on the so-called 'annuity puzzle', i.e. the very low rate of voluntary annuity purchases observed in multiple countries, despite the fact that economic modelling suggests a rational, 'utility maximising' individual with uncertain life expectancy would in fact annuitise all of their wealth.

Three broad categories of explanations for the annuity puzzle have been studied in academic research on the topic.[12] Potential **supply-side factors** that may explain the annuity puzzle include:

- **Poor value for money** – the life annuities on offer to consumers do not offer good value-for-money;
- **Aggregate mortality risk** – the potential for medical advances or other changes to cohort life expectancy depresses the annuity rates that providers will offer;
- **Incomplete markets** – annuity providers fail to offer annuity products that reflect the preferences of consumers sufficiently closely.

'Rational' demand-side factors for explaining the annuity puzzle are those that assume individuals are logical, rational and informed. They include:

- **Bequest motives** – individuals want to preserve their wealth in order to leave it as an inheritance;
- **'Consumption' preferences around housing** – since owner-occupied homes represent a good that is also a form of 'annuitised consumption', individuals prefer to allocate their wealth to housing as a guaranteed 'consumption stream', rather than an annuity as a guaranteed 'income stream';
- **'Pre-annuitisation' through state pension and other sources** – some individuals, particularly with low levels of overall saving, may feel they have sufficient annuitised income from other sources, such as the state pension or other Defined Benefit (DB) pension provision.

Reflecting growing interest in behavioural economics across multiple academic disciplines, researchers have investigated **'behavioural' demand-side factors** that may explain the annuity puzzle, which emphasize psychological responses and various types of non-rational behaviour. These include:

Retirement Saving, IFS, London

[12] For a more detailed review of the literature on the 'annuity puzzle', see Lloyd J (2014) *New Annuity Era*, Strategic Society Centre, London

- **Framing** – presented with the option of an annuity in an ‘investment frame’ – rather than a ‘consumption frame’ – individuals judge it a poor or risky investment compared to alternatives;
- **Hyperbolic discounting** – individuals excessively discount the value of receiving income in the future, as opposed to the present;
- ‘**Loss of control**’ – individuals may experience a sense of ‘control’ in relation to their pension pot, which they are reluctant to give up through annuitisation.

Crucially, the number of factors identified in research as explaining the annuity puzzle suggest it may be ‘over-determined’, with the result that policy interventions to boost the prevalence of annuitisation may struggle to be successful.

4.Methodology and data

4.1. Methodology

Defined Capability used analysis of Wave 3 of the Wealth and Assets Survey (WAS) to build a picture of three groups of key interest to policymakers in the wake of Budget 2014:

- **DC pre-retirees** - individuals aged 55 to 64 with some amount of DC pension savings;
- **DC retirees** - individuals aged 65+ with some amount of DC pension saving or a DC pension income;
- **Low-income DC retirees** - individuals aged 65+ with some amount of DC pension saving or a DC pension income and their total equivalised[13] household income is below the median for their age group.

The low-income group was included because:

- DC retirees with the highest incomes may not be reflective of the broader DC retiree population and in fact may skew the statistical average;
- For low-income DC retirees, the marginal impact of poor decision-making on their retirement income and wealth will be greater, so it is particularly important for policymakers to obtain a detailed understanding of the levels of financial capability in this group.

Findings among these three groups are presented in this report alongside analysis of all individuals aged 16 and over, grouped by 10-year age-band.

It should be noted that these groups are not mutually exclusive. DC pre-retirees are also included in analysis of 55 to 64 year olds and DC retirees are also included the top three age groups of 65 to 74, 75 to 84, and 85+. Similarly, low-income DC retirees are included within the DC retirees group and are therefore also in the top three age groups.

This report uses the Wealth and Assets Survey (WAS) to explore DC pre-retirees, DC retirees and Low-income DC retirees and compare them to pensioners and individuals as a whole. The study focuses on the following areas:

- Income and assets
- Financial products
- Financial decision making
- Financial management
- Saving, risk and financial position
- Financial engagement

[13] Equivalisation takes into account the size and composition of the household, so that the incomes of different types of households are comparable.

The report presents a descriptive analysis, mainly showing the proportions for each group, for example, the proportion of males and proportion of those who rent their own homes. Some of the analysis of financial information shows the quartile and 95th percentile amounts for each group, for example, in relation to net property wealth.

4.2. Data

The research comprises secondary analysis of data from Wave 3 of the WAS, which covers the period 2010-2012, and uses data from Wave 1 and 2 of WAS where appropriate.[14]

The WAS collects information about the economic wellbeing of households and individuals in Great Britain. The WAS is a longitudinal survey, which commenced with a first wave of interviews carried out over two years from July 2006 to June 2008. The first wave of WAS ran during 2006-2008 and sampled all private households in Great Britain. The second wave covered July 2008 to June 2010 and the third wave commenced in July 2010, running until June 2012. Interviewees in each wave are followed up and invited to participate in the next wave of the survey two years later, thereby ensuring the data tracks changes in each person's economic position over two-year periods.

The WAS asks people about their assets and liabilities in order to estimate household and personal wealth. This includes information on: property, financial, physical and private pension wealth; savings, debt, borrowing and arrears. The survey also asks people about their attitudes to debt, saving and retirement. A range of demographic data is also available such as sex, age, employment status, socio-economic classification, geography and education.

Funding for the WAS came from the Office of National Statistics (ONS); Department for Work and Pensions (DWP); Department for Business, Innovation and Skills (BIS); HM Treasury (HMT); HM Revenue & Customs (HMRC); Department for Communities and Local Government (DCLG) and the Cabinet Office.

[14] The WAS data was accessed through the UK Data Service: Office for National Statistics. Social Survey Division, Wealth and Assets Survey, Waves 1-3, 2006-2012: Special Licence Access [computer file]. 13th Edition. Colchester, Essex: UK Data Archive [distributor], February 2015. SN: 6415, http://dx.doi.org/10.5255/UKDA-SN-6415-9

5.Understanding DC retirees

Key results:

- **The majority of DC pre-retirees and DC retirees are male and married;**
- **64% of DC retirees report a longstanding illness, disability or infirmity, rising to 70% of low-income DC retirees.**

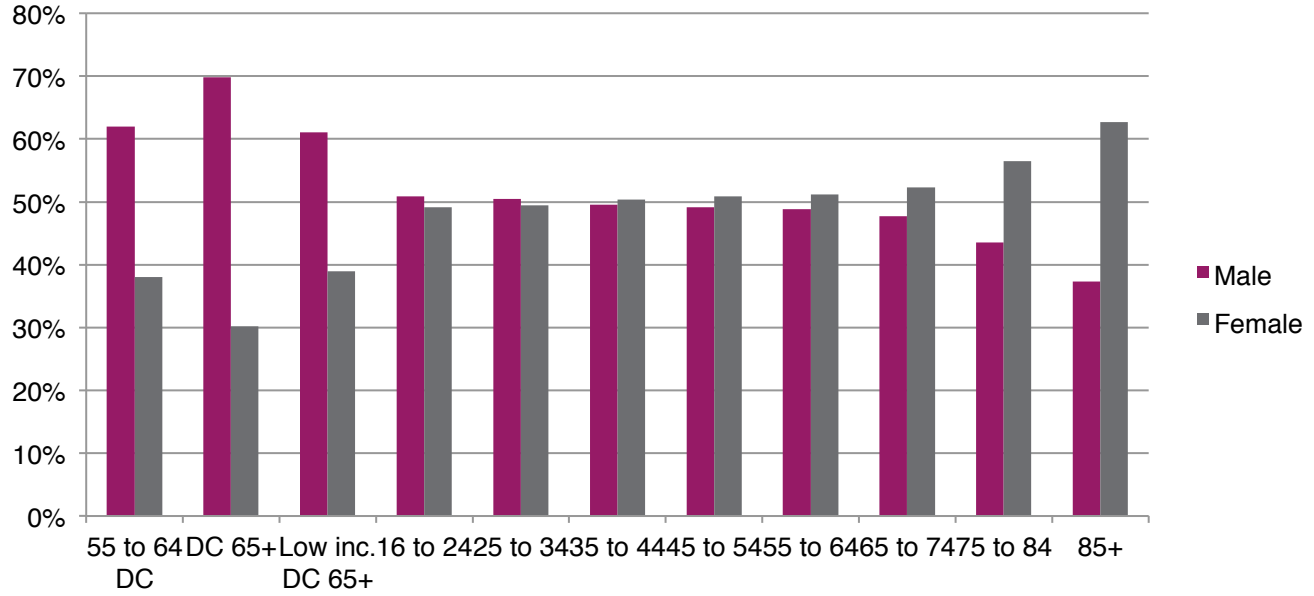
5.1. Introduction

This chapter describes the general characteristics of the three DC groups of interest, and how their characteristics compare to different age groups.

5.2. Demographic characteristics

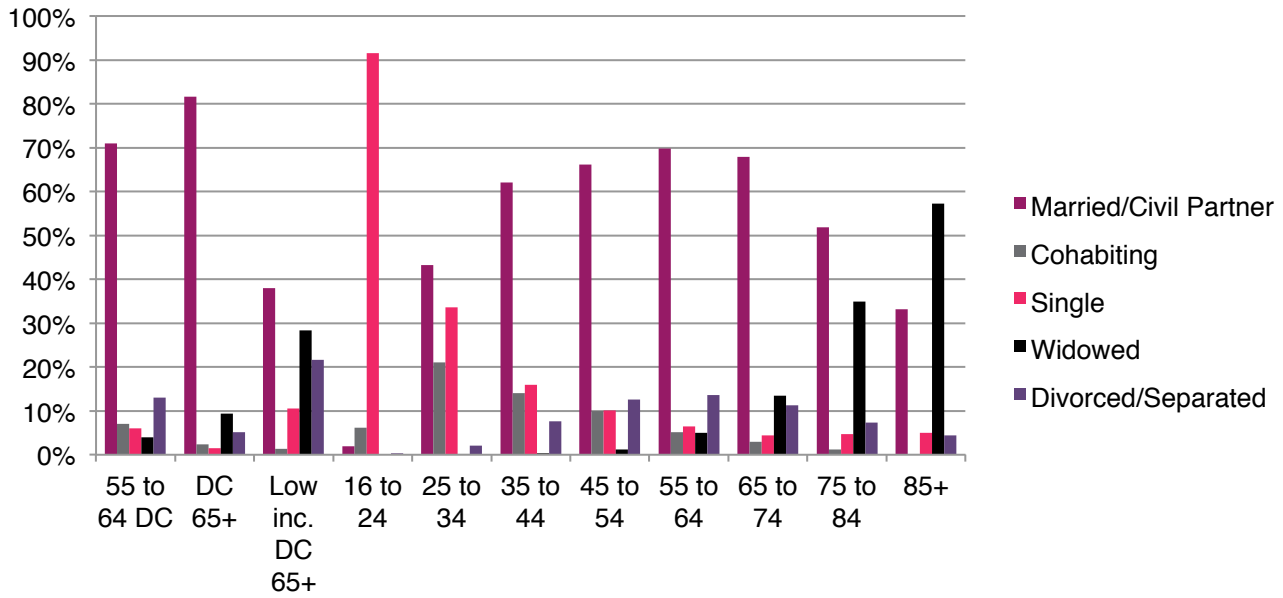
Individuals with DC savings or income in retirement were more likely to be male, even though women outnumber men in old age, reflecting differences in life expectancy. Among those aged 55 to 64 with DC pension savings, 62% were male, while among DC retirees, 70% were male. However, among low-income DC retirees, the gender gap was narrower.

Gender, 2010-2012 (WAS, Wave 3)



The majority of individuals with DC savings or income are married, except for those in the low-income DC group, half of whom were widowed or divorced, which itself may account for their lower household income.

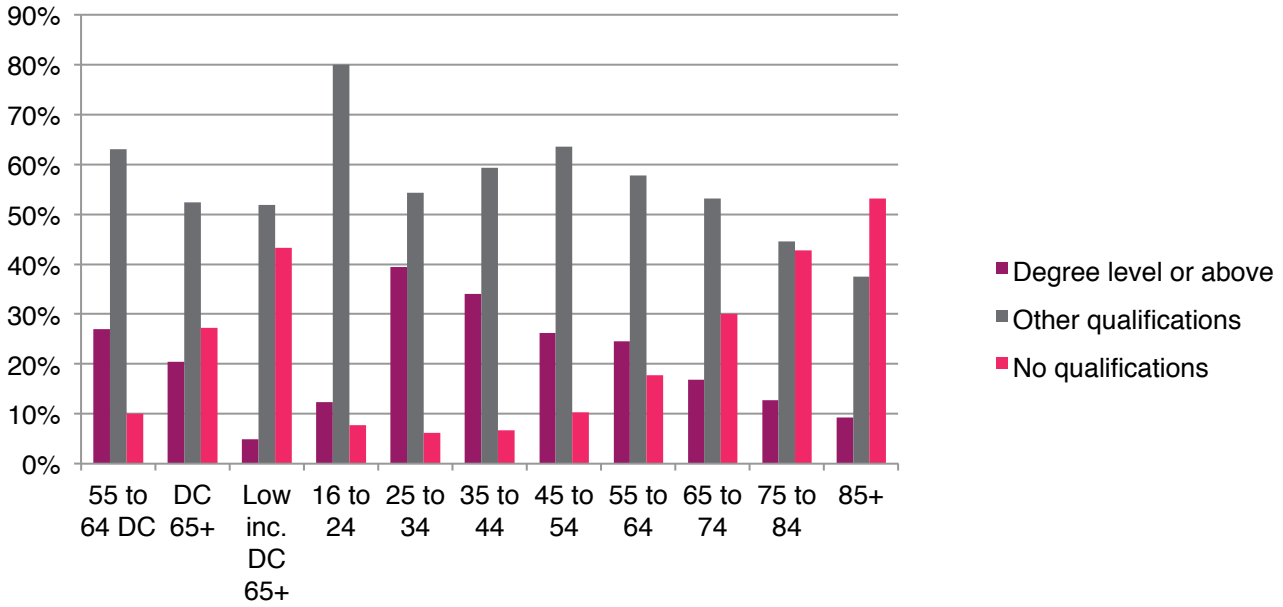
Partnership status, 2010-2012 (WAS, Wave 3)



5.3. Socio-economic characteristics

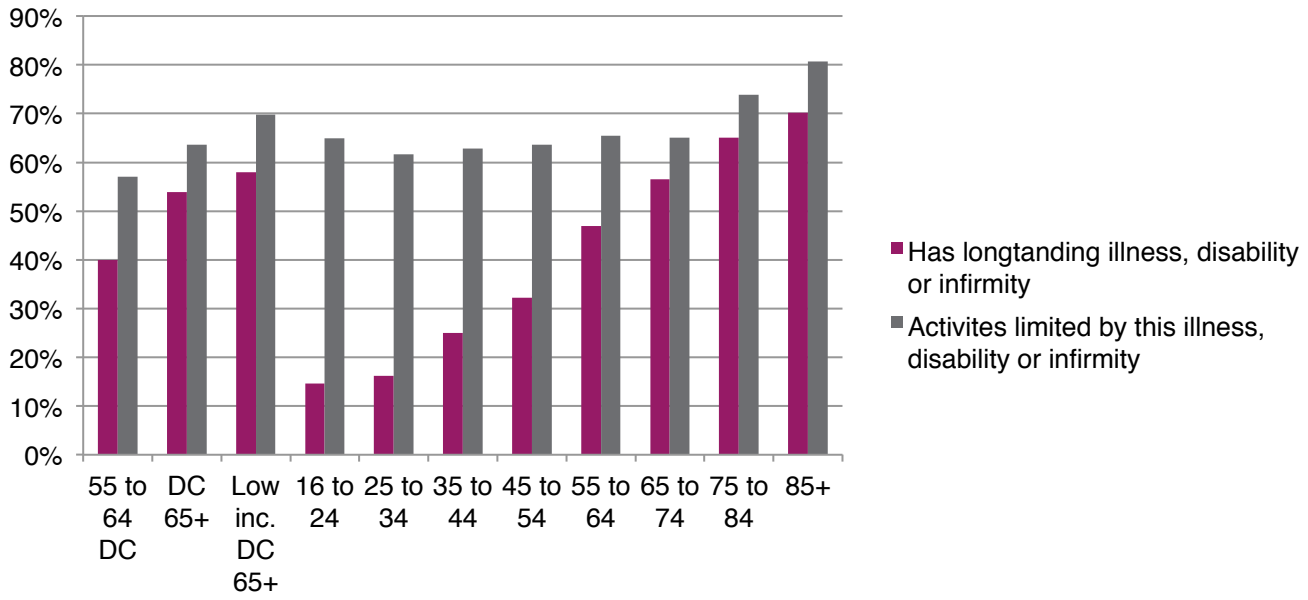
Less than one-third of people aged 55 to 64 with DC savings had degree level education, dropping to one in five of the DC retiree group. However, only 5% of the low-income DC group had degree level education, and 43% had no qualifications.

Level of education, 2010-2012 (WAS, Wave 3)



The following chart shows that around 40% of the pre-retiree DC group aged 55 to 64 report some longstanding illness or disability, although this is actually lower than the wider 55 to 64 age group, suggesting workers with DC savings are healthier than average. The chart also shows the proportion of individuals whose activities are limited as a result of their longstanding illness, disability or infirmity.

Longstanding illness, disability or infirmity, 2010-2012 (WAS, Wave 3)

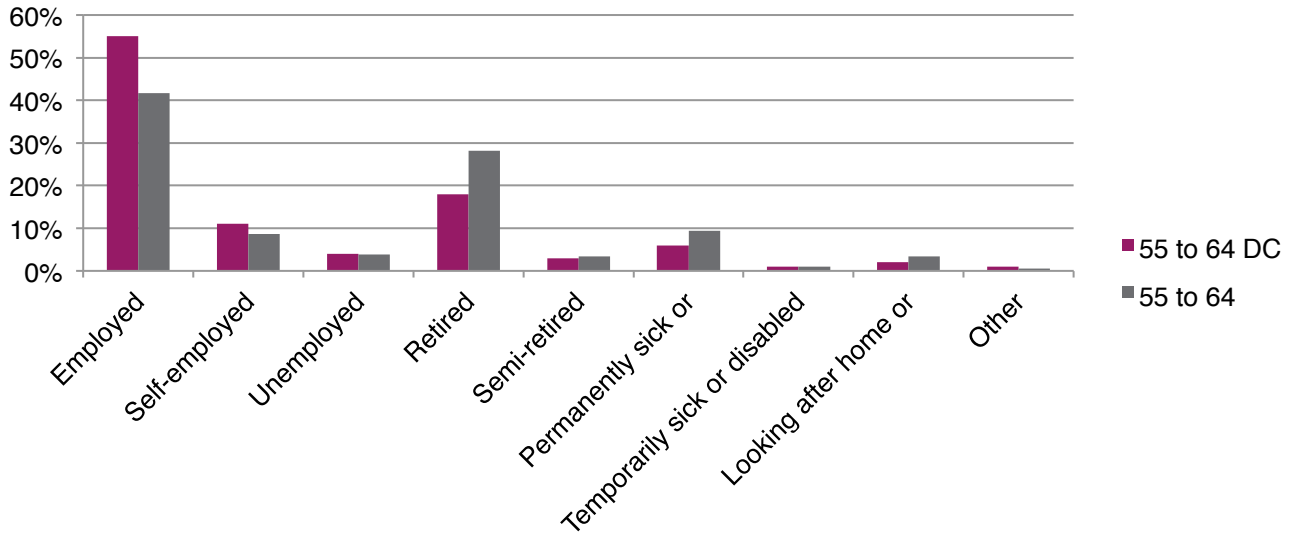


The incidence of longstanding illness, disability or infirmity steadily increases with age; by the age of 85+, 70% fall into this category. In assessing the extent that a longstanding illness or disability impacts on financial capability, this finding suggests that there may be a risk of lower financial capability among older age groups. Disability, for example, could impede visiting a financial advisor.

5.4. Early retirement

The following chart shows that compared to the wider age group, individuals aged 55 to 64 with DC pension savings are more likely to be in work (55% to 42%), and less likely to be retired (18% to 28%).

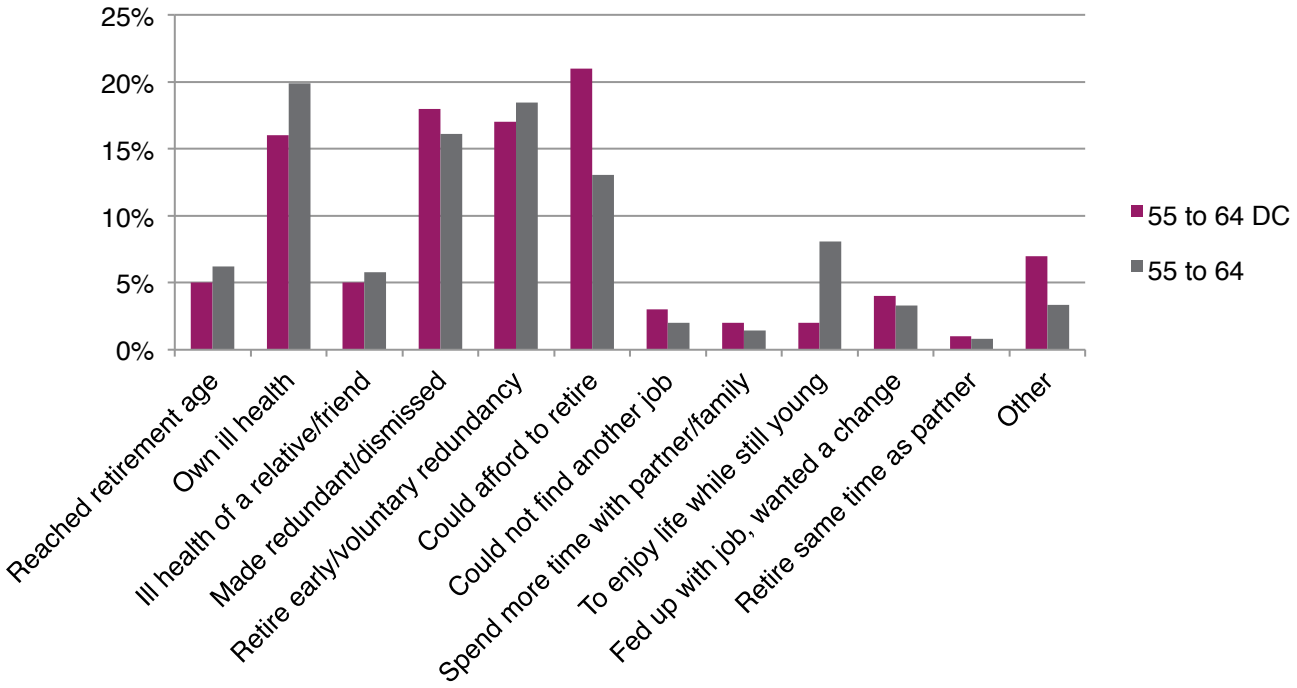
Current employment situation, 2010-2012 (WAS, Wave 3)



However, following the Budget 2014 changes, individuals will be able to access their DC pension savings from the age of 55, paying only their marginal rate of income tax on withdrawals. As such, the employment choices of some individuals with DC savings in this age group may change as a result.

The following chart shows the most commons reasons for taking early retirement among all individuals aged 55 to 64 who have done so, and among those in this age group with DC pension savings. The chart shows that the most common reason (21%) for early retirement among DC pre-retirees was that they could afford to, while 17% opted for voluntary redundancy and 18% describe themselves as retired following involuntary redundancy.

Reasons for early retirement, 2010-2012 (WAS, Wave 3)



This suggests that economic considerations played a part in the early retirement of over half of individuals with DC pension savings aged 55 to 64. In this context, the ability to access DC pension savings from 55 paying only marginal rate of income tax may result in an increase in the proportion of the DC pre-retiree group who take early retirement.

5.5. Conclusion

This chapter has reviewed the demographic and socioeconomic characteristics of individuals with DC pension saving. Overall, they are more likely to be male, well educated and healthy, and over half are likely to be married.

6.Income and assets

Key results:

- **Although 91% of DC retirees own their home, 32% of the low-income DC retiree group rent, as do 15% of DC pre-retirees;**
- **Among DC pre-retirees, median net property wealth is £180,000, and 5% have a buy-to-let investment;**
- **Median level of net financial assets is £40,000 among DC pre-retirees, £30,000 among DC retirees and £8,000 among low-income DC pre-retirees. However, distribution is skewed: 25% of DC pre-retirees have at least £320,000, and 5% of low-income DC retirees have at least £345,000, suggesting some could annuitise their financial wealth to increase their income if they wished.**
- **Interestingly, although financial wealth declines with age, the amount that individuals have in their current account actually increases.**

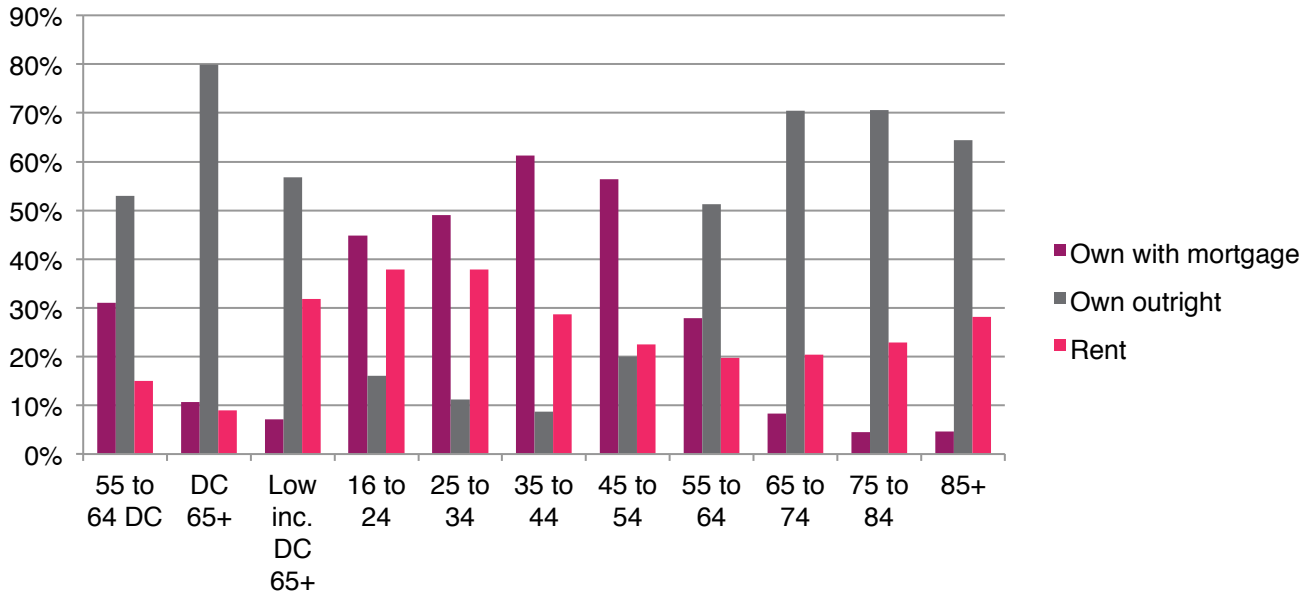
6.1. Introduction

This chapter explores the assets and income of individuals with DC pension savings and incomes.

6.2. Property wealth

Individuals with DC savings or income are more likely to own their own home. Indeed, among DC retirees, 91% own their home. In contrast, 32% of the low-income DC retiree group rent, which is actually higher than the level observed across the whole retired population.

Tenure, 2010-2012 (WAS, Wave 3)

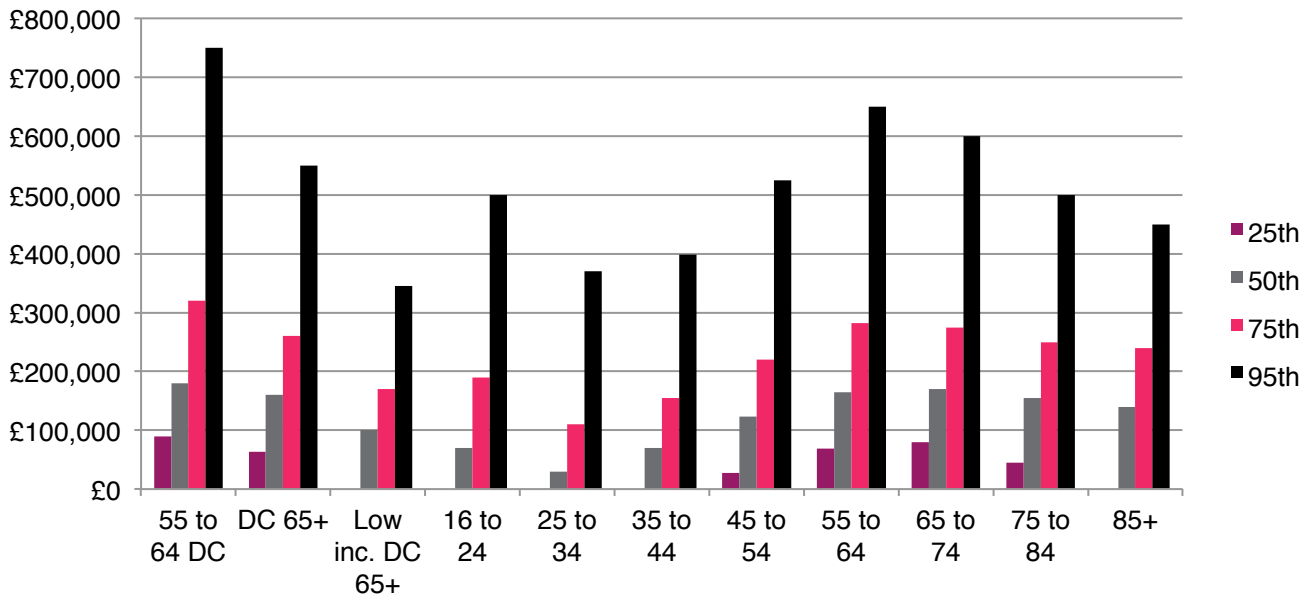


The research found that 31% of the DC pre-retiree group aged 55 to 64 had mortgage debt outstanding on their home. This suggests that following changes to the taxation of DC pension saving in April 2015, around one in three DC pre-retirees may be incentivised to use their DC retirement savings to pay off their mortgage.

For any individual with DC private pension savings who rents, decisions around what to do with their money can be complicated given their savings affect their entitlement to means tested benefit support for their rental costs from the state. In this context, it is interesting to note that around 15% of DC savers in the 55 to 64 age group rent, and these individuals may disqualify themselves from means tested housing support if they choose to withdraw their pension savings and retain this wealth as cash.

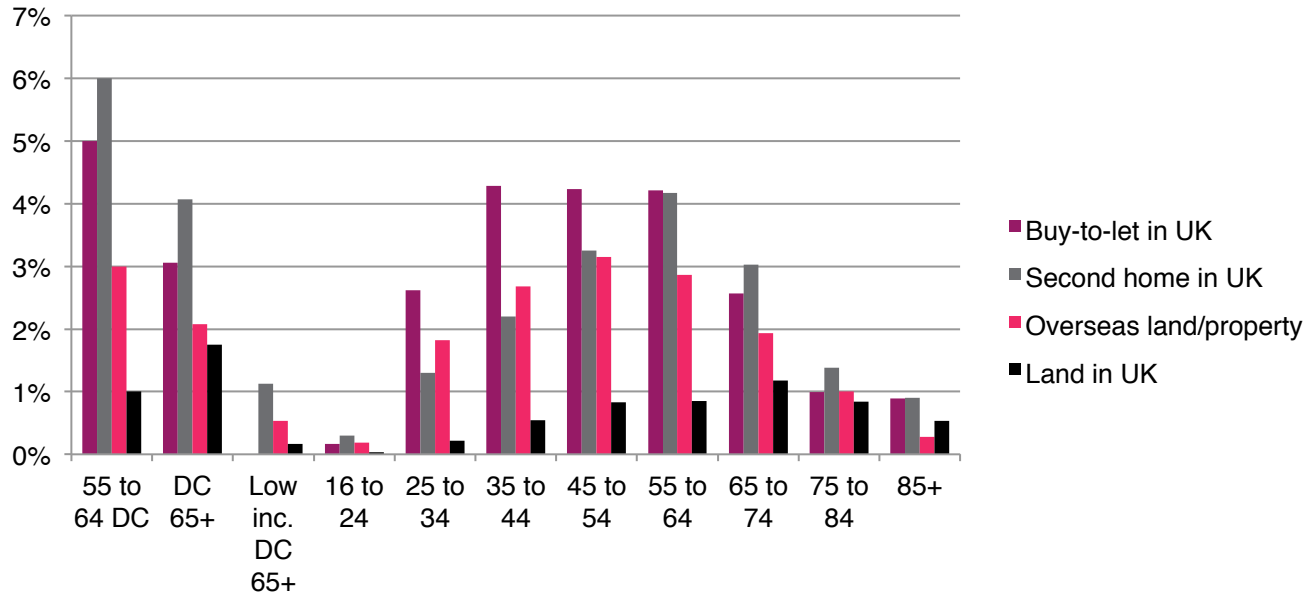
Tenure is a key predictor of property wealth. As found in multiple studies, substantial inequality exists in net household property wealth among individuals in different age groups, and across age groups, reflecting both patterns of tenure and regional variations in property prices. Among those aged 65 and over with DC pension savings or income, median net property wealth was £160,000, but among the low-income DC retiree group, median net household property wealth was just £100,000.

Net property wealth percentiles, 2010-2012 (WAS, Wave 3)



Some individuals with DC pension savings or income have other property assets besides their main home. Indeed, around one in 20 individuals aged 55 to 64 with DC pension savings have a buy-to-let property, and 6% have a second home.

Other land or property, 2010-2012 (WAS, Wave 3)



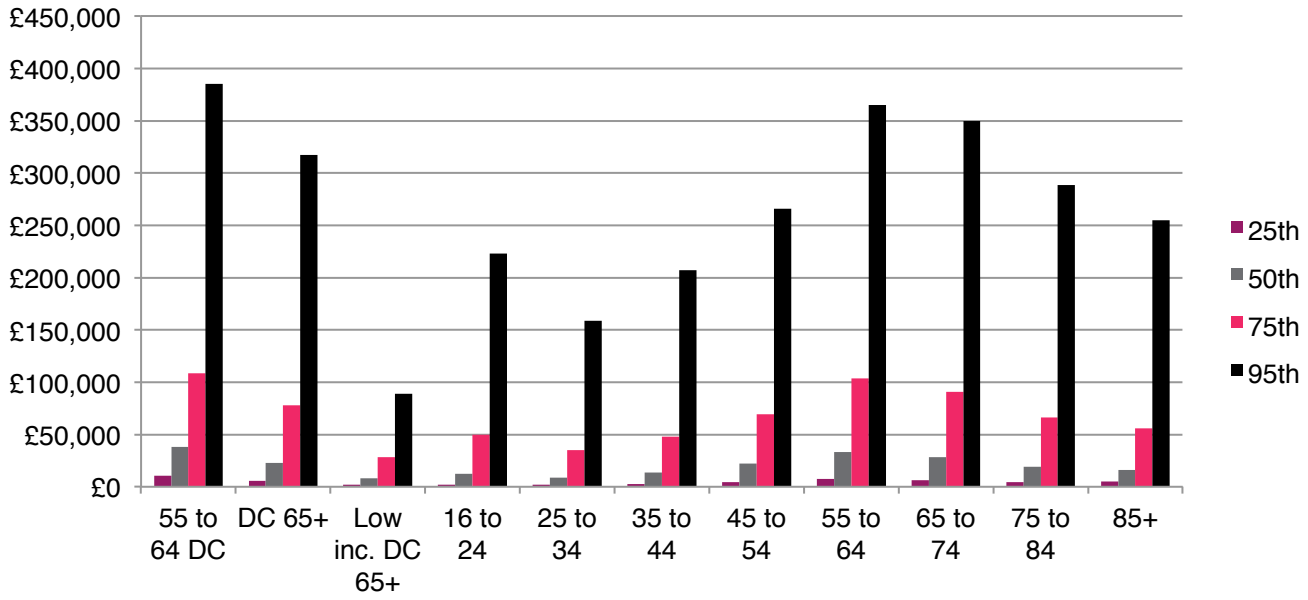
In the context of the Freedom and Choice changes to taxation of DC pension savings, some individuals may use enhanced access to their DC pension savings to expand their property portfolio, or pay off mortgage debt – for example, to pay off a buy-to-let mortgage – in order to increase the net income derived. It is therefore interesting to note that the prevalence of buy-to-let investments is higher among DC pre-retirees than any other group examined in this study.

6.3. Financial assets

Some individuals with DC savings or income maintain relatively high levels of financial assets (savings, ISAs, investments, bonds, etc.). Among those aged 55 to 64 with DC pension savings, median financial assets are nearly £40,000. Among DC retirees, the median amount is nearly £25,000; however, one quarter had at least £78,000 of financial assets.

Interestingly, among low-income DC retirees, 5% had financial assets of around £90,000 or more, suggesting some in this group could annuitise this wealth to increase their income, but choose not to. Median financial assets among low-income DC retirees were only around £8,000, lower than any other group – including the youngest age-groups of 16 to 24 and 25 to 34 who generally have lower levels of financial assets, highlighting the financial vulnerability of this group.

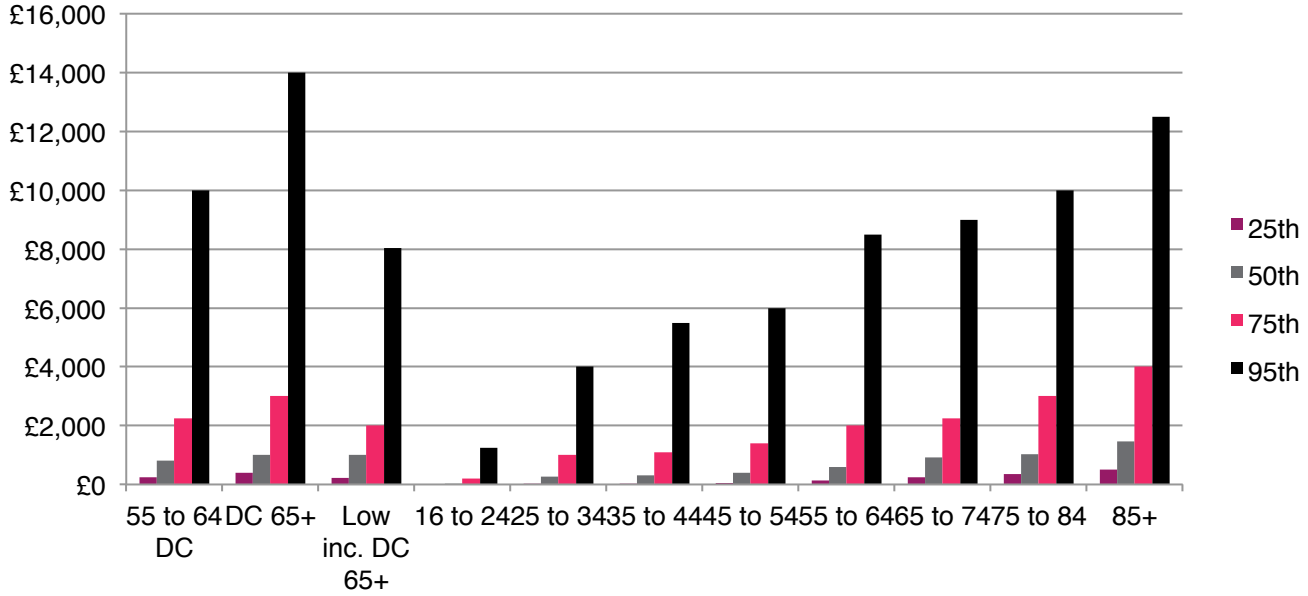
Net financial assets, 2010-2012 (WAS, Wave 3)



Overall, the findings suggest that many DC retirees – including a small number of low-income DC retirees – would be in a position to supplement their income through annuitisation of savings, but have not taken this decision, perhaps reflecting factors explored in academic research on the 'annuity puzzle', reviewed in previous chapters.

Interestingly, although net financial assets decline during retirement, the amount that individuals have in their current account appears to increase:

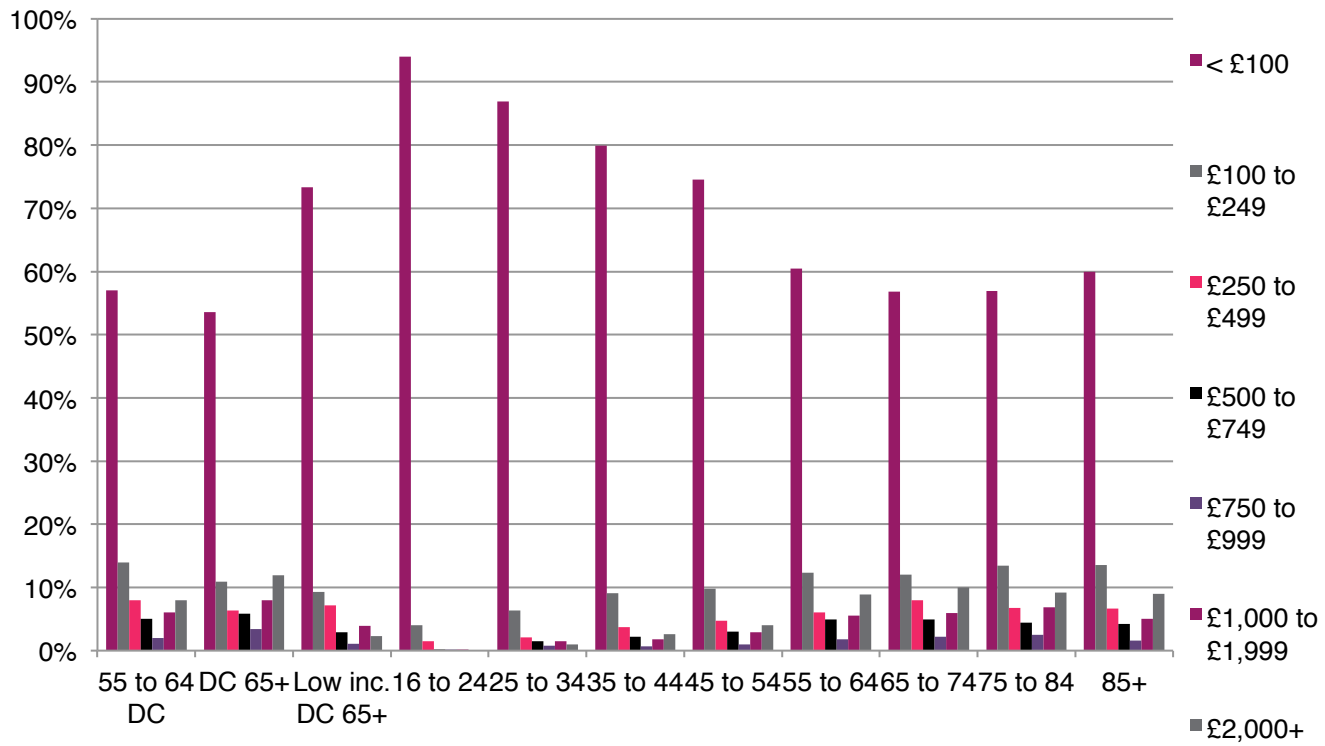
Current account wealth, 2010-2012 (WAS, Wave 3)



In addition to annuitisation, individuals could derive an income from their financial assets, whether through drawing down their savings over time, or supplementing their income with interest or investment earned (after inflation). However, despite relatively high levels of financial assets among some groups, the annual income being received from these savings and investments is relatively low, with over half of all groups reporting it is less than £100 per year.

Among DC retirees, 8% received an annual income of £1,000-2,000, and 12% received an income of £2,000+

Annual income from savings and investments, 2010-2012 (WAS, Wave 3)

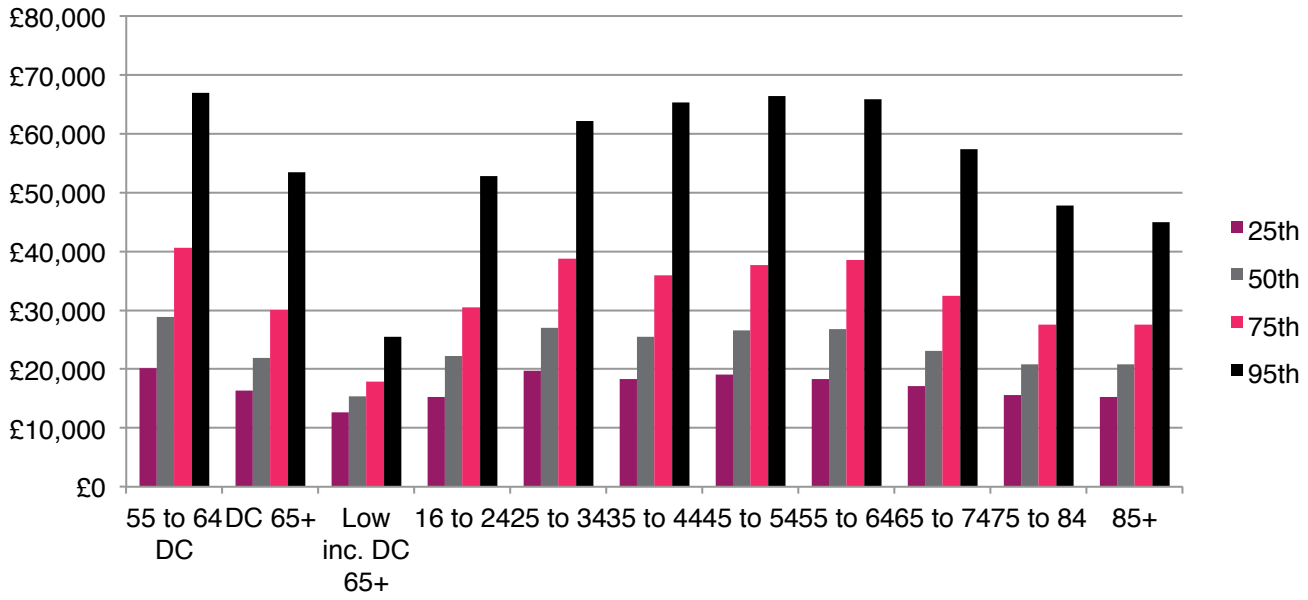


The relatively low annual income derived from savings and investments among DC retirees could reflect low interest rates or returns or poor financial management. Alternatively, some retirees may be choosing not to use their savings and investment to fund an income, but instead keep returns invested, i.e. they treat savings and investments as a 'nest-egg' rather than a source of income.

6.4. Income

There is significant income inequality among DC retirees, when equivalised to a household level. Among DC retirees, median equivalised household income was just under £22,000, which may include State Pension entitlements and other benefits, Defined Benefit pension incomes and DC incomes. Median equivalised household income in the low-income DC retiree group was just over £15,000.

Equivalised net annual household income, 2010-2012 (WAS, Wave 3)



6.5. Conclusion

Analysis of income and wealth among older people with DC pension savings reveals a wide range of circumstances. On the one hand, 5% of DC pre-retirees have buy-to-let properties, and may choose to exploit the 'Freedom and Choice' changes to use their DC pension savings to pay off a buy-to-let mortgage, offsetting any income tax incurred with the mortgage interest charges they have saved.

At the other end of the scale, median net financial assets among low-income DC retirees is around £8,000, and roughly one in three rent their home. In future, households with such characteristics will be inclined to use their DC pension savings to boost their buffer savings; however, they may be penalised in doing this by rules on means tested housing support, highlighting the complexity of choices for households in this category.

7.Use of financial products

Key results:

- **The most common financial products across the population are savings accounts and ISAs, although one-in-four (23%) of DC pre-retirees and over one-third of low-income DC retirees have neither;**
- **Among DC retirees, 20% have fixed-term investment bonds and 8% have a unit or investment trusts, dropping to 12% and 2% for low-income DC retirees;**
- **Across all age groups, general insurance is the most common product recently taken out, followed by an investment product among older age groups, for example, 15% of DC retirees, albeit dropping to just 6% of low-income DC retirees;**
- **However, many individuals have not personally taken out any new financial products during the last two years, with over half of retirees falling in this group, 40% of DC pre-retirees and 57% of low-income DC retirees.**

7.1. Introduction

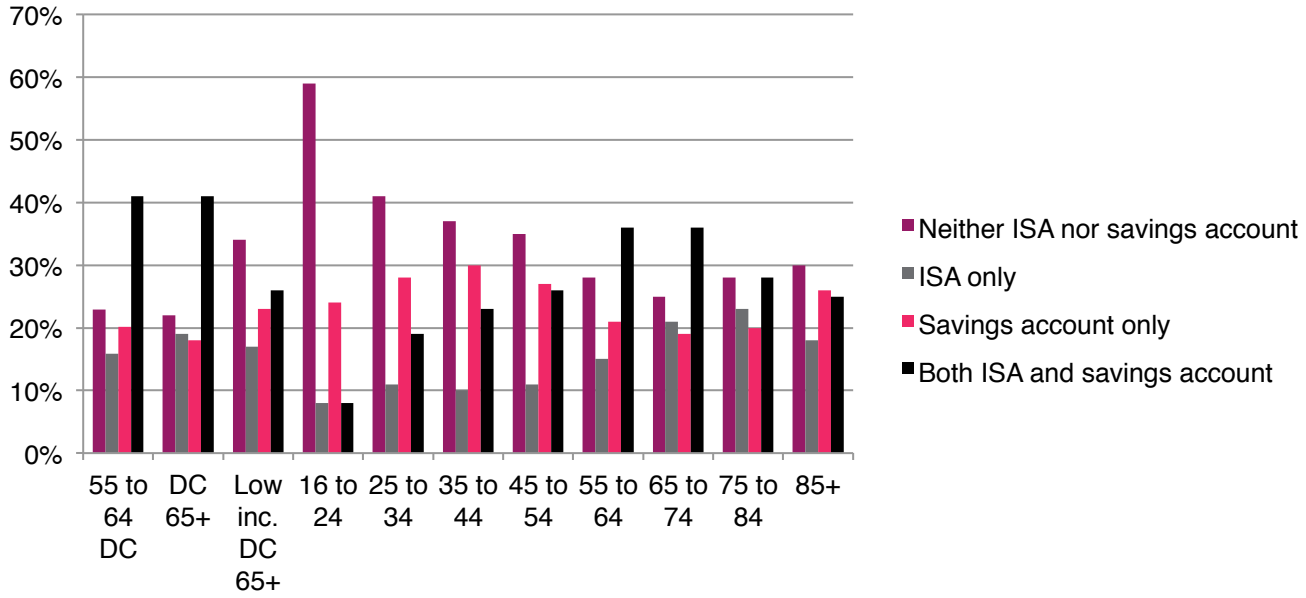
Chapter 1 noted that the Budget 2014 changes to rules on taxation of DC pension savings imply increases in personal responsibility for managing income in retirement. From the age of 55, DC savers may opt to place their pension savings in a range of potential product types, from current accounts to investment trusts.

In part, financial capability results from real-life experience of using different products. In order to explore levels of financial capability derived from experience of holding different types of financial product, Defined Capability examined use of financial products by DC retirees and other groups.

7.2. Usage of financial products

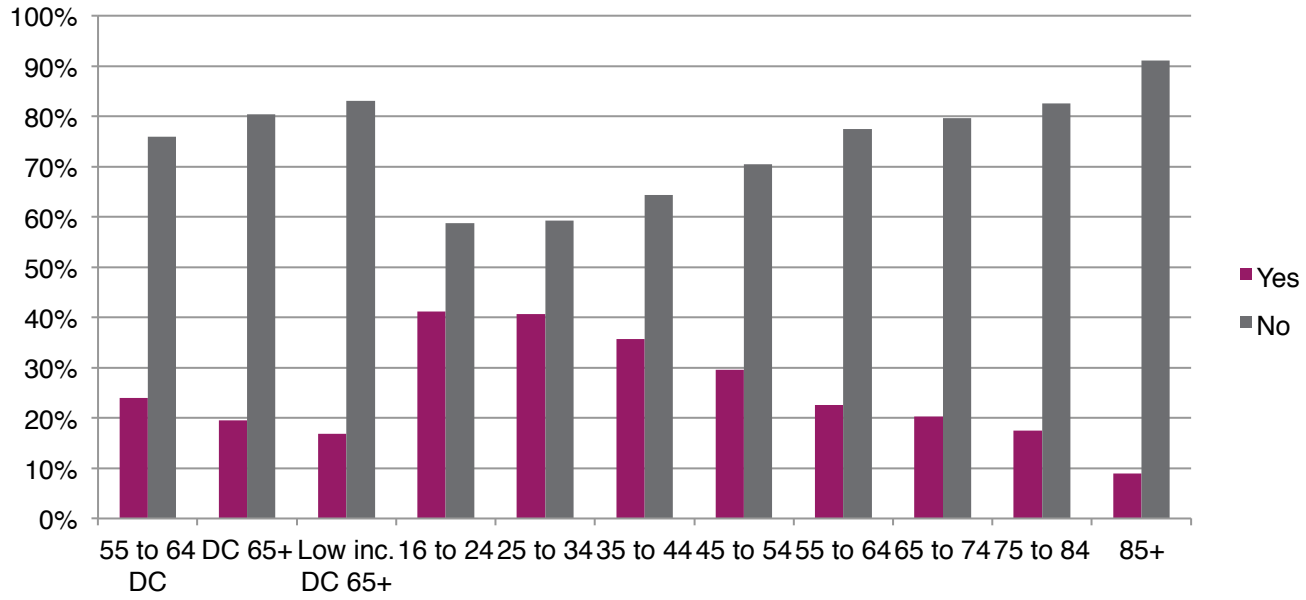
The most common types of financial product used across the population are savings accounts and ISAs. However, it is particularly notable that 23% of DC pre-retirees and over one-third of low-income DC retirees do not have a savings account or an ISA.

Use of savings account or ISA, including held jointly or overseas, 2010-2012 (WAS, Wave 3)



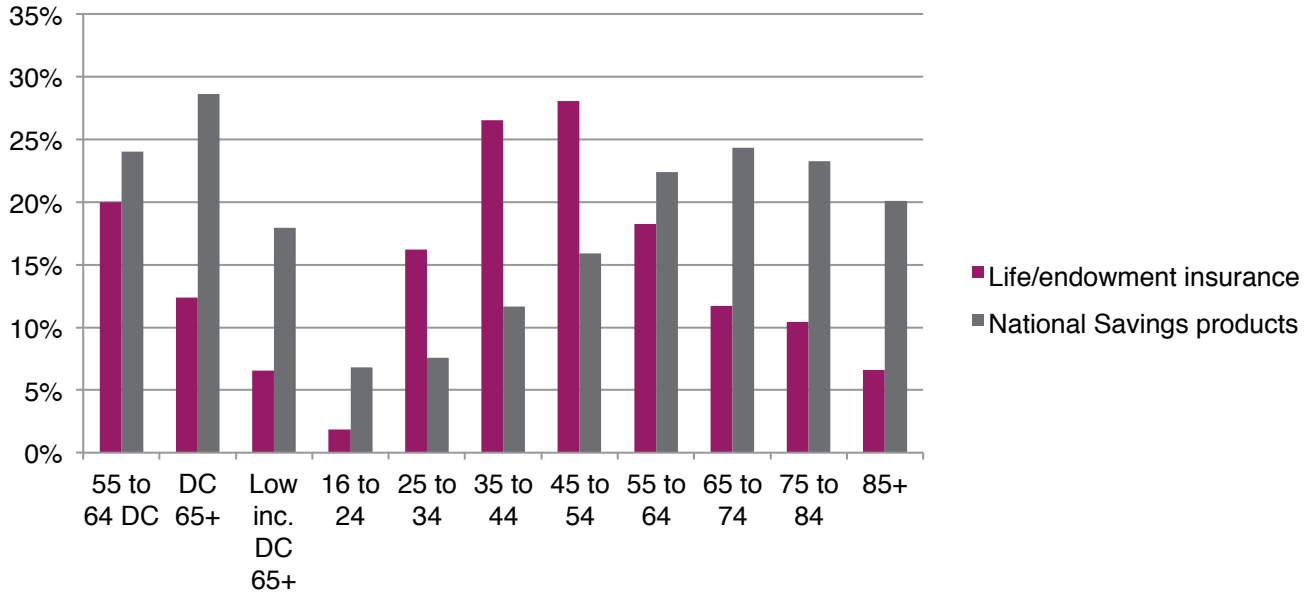
ISA usage appears to increase with age, potentially reflecting their promotion as a medium to long-term savings vehicle. This is borne out by figures on ISA withdrawals, which are progressively less likely as individuals age, although this may also indicate individuals are less likely to move their ISA in search of a better return.

Whether has withdrawn money from ISA during last two years, 2010-2012 (WAS, Wave 3)



Turning to the next most common financial product, analysis found that 18% of the population had a life/endowment insurance product and 16% had a National Savings product (figures not shown in chart).

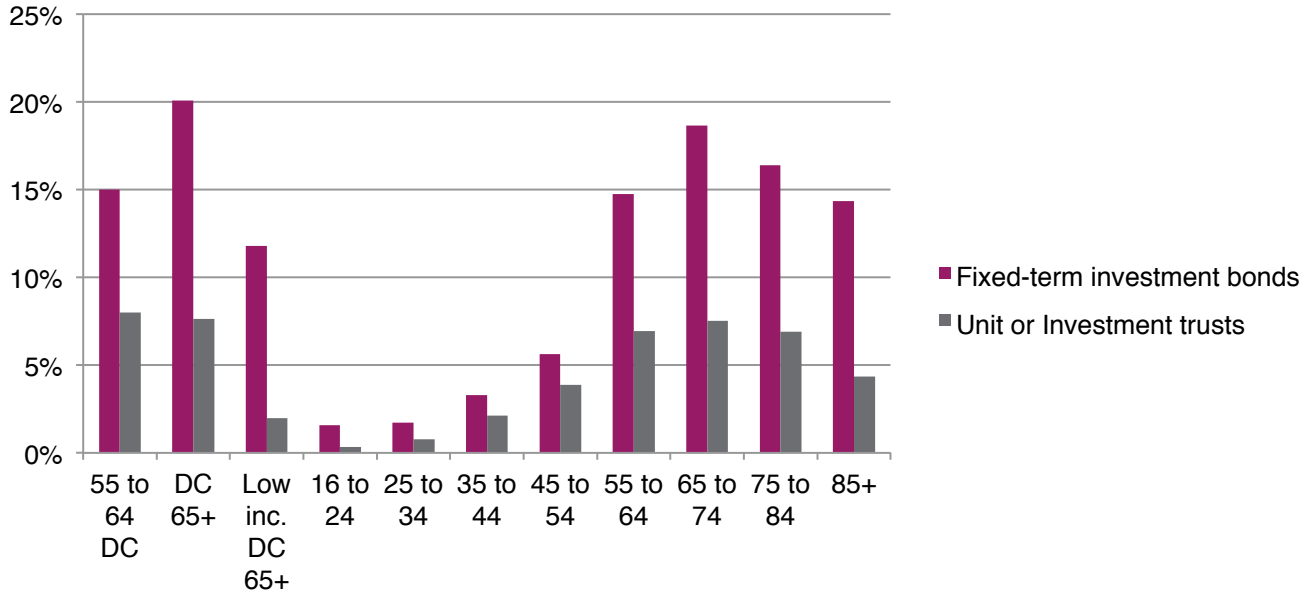
Has fixed-term investment bonds, or unit or investment trusts including jointly or overseas, 2010-2012 (WAS, Wave 3)



Interestingly, nearly 30% of DC retirees have National Savings products, and overall, their use peaks at around one in four among the 65 to 84 age group, although this drops to 18% of low-income DC retirees.

Turning to more sophisticated financial products that may indicate an appetite and understanding of investment risk, among DC retirees, 20% have fixed-term investment bonds and 8% have a unit or investment trusts, dropping to 12% and 2% for low-income DC retirees.

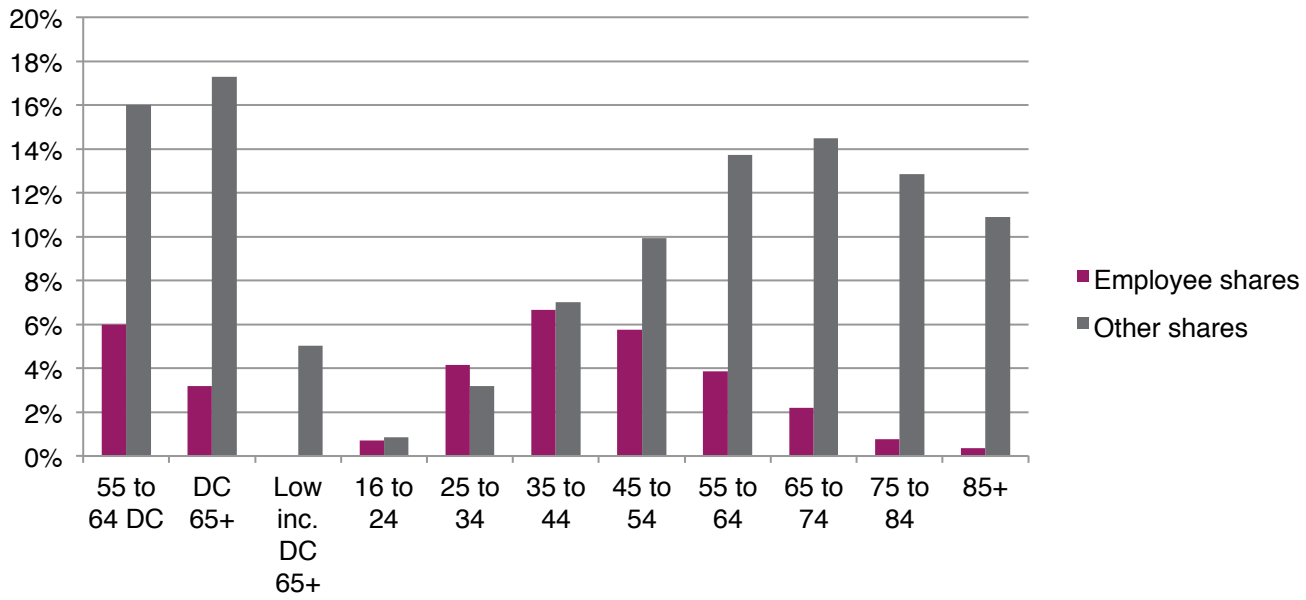
Has fixed-term investment bonds, or unit or investment trusts including jointly or overseas, 2010-2012 (WAS, Wave 3)



Although possession of employee shares is relatively low, possession of other shares rises with age to nearly one in five among the DC retiree group. Holding shares may indicate higher

levels of financial capability, although financial advisers often guide individuals to reduce exposure to the investment risk of share ownership during retirement.

Has employee shares or other shares including jointly or overseas, 2010-2012 (WAS, Wave 3)

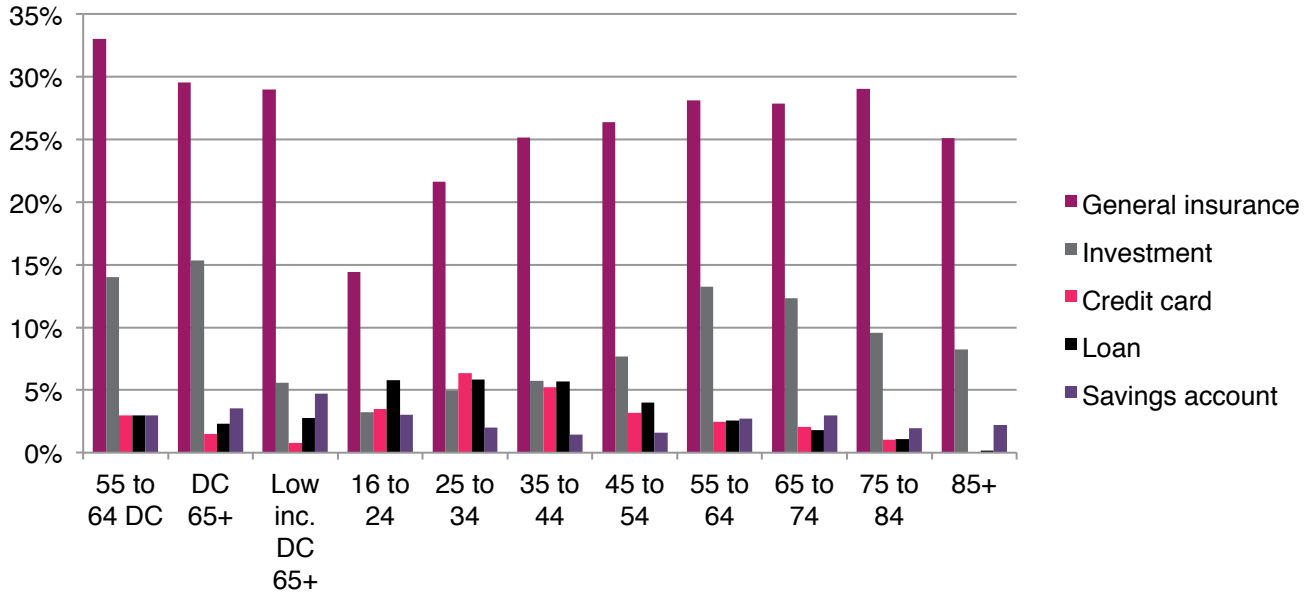


Of particular note, just 5% of low-income DC retirees own other shares.

7.3. Recent product use

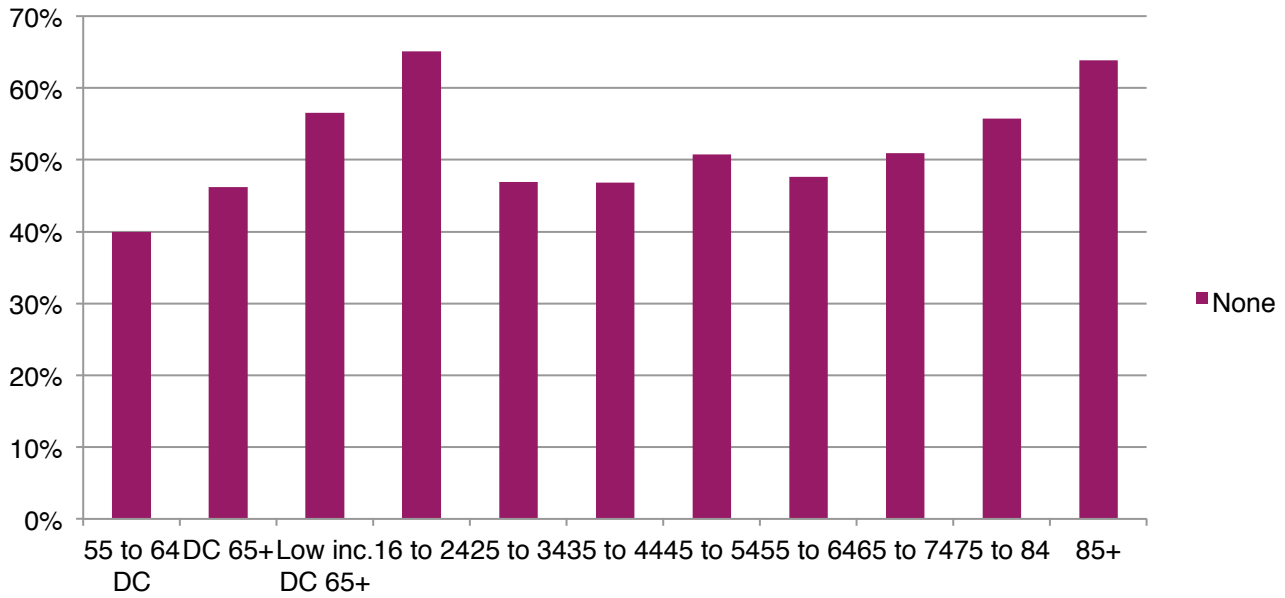
Financial products held by DC pre-retirees and other groups could have been purchased several years or decades previously, and may have been set up by a partner or financial adviser. It is therefore useful that in addition to reviewing financial products currently held, WAS explores the types of products individuals have personally taken out during the preceding two years. Across all age groups, general insurance is the most common product recently taken out, followed by an investment product among older age groups, for example, 15% of DC retirees, albeit dropping to just 6% of low-income DC retirees.

Whether has personally taken out any of these products during last two years, 2010-2012 (WAS, Wave 3)



Conversely, many individuals have not personally taken out any new financial products during the last two years, with over half of retirees falling in this group, 40% of DC pre-retirees and 57% of low-income DC retirees.

Whether during last two years has taken none of: general insurance; investments; credit cards; loans; savings accounts; mortgage, insurance; current account, 2010-2012 (WAS, Wave 3)



7.4. Conclusion

This chapter has reviewed usage of financial products among DC retirees and other groups. Savings and ISAs are the most common form of financial products held, as well as National Savings products.

Significant minorities hold investment products such as unit trusts, or shares directly, although typically not more than one in five of the DC retiree group.

Indeed, amongst the DC pre-retiree group, over 80% have not personally taken out a savings or investment product in the preceding two years. This suggests that the majority of DC pre-retirees may not engage in active financial management of their wealth and assets in the period leading up to retirement, and may therefore be ill-prepared if they opt to cash-in their DC pension savings and attempt to derive an income from it for the rest of their life.

8.Financial decision making

Key results:

- **The majority of DC retirees – around 54% - have personally taken out a financial product during the preceding two years, and WAS explores what information and advice was most influential in making a choice;**
- **The most influential sources of information and advice among older people (cited by 21%) was information from product providers, including websites;**
- **However, the most influential source of information and advice across all age groups was 'best buy information' cited by 33%, although influence falls steadily from 40% of the 25 to 34 age group to 15% of those aged 75 to 84;**
- **Across all age groups, the next most influential source of influence in choosing financial products – around 12% - was friends or family. In contrast to other information sources, the influence of friends or family across age groups is U-shaped, i.e. high among those aged 16 to 24 (22%) before dropping to 7% of 45 to 64, before rising to 20% of those aged 85%;**
- **Conversely, just over one in five of the 65+ age group say they did not collect any information in choosing a financial product, with the prevalence rising steadily from the age of 55 to 64 (13%) to 85+ (33%). Among DC retirees, 17% did not collect any information, rising to 24% of low-income DC retirees.**

8.1. Introduction

By removing the obligation to convert DC pension savings into a secure retirement income, no matter what the size of someone's total DC pension pot, the changes announced at Budget 2014 significantly increased the importance – and impact on retirement income and wealth – of the financial decisions of individuals.

The previous chapter noted that the majority of DC retirees – around 54% - had personally taken out a financial product during the preceding two years. WAS also explores how the choice of this product was reached, particularly in relation to influence and advice, asking respondents:

> Which ONE source of information or advice did you feel most influenced your decision about which particular product you decided to take out?
>
> - Information collected from providers or providers websites
> - Best buy information, comparison website or shopped around a lot of different sources
> - Friends or family
> - Independent Financial Adviser (including relatives who are IFAs)
> - Independent information in newspapers, magazines, radio or TV programmes, etc.
> - Information about specific products received in the post, or seen or heard on adverts

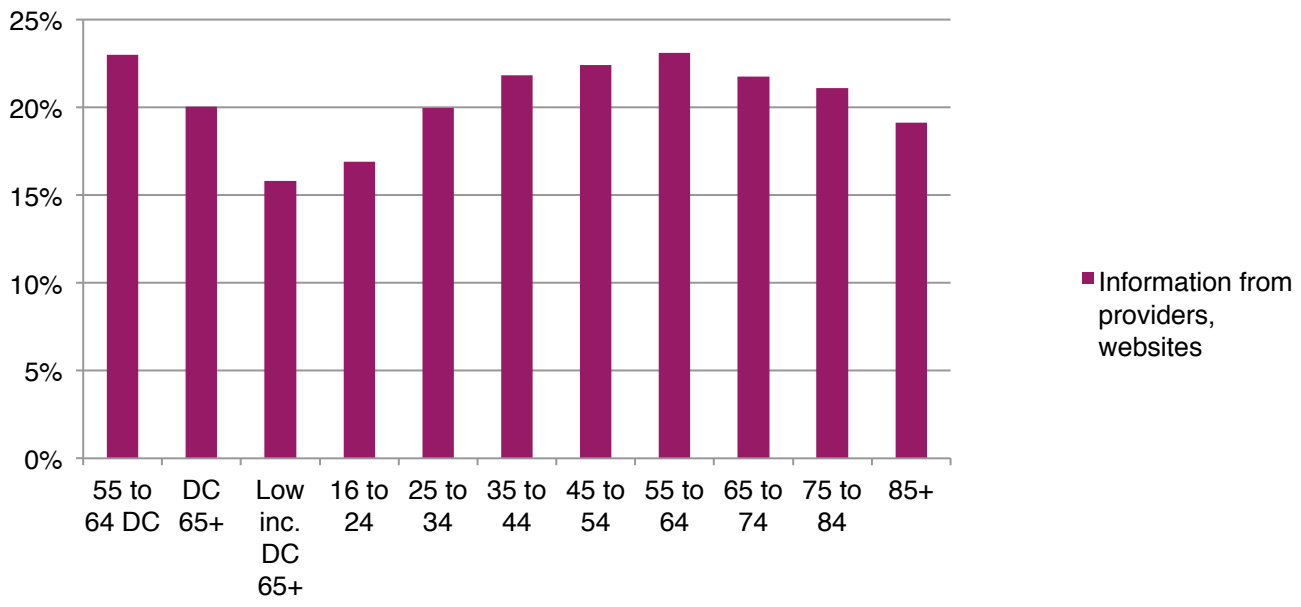
- No information collected at all

Examining responses to this question enables exploration of which sources of information and advice are most important in shaping decision around financial products, and how the relative influence of different sources of information and advice varies over the life course.

8.2. Financial decision making

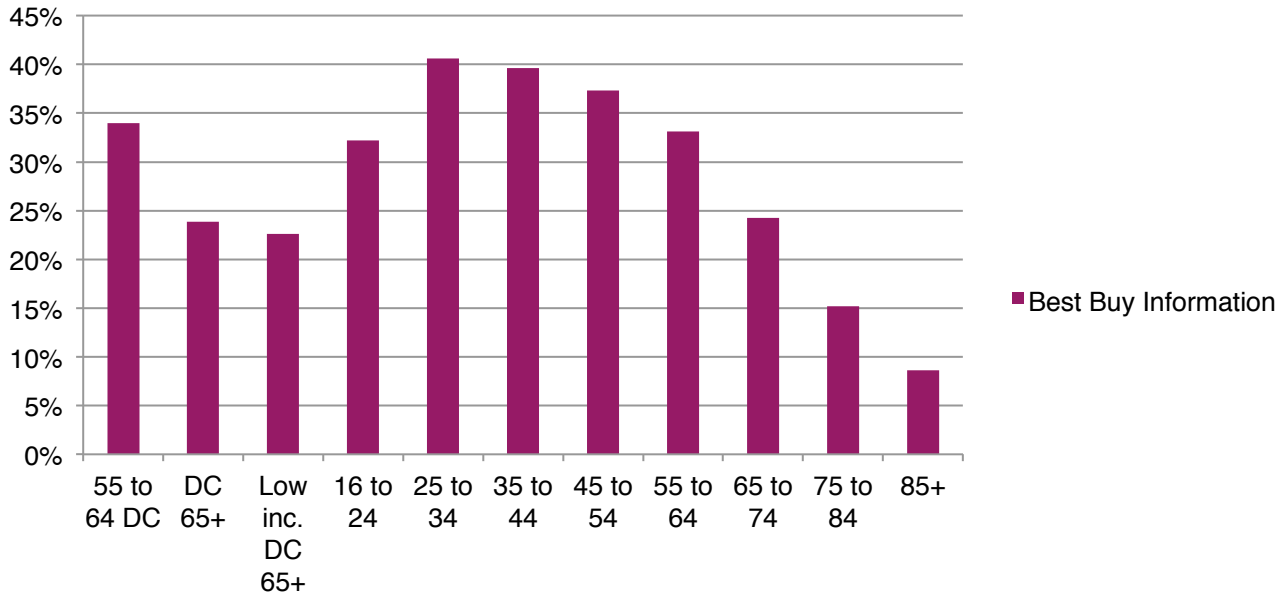
Overall, the most influential source of information and advice among retirees – cited by 21% of the 65 and over - was information from product providers, including websites (not shown in chart):

Product decision influenced by information from providers, websites, 2010-2012, (WAS Wave 3)



However, the most influential source of information and advice across all age groups was 'best buy information' cited by 33%. Nevertheless, despite being cited by over 40% of the 25 to 34 age group, the usage and influence of best buy information appears to decline steadily by age, to less than a quarter of those aged 65 to 74, and just 24% of DC retirees.

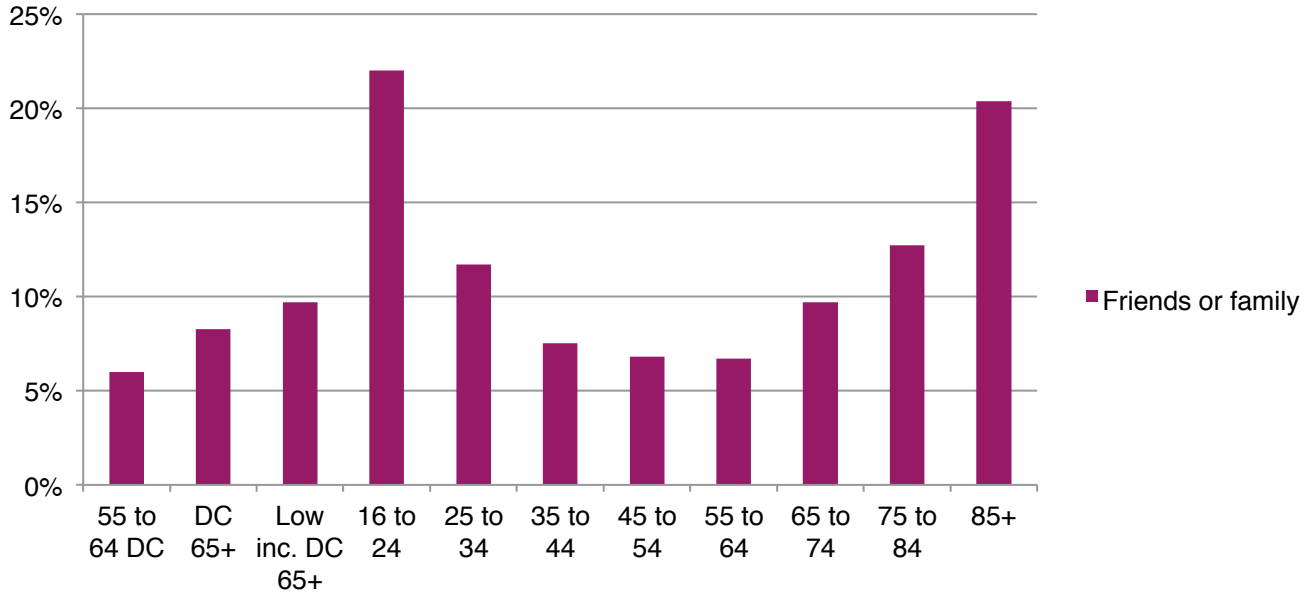
Product decision influenced by best buy information, 2010-2012, (WAS Wave 3)



The declining influence of best buy information may be related to the 'search costs' (time, energy etc.) of comparing 'best buy' tables, or the greater role of 'relationship' and 'trust' with a financial services provider for older people, who may opt to go for a brand they have used over a number of years. Best buy tables may also be sought out online, with their lower influence reflecting lower rates of Internet usage among older age groups.

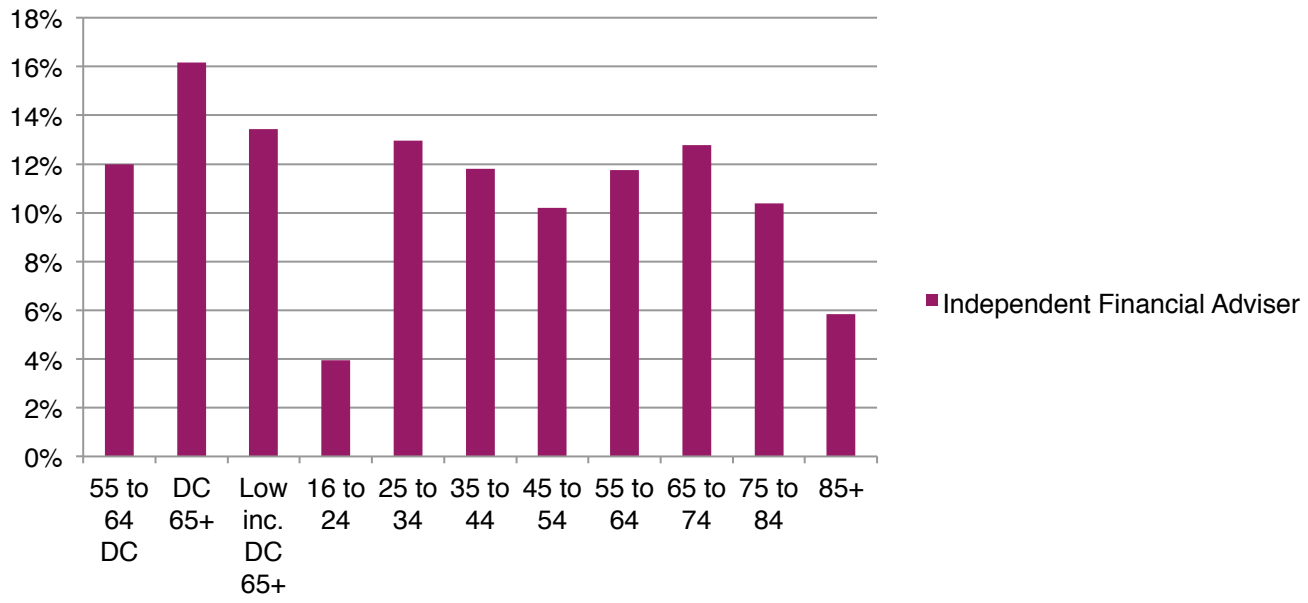
Across all age groups, the next most influential source of influence in choosing financial products – around 12% - was friends or family. In contrast to other information sources, the influence of friends or family across age groups is U-shaped, i.e. high among those aged 16 to 24 (22%) before dropping to 7% of 45 to 64, before rising to 20% of those aged 85%. However, among DC retirees, at 8%, the influence of friends or family was relatively low.

Product decision influenced by friends or family, 2010-2012 (WAS, Wave 3)



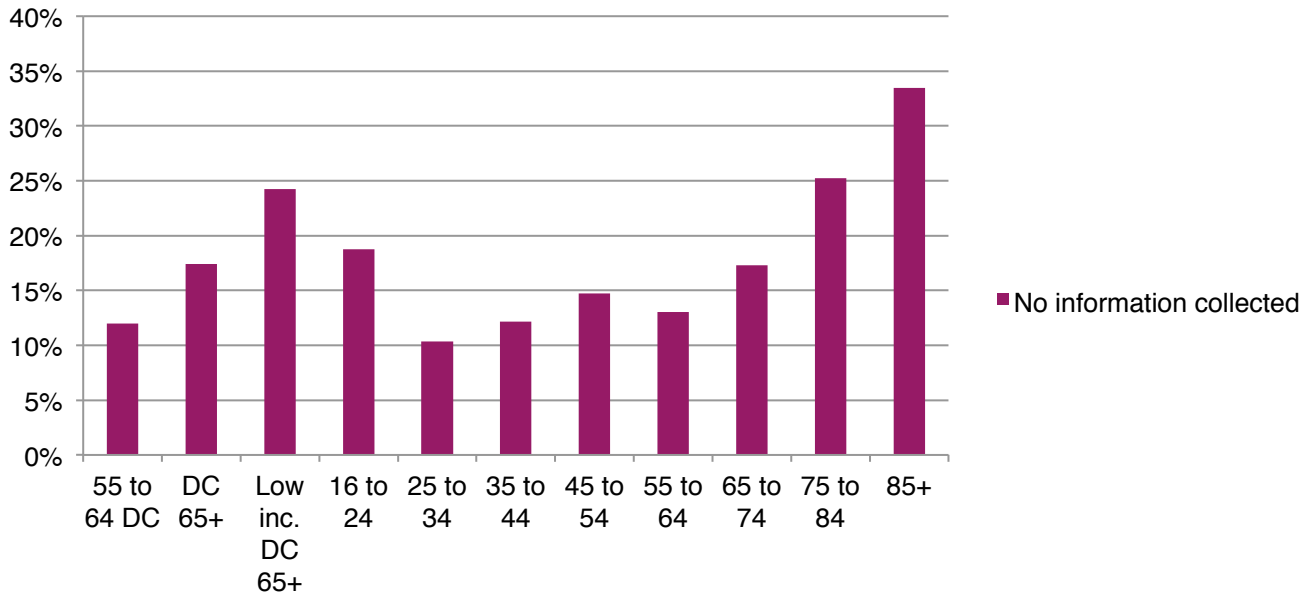
Among all age groups, and among the 65+ group, 11% cited an independent financial adviser (IFA) as being the most influential in their decision. Interestingly, at 16%, the influence of IFAs was highest among DC retirees, and low-income DC retirees, at 13%.

Product decision influenced by Independent Financial Adviser, 2010-2012 (WAS, Wave 3)



Finally, it is useful to explore whether individuals choose financial products without collecting any information. Just over one in five of the 65+ age group did not collect information, with the prevalence rising steadily from the age of 55 to 64 (13%) to 85+ (33%). Among DC retirees, 17% did not collect any information, rising to 24% of low-income DC retirees.

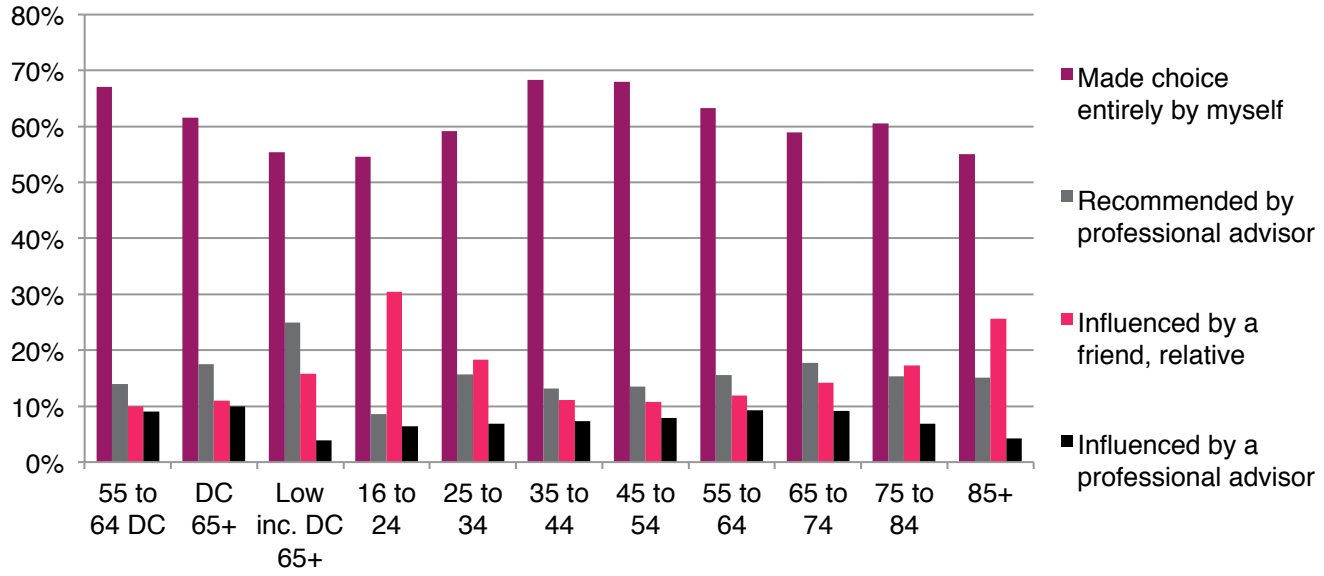
Product decision influenced by no one, 2010-2012 (WAS, Wave 3)



Having reviewed the most influential source of information and advice in choosing a product they had personally taken out, WAS asks individuals which statement best describes the way

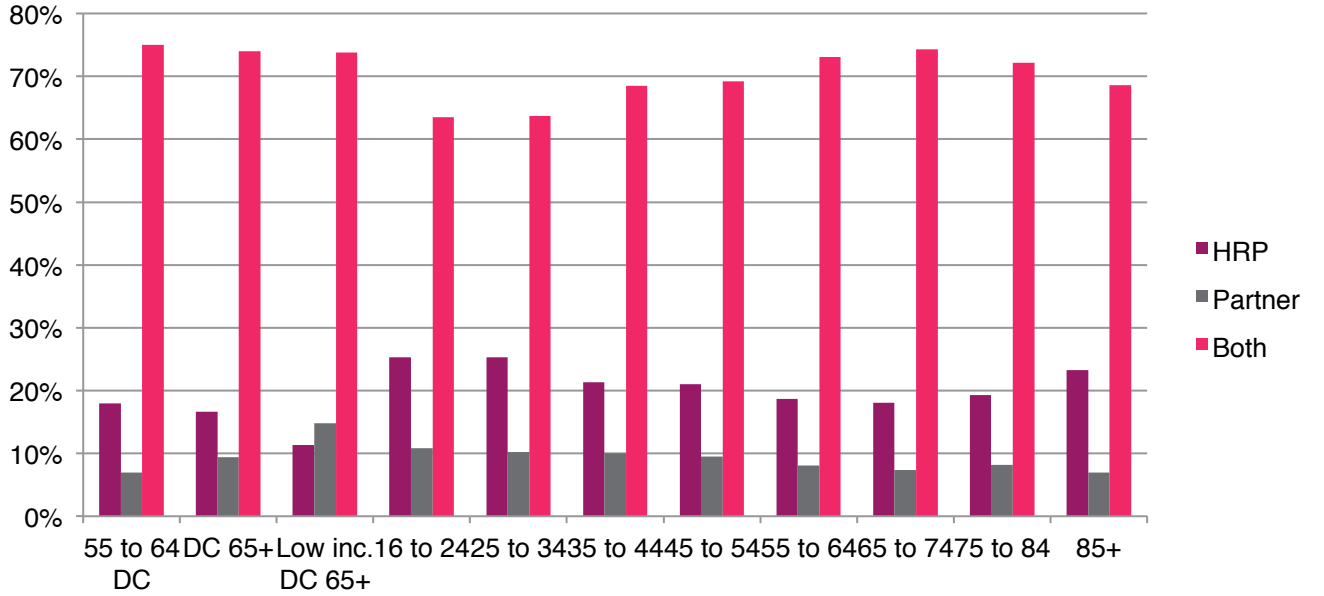
they decided which product to take out. Across all groups, over half said they made the choice entirely by themselves, albeit with more than 25% of those aged 16 to 24 and 85+ reporting they were influenced by a friend or relative.

Which one of the following statements best describes the way you chose which product you decided to take out?, 2010-2012 (WAS)



It is also important to note that for individuals with a partner, choices around financial products may be shared. Indeed, over half of individuals in households of two partners report that both make financial decisions.[15]

Who makes financial decisions in households of two partners, 2010-2012 (WAS, Wave 3)



[15] 'HRP' refers to Household Reference Person.

8.3. Conclusion

This chapter has reviewed the reported influence of different sources of information and advice on financial decision-making among those who have purchased a financial product in the preceding two years. The results of the analysis are interesting for:

- The relative influence of different sources of information

DC retirees report that provider websites and information, and best buy tables, were more influential than IFAs, presumably because use of the latter may involve a charge. However, the influence of all of these 'informed' sources of advice and information declines with age.

- Life course changes in influence during retirement

As individuals age, their financial decision-making increasingly relies on family and friends, or no information or advice at all, rather than provider websites, best-buy information, etc. Individuals appear more likely to 'switch off' and 'withdraw' from aids to financial decision-making as they get older.

This result is notable in the context of the 'Freedom and Choice' changes to rules on DC pension savings, and any assumption by policymakers that individuals with wealth accumulated as DC pension savings will make optimal, informed decisions around their income and wealth through their retirement into their late old age.

- Low income DC retirees

The marginal impact of differences in the effectiveness of financial decision-making will be highest for low-income DC retirees, compared to the broader DC retiree group. However, the findings indicate that low-income DC retirees are less likely to be influenced by information and advice sources, such as best buy tables or provider information. This underlines the importance of accessible, useful information and advice sources for this group, the majority of whom are unlikely to have any recourse at all to paid-for advice.

9.Financial management and budgeting

Key results:

- **41% of DC retirees check their current account just once a month or less, rising to 47% of low-income DC retirees, and 68% of the 85+;**
- **However, the proportion of the population who describe themselves as very organised rises steadily with age, as does the percentage of each age group who report that they are keeping up with bills and credit commitments;**
- **Similarly, the proportion of individuals who report they never run out of money before the end of the month rises from 33% of the 16 to 24 age group to 87% of the age 85+ age group. Individuals are also more likely to report their income is adequate as they age, including 82% of DC retirees and 65% of low-income DC retirees;**
- **Retirees were much more likely to report they could cope for 12 months or more with a one-quarter drop in their income level, including over 60% of DC retirees. For low-income DC retirees, just 29% reported they could cope for 12 months or more.**

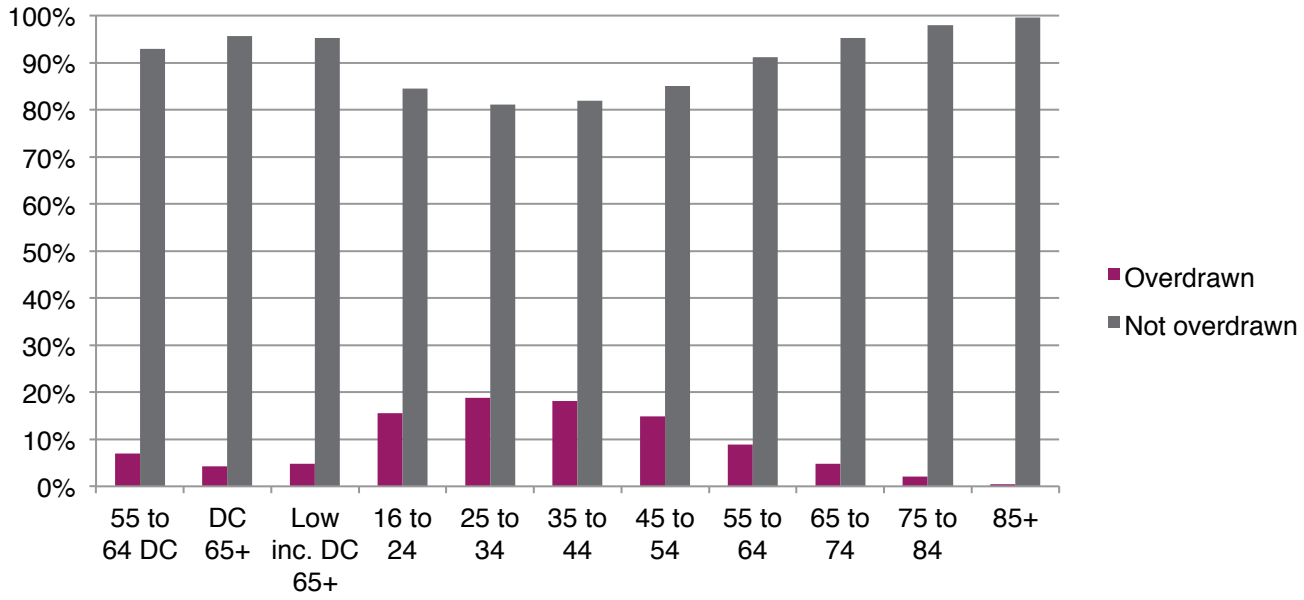
9.1. Introduction

An important indicator of financial capability is how individuals manage their everyday finances. Day-to-day financial management can also provide key indicators of how likely it is individuals will run out of money, and also of their attitudes to risk, spending and saving.

9.2. Day-to-day financial management

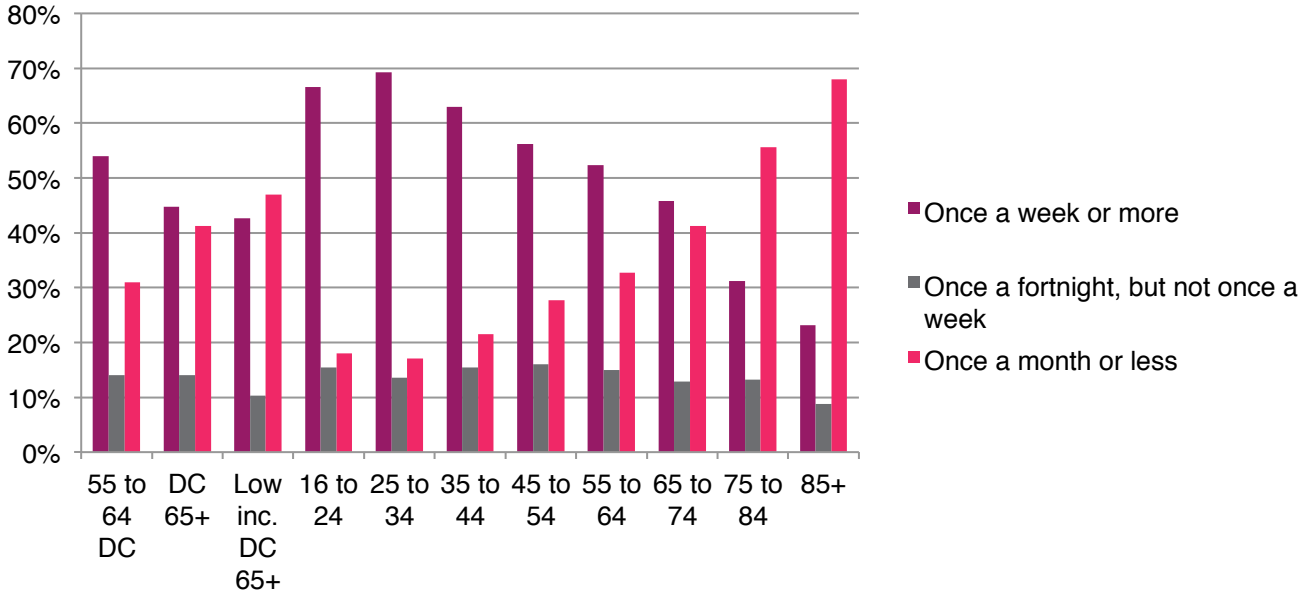
Very few people in the adult population are overdrawn. The propensity to have an overdrawn current account peaks among the 25 to 34 year old age group, then steadily declines with age. Among DC retirees, 4% reported being overdrawn.

Whether current account is overdrawn, 2010-2012 (WAS, Wave 3)



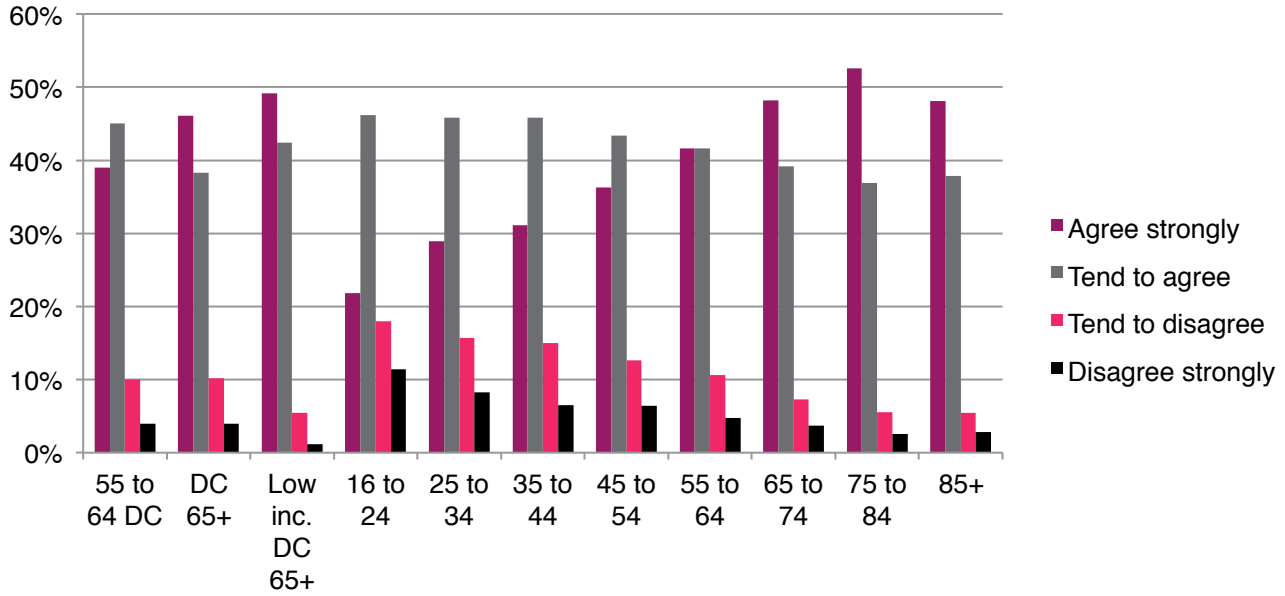
Despite the chances of being overdrawn declining with age, individuals also check their current account less frequently as they age. This could reflect an increased ability to 'live within your means' that individuals develop as they age, reduced outgoings or the accumulation of savings in the current accounts of older people, which acts as a buffer against variations in expenditure. For example, 41% of DC retirees check their current account once a month or less, rising to 47% of low-income DC retirees.

How often normally checks current account, 2010-2012 (WAS, Wave 3)



Although most individuals regard themselves as very organised when managing their money day to day, a strong age effect is observable. Not only does the overall proportion of the population who describe themselves as very organised with managing money day-to-day rise from 68% of the 16 to 24 age group to 86% of the 85+, the percentage who agree strongly that they are organised also rises with age.

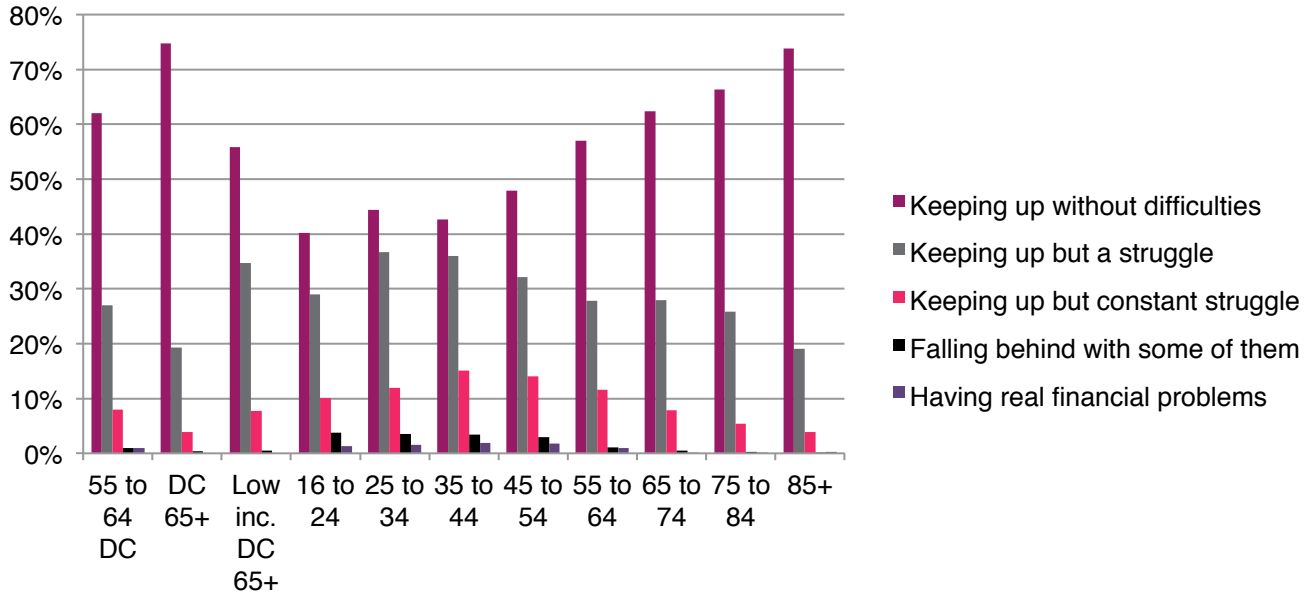
"I am very organised when it comes to managing my money day to day", 2010-2012 (WAS, Wave 3)



Interestingly, low-income DC retirees are more likely to agree (strongly) than DC retirees that they are organized in managing money day to day, potentially indicating that a focus on household budget management is correlated with (lower) household income.

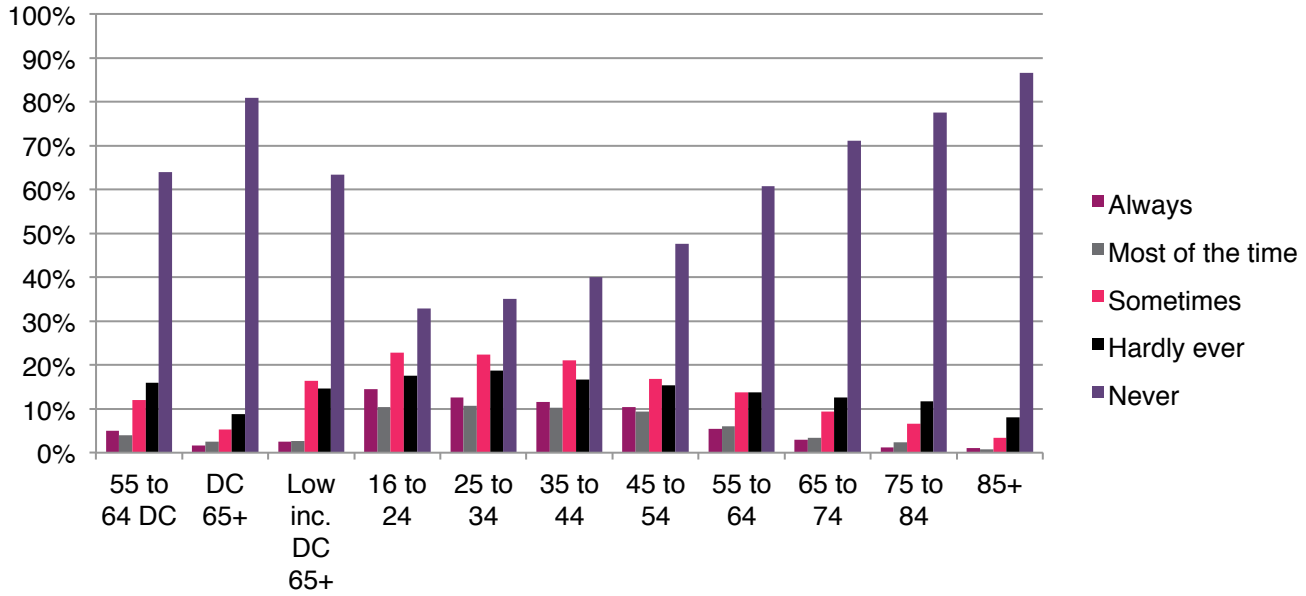
Similarly, the percentage of each age group who report that they are keeping up with bills and credit commitments rises steadily with age. This could reflect both reduced bills among older age groups – notably reduced mortgage payments – or financial capability accumulated over the life course, and an adjustment of expenditure to (fixed) income in retirement.

What best describes how well you are keeping up with your bills and credit commitments at the moment?, 2010-2012 (WAS, Wave 3)



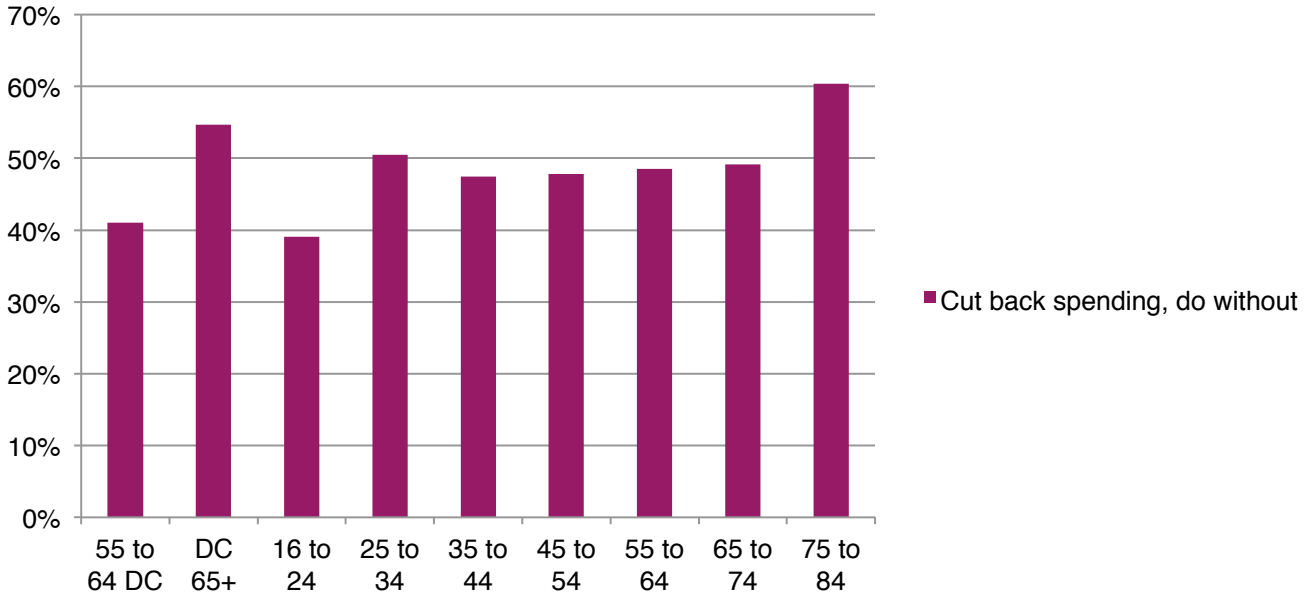
Similarly, the proportion of individuals who report they never run out of money before the end of the month rises from 33% of the 16 to 24 age group to 87% of the age 85+ age group. Again, this could reflect reduced expenditure with ageing, accumulated financial capability or changing expenditure patterns. Among low-income DC retirees 63% report never running out of money before the end of the month, suggesting they have adapted to a low income.

In the past 12 months, how often have you run out of money before the end of the week or month or needed to use a credit card or overdraft to get by?, 2010-2012 (WAS, Wave 3)



Among the small proportion that do run out of money at the end of the month, the most common method for dealing with this across all age groups is to cut back spending.

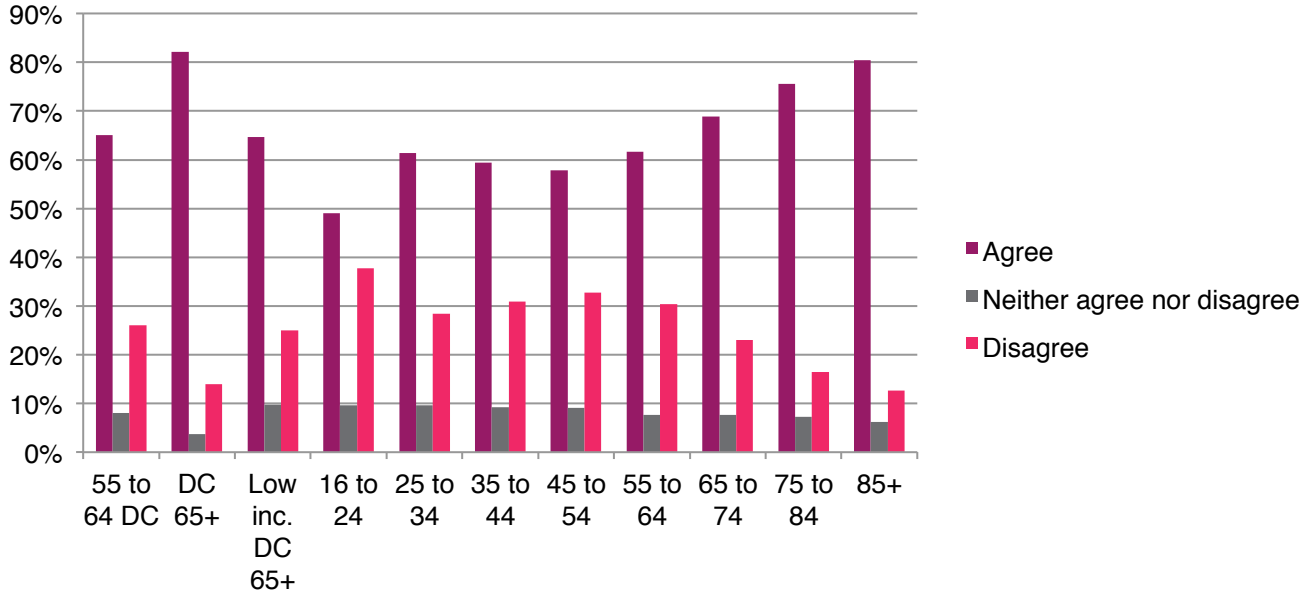
What usually does when runs out of money?, 2010-2012 (WAS, Wave 3)



9.3. Managing expenditure

The results above indicate older households are increasingly on top of their overall household budget as they age, even as they grow less likely to check their current account. As noted, this may be the result of reduced expenditure needs, and matching outgoings to income. In this regard, it is interesting to note that as individuals age, they are increasingly likely to report that their income is sufficient for everyday outgoings.

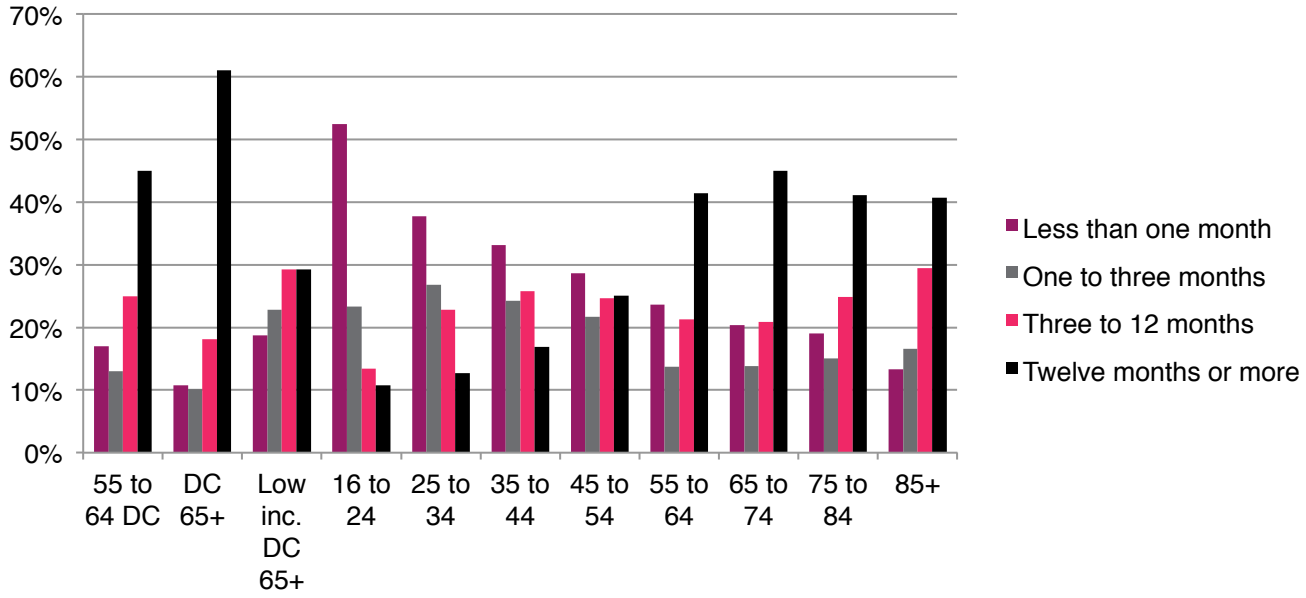
"My income is enough to meet the cost of my everyday outgoings", 2010-2012 (WAS, Wave 3)



Income adequacy is also likely to be a simple function of overall income level, and it is interesting to note that among DC retirees, over 80% report that their income is adequate. Again, even among low income DC retirees 65% report that their income is adequate, suggesting that they may limit the cost of their everyday outgoings to match their low income.

Another aspect of income adequacy is how long individuals could cope if their income dropped by a quarter. Again, analysis found that retirees were much more likely to report they could cope for 12 months or more, including over 60% of DC retirees; however, among all of those aged 55 and over the proportion in this category does not vary significantly. For low income DC retirees, just 29% reported they could cope for 12 months or more if their income dropped by a quarter, and over half could cope for less than three months.

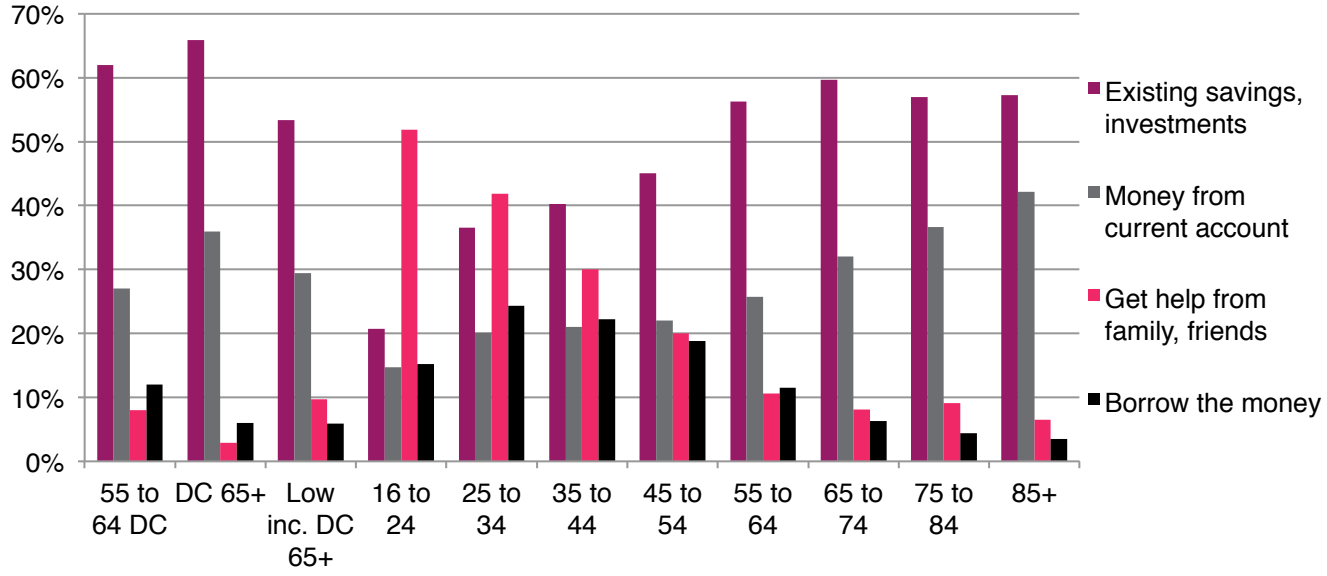
How long could make ends meet if income dropped by a quarter, 2010-2012 (WAS, Wave 3)



In the context of 'Freedom and Choice', these results are interesting as they suggest that many DC retirees may be relatively 'unattached' to their higher income, and therefore more open to the idea of substituting it for cash. However, the results also suggest individuals in the low-income DC retiree group may be unwilling to 'lock away' their money in retirement in long-term investments, which may in turn reduce the returns they can achieve on their crystallised DC pension savings.

Another important measure of financial adequacy is how individuals would cope with unexpected expenditure. The propensity to being ready to meet such expenditure through savings and investments increases steadily as individuals age. Many older individuals also report they would meet such expenditure from money in their current account, suggesting older people are more likely to see their current account as a 'nest-egg' or 'savings buffer'. Low income DC retirees would also mostly meet an unexpected major expense through savings or money from their current account (83%).

How would find the money to meet an unexpected major expense, 2010-2012 (WAS, Wave 3)



9.4. Conclusion

This chapter has explored variations in day-to-day financial management among the groups examined in the study.

Overall, although individuals are less likely to check their current account balance as they age, they are also more likely to be organised with their day-to-day household finances. Interestingly, individuals are more likely to report they have adequate income as they age. On the one hand, this could reflect lower outgoings, for example, because of declining participation in leisure activities as individual age. Alternatively, it may simply reflect reductions in expenditure to match income.

It is also interesting to note that as individuals age, they are more likely to report that they would meet the cost of an unexpected major expense from their current account – including over one-third of DC retirees. This suggests that current accounts increasingly represent a form of 'buffer savings' for individuals.

10. Saving, risk and financial position

Key results:

- **Despite being above retirement age, 49% of the 65+ population reported saving during the preceding two years (not shown in chart), rising to 56% of DC retirees. However, more than any other retired group, 59% of the low-income DC retiree group did not save;**
- **Looking ahead, 44% of the 65+ population report they are likely to save money during the next 12 months, rising to 50% of DC retirees, but dropping to 38% of low-income DC retirees;**
- **Across most age groups, unexpected expenditure was significantly the most cited motivation for saving;**
- **'Accidental' saving - i.e. unspent income in your current account at the end of the month - is highest among DC retirees (62%) and increases overall with age;**
- **Over half of retirees report that they leave money left over at the end of the month in their current account. One in five DC retirees leave the money in a savings account, and 12% move it from a current account to savings account. Interestingly, among all the groups studied, low income DC retirees are most likely to leave left over money in a current account;**
- **As individuals age, they are significantly more likely to report they always have money saved for a rainy day;**
- **People's attitudes to investment risk are consistent across age-groups, with DC retirees particularly likely to agree that it is better to play it safe with your savings and investments. However, a hardening of attitudes against investment risk is observable as individuals age;**
- **Nevertheless, most individuals accept that a good return on investment is associated with risk, although people are less likely to agree with this as they age, and agreement is lower among low-income DC retirees.**

10.1. Introduction

By definition, individuals with DC pension savings at retirement are 'savers', who have set aside earnings during their working life to fund their retirement. Such responsible financial behaviour has been cited as evidence by policymakers that greater freedom and choice in the use of DC pension savings will not result in individuals spending down their savings and running out of money.

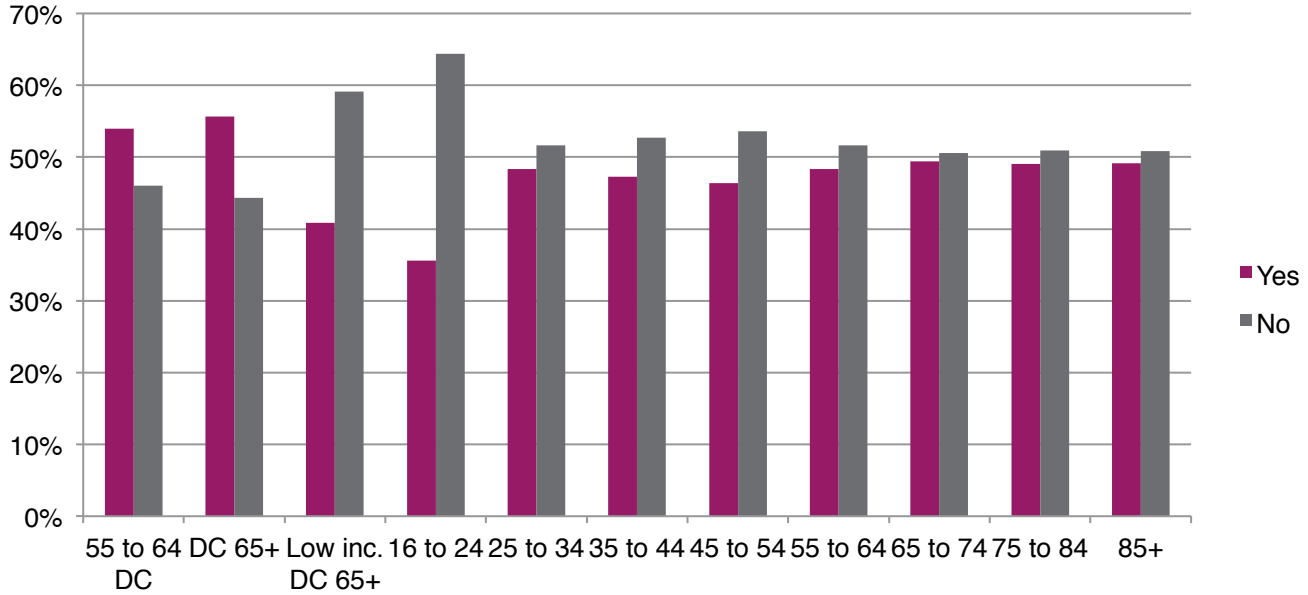
However, an opposing risk is just as important: retirees may be afraid to spend down pension savings to fund an income because they fear running out of money before they die, i.e. just the risk annuities address. More widely, it would be reasonable to expect that savings behaviour would vary over the life course as individuals adjust to: living on a fixed income; not earning a salary; and, the risk of end-of-life costs such as residential care.

Analysis of WAS enables exploration of these issues among the different DC groups of interest, and across all age groups.

10.2. Savings activity

Despite being above retirement age, 49% of the 65+ population reported saving during the preceding two years (not shown in chart), rising to 56% of DC retirees.

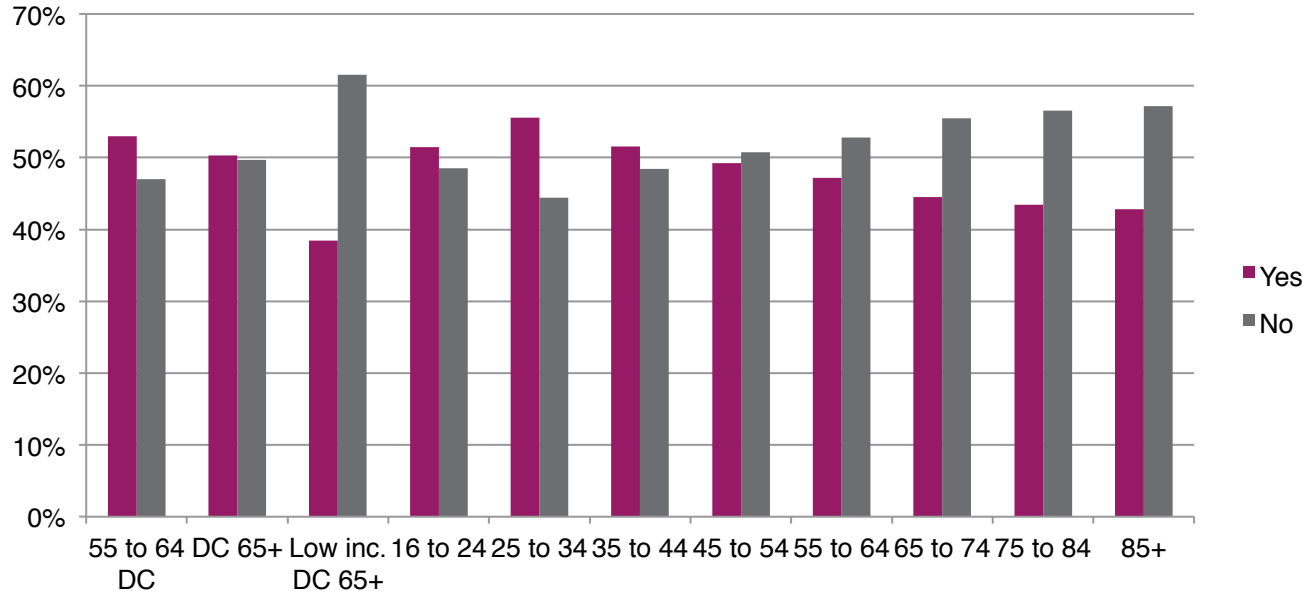
Any income saved during last two years, excluding pensions, 2010-2012 (WAS, Wave 3)



However, more than any other retired group, 59% of the low-income DC retiree group did not save.

Looking to the future, 44% of the 65+ population report they are likely to save money during the next 12 months, rising to 50% of DC retirees, but dropping to 38% of low-income DC retirees.

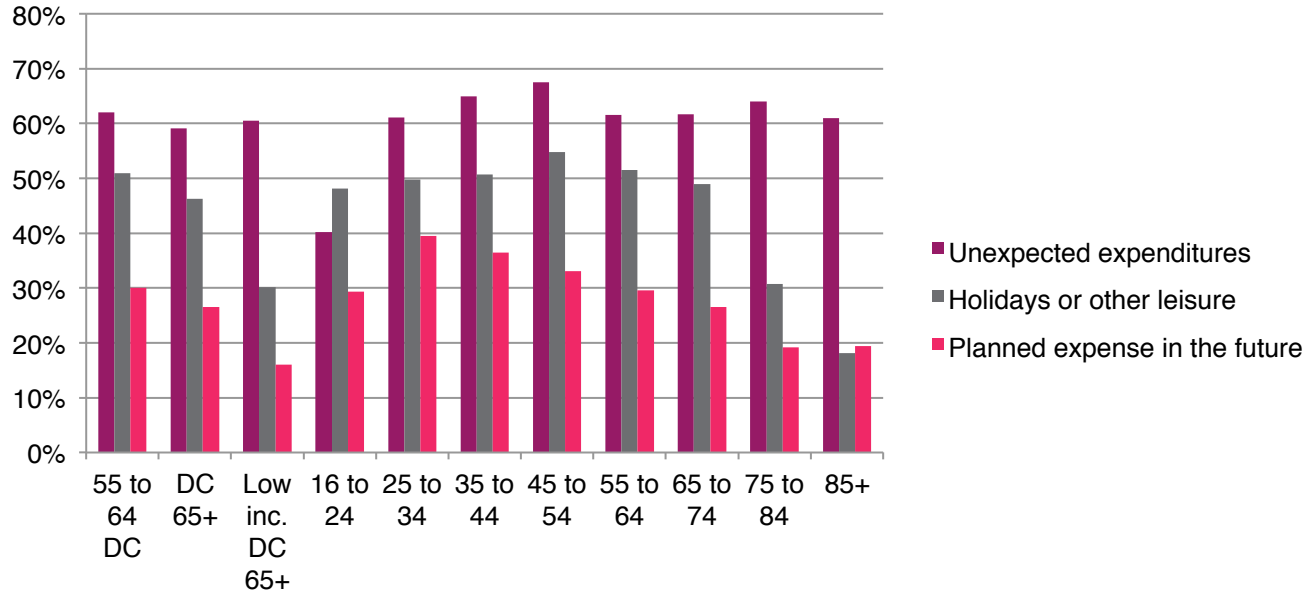
Whether likely to save money during next twelve months, 2010-2012 (WAS, Wave 3)



These results indicate a relatively high prevalence of planned saving among the older population, with DC retirees even more likely to save than other older groups. This suggests that the majority of DC retirees do not stop saving when they reach retirement, although low-income DC retirees display reduced ability to save.

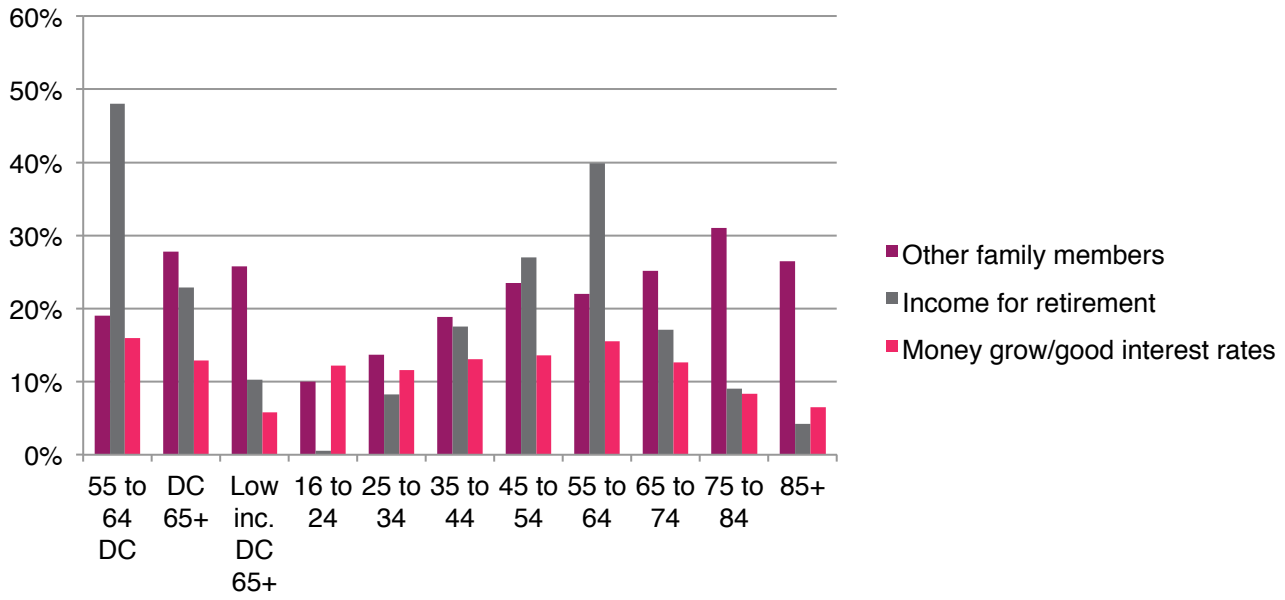
When asked why they save, individuals across nearly all age groups are most likely to cite unexpected expenditure as the principal reason.

Reason for saving money during last two years, 2010-2012 (WAS, Wave 3)



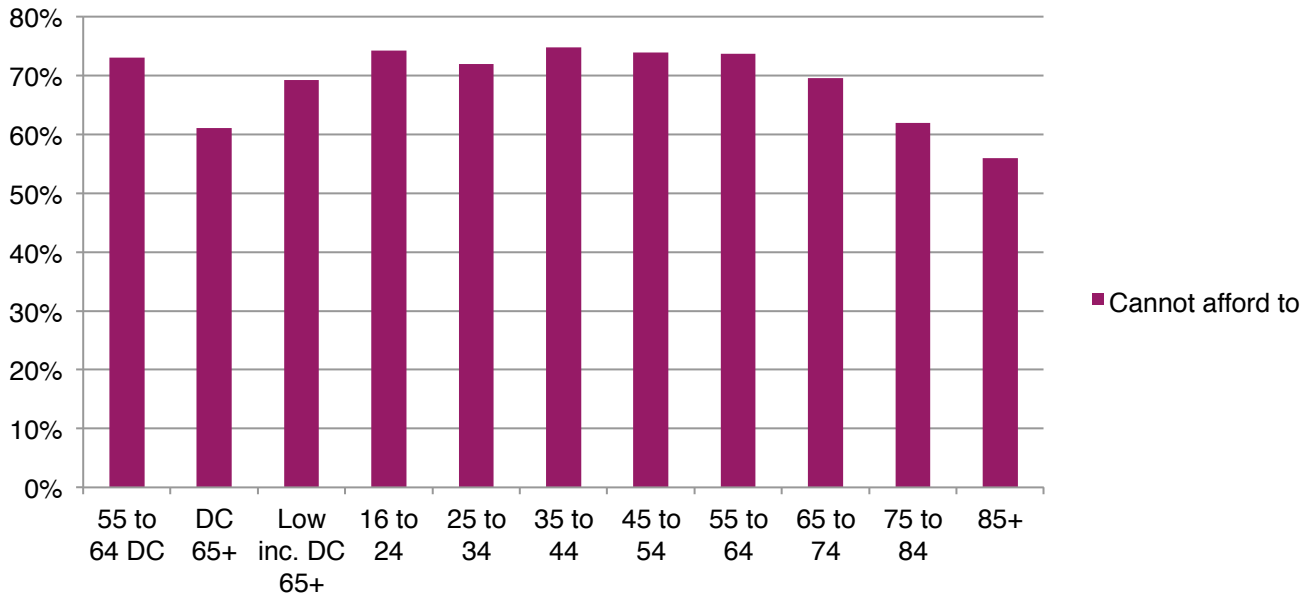
The second most popular motivation is saving for holidays or leisure; however, this motivation declines with age (see above), and to some extent, appears substituted with a rising prevalence of saving for other family members (see below).

Reason for saving money during last two years, 2010-2012 (WAS, Wave 3)



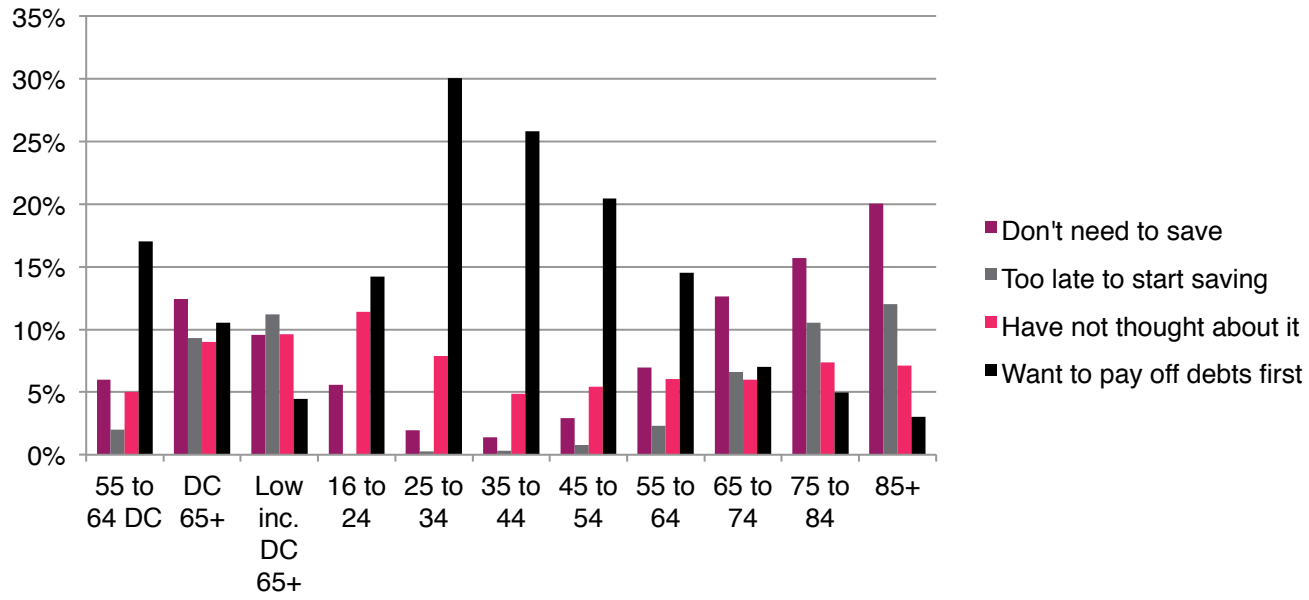
Conversely, among individuals who do not save, most report that they cannot afford to.

Reason for not saving during last two years, 2010-2012 (WAS, Wave 3)



Among the other principal reasons cited for not saving, the proportion of individuals who report not needing to save does rise in old age, but only to 20% of the 85+. Not saving due to wanting to pay debts off first falls with age, particularly between those aged 55 to 64 (15%) and those aged 65 and older (6%, not shown in chart) suggesting this is something people prioritise prior to retirement.

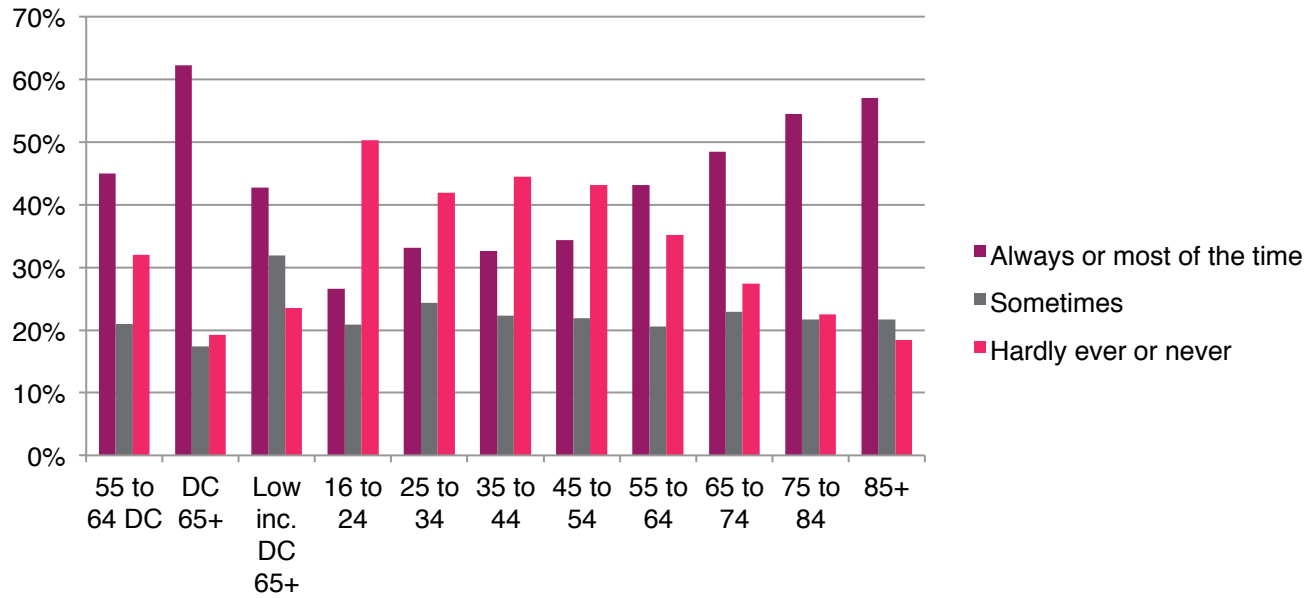
Reason for not saving during last two years, 2010-2012 (WAS, Wave 3)



10.3. Indirect saving

Savings may comprise deliberate saving – transferring a monthly, pre-planned amount from a current account to a savings account – or 'indirect', 'accidental' saving, i.e. unspent income in your current account at the end of the month. The chart below shows that most individuals have money leftover in their account at the end of the month, and the propensity is highest among DC retirees (62%) and increases overall with age.

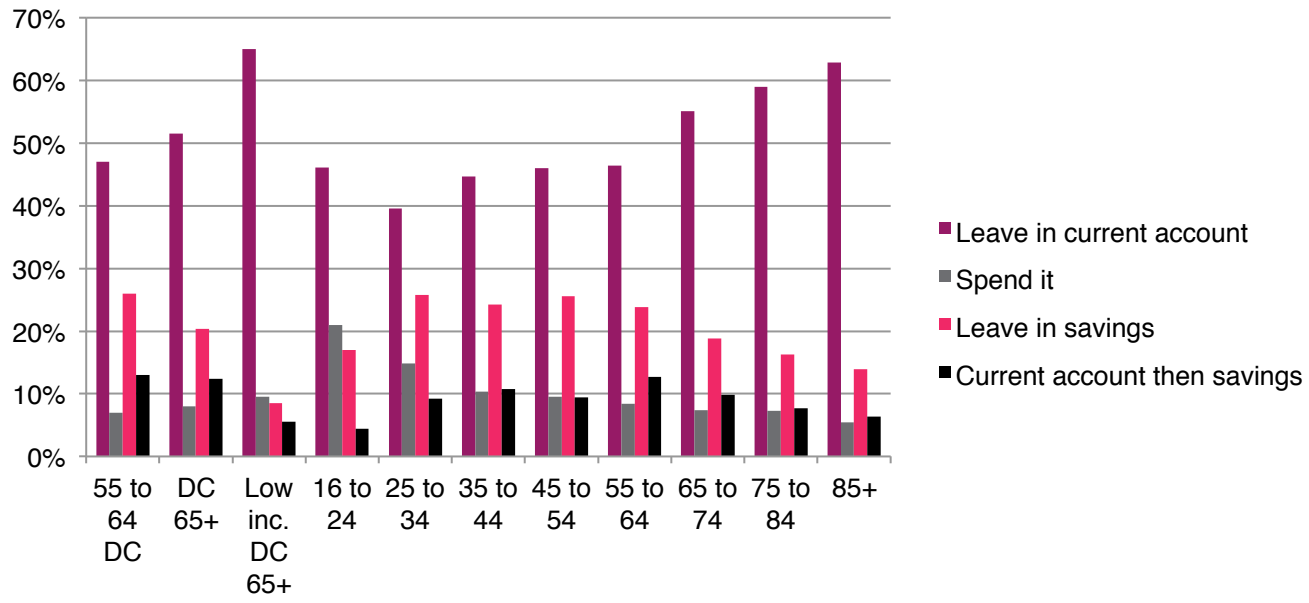
How often had money left over at end of week/month during last year, 2010-2012 (WAS, Wave 3)



Interestingly, over half of retirees report that they leave money left over at the end of the month in their current account. One in five DC retirees leave the money in a savings account,

and 12% move it from a current account to savings account. Interestingly, among all the groups studied, low income DC retirees are most likely to leave left over money in a current account.

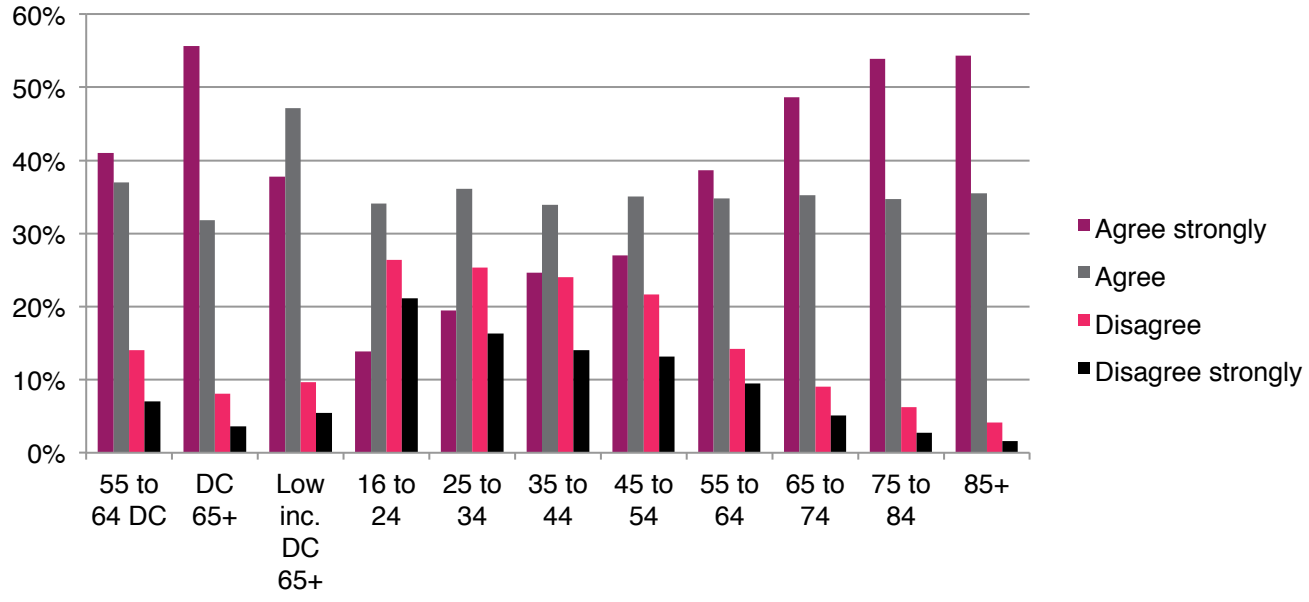
What does with money left over, 2010-2012 (WAS, Wave 3)



10.4. Attitudes to saving

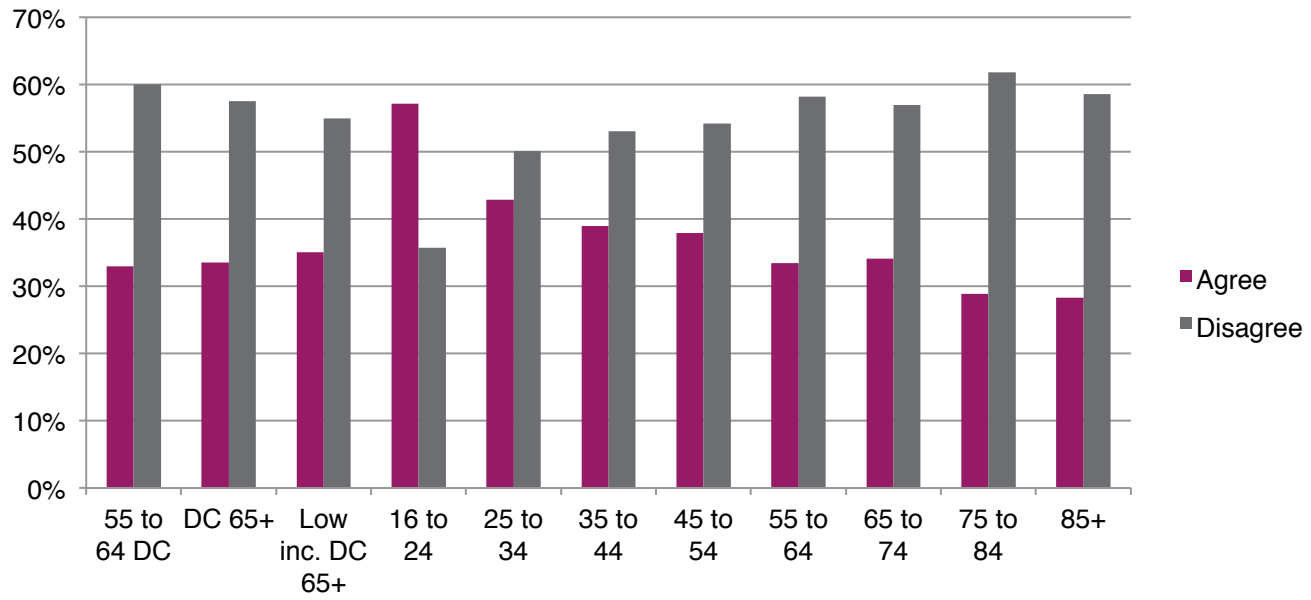
As individuals age, they are more likely to report they always have money saved for a rainy day.

"I always make sure that I have money saved for a rainy day", 2010-2012 (WAS, Wave 3)



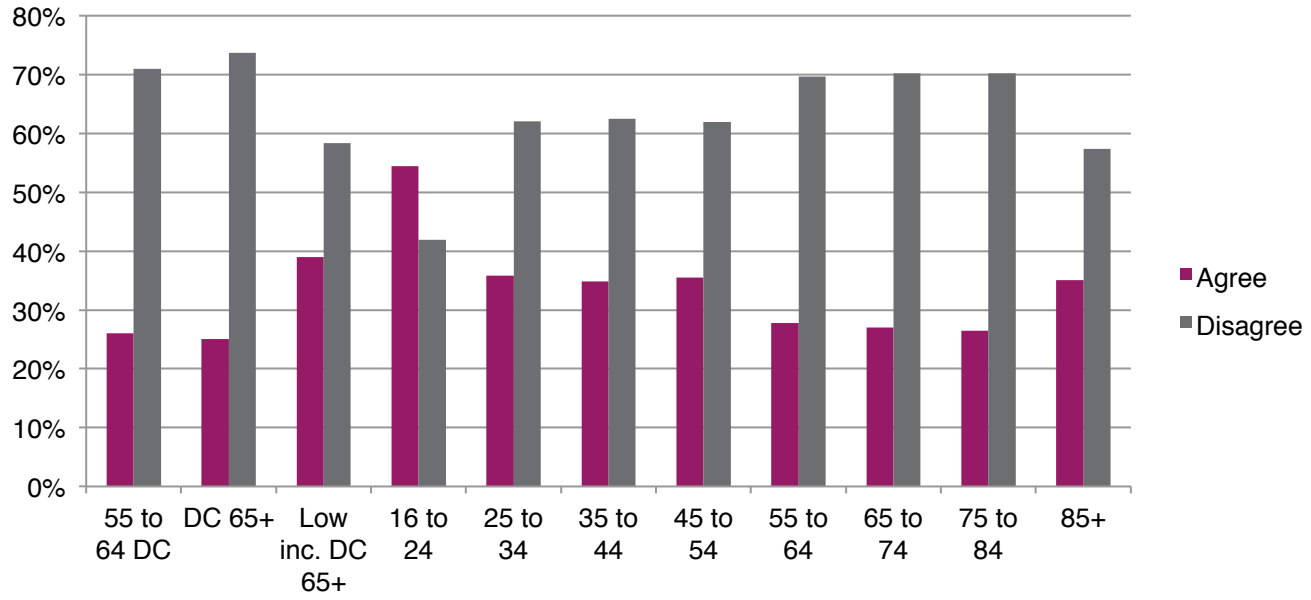
Interestingly, most people report they find it more satisfying to save than spend, and the tendency to report this increases with age.

"I find it more satisfying to spend money than to save it for the long term", 2010-2012 (WAS, Wave 3)



Similarly, the majority of people report they do not "live for today", and this is particularly true of older people with DC pension saving.

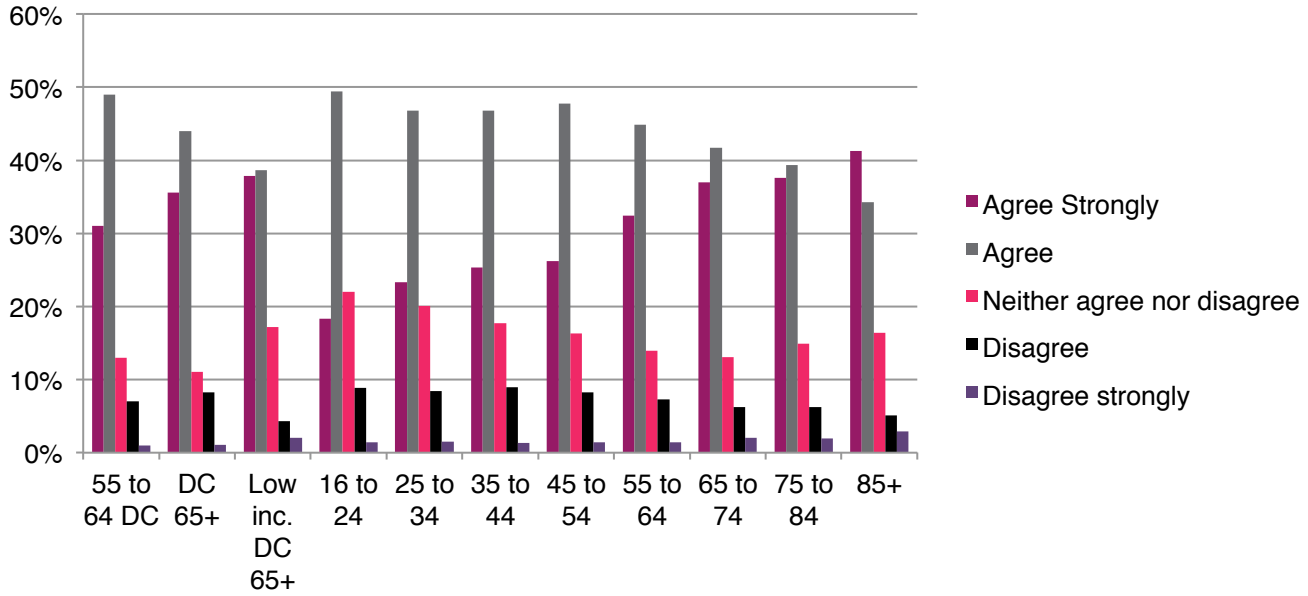
"I tend to live for today and let tomorrow take care of itself", 2010-2012 (WAS, Wave 3)



10.5. Attitudes to investment risk

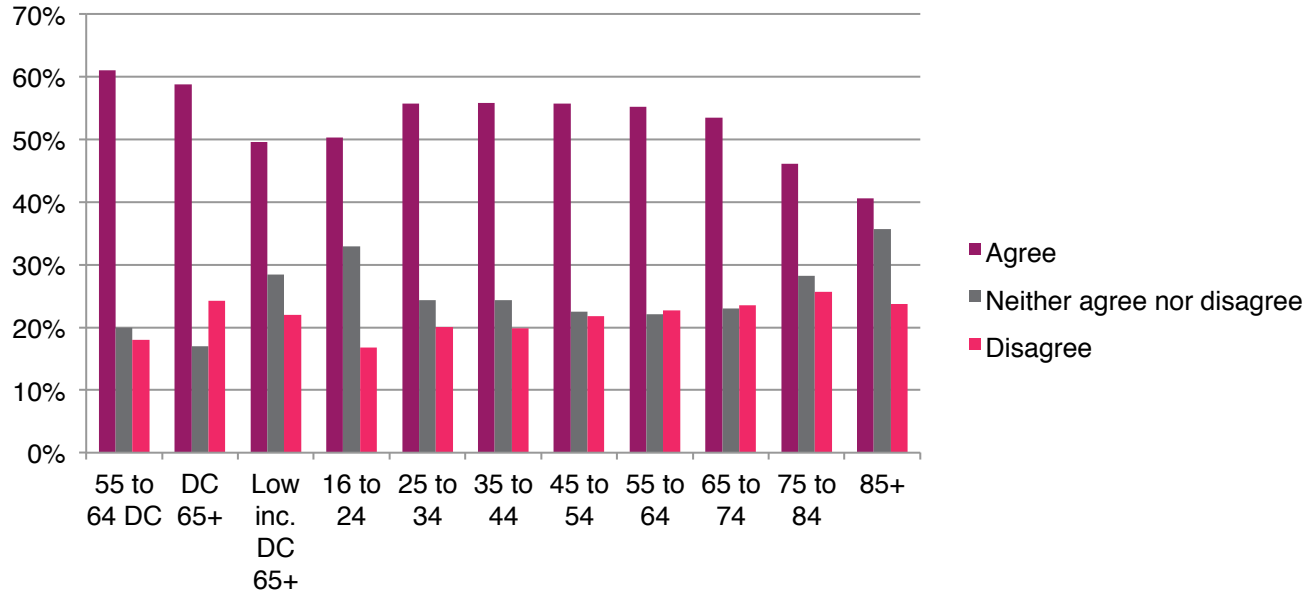
People's attitudes to investment risk are highly consistent across age-groups, with DC retirees particularly likely to agree that it is better to play it safe with your savings and investments. Indeed, a hardening of attitudes against investment risk is observable as individuals age.

"It is better to play it safe with your savings even if investing in higher risk investments could make you more money", 2010-2012 (WAS, Wave 3)



Nevertheless, most individuals accept that a good return on investment is associated with risk, although people are less likely to agree with this as they age, and agreement is lower among low-income DC retirees.

"You can't expect to get a good return on your money if you don't take certain risks", 2010-2012 (WAS, Wave 3)

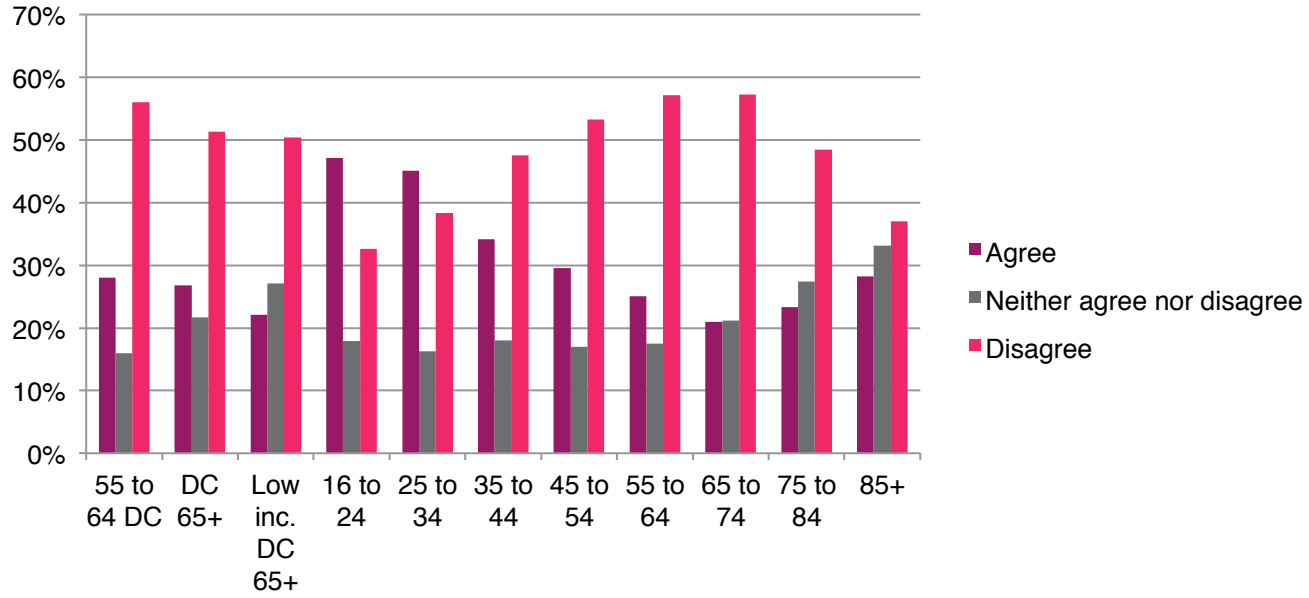


10.6. Financial position

To some extent, savings behaviour and attitudes, as well as attitudes toward risk, may reflect subjective financial position: whether individuals feel better or worse off than in preceding years, and whether they expect to be better or worse off in future.

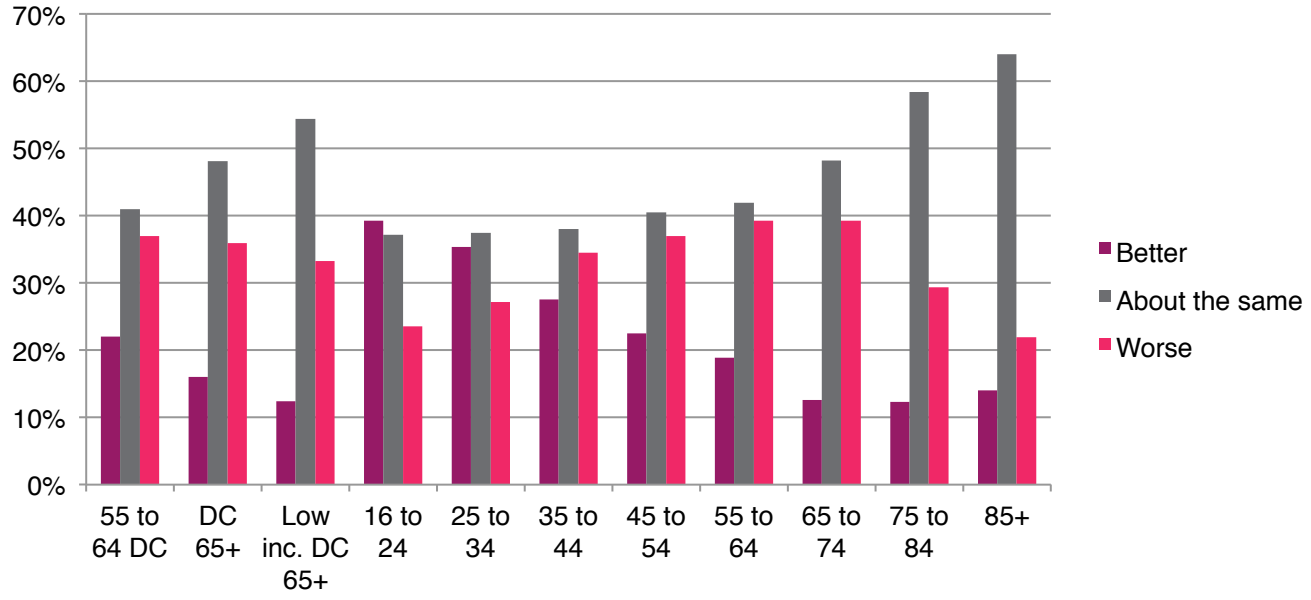
Analysis of WAS reveals that beyond the 25 to 34 age range, individuals are most likely to disagree that they are better off than a couple of years ago – although such a result must be interpreted in the context of the economic climate during the period of the survey: 2010-12.

"I am better off than I was a couple of years ago", 2010-2012 (WAS, Wave 3)



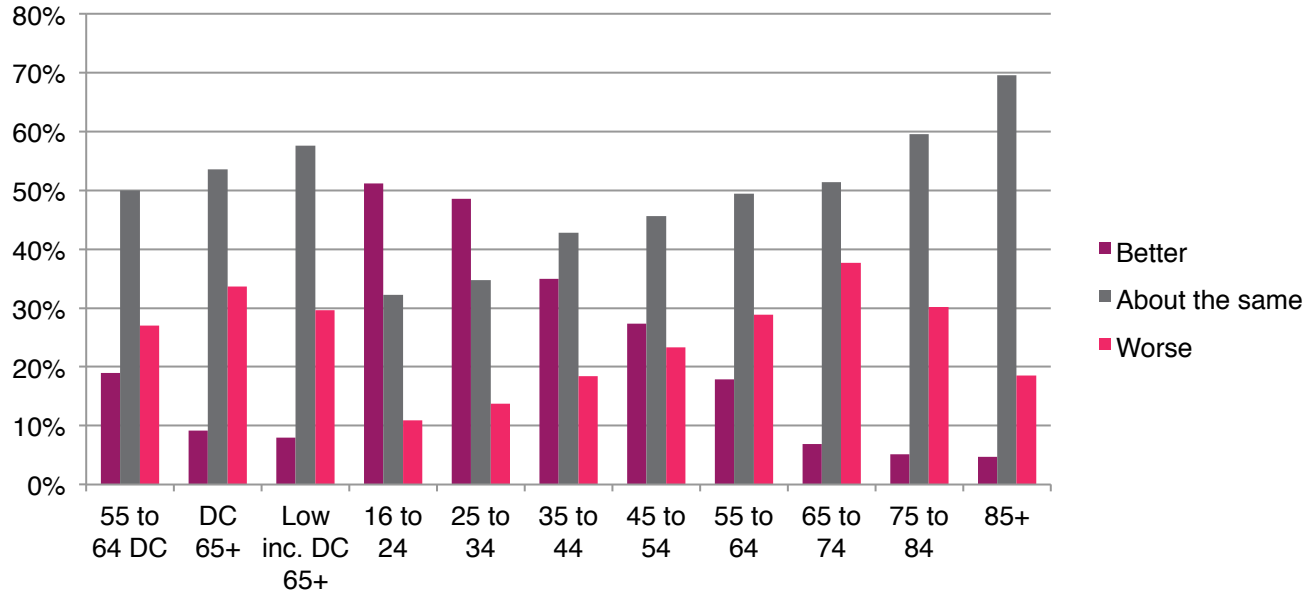
Rather than feeling better off, most individuals say their financial position is about the same as two years previously.

Compared with two years ago, financial position is..., 2010-2012 (WAS, Wave 3)



Looking to the future, as individuals age, they are increasingly likely to say they expect their financial situation to be the same in two years, and less likely to expect to be worse off, perhaps reflecting people's adjustment to living with a fixed, lower income in retirement.

Over the next two years, do you expect your financial situation to be..., 2010-2012 (WAS, Wave 3)



10.7. Conclusion

This chapter has examined savings behaviour, attitudes to risk and perceived financial position among the groups under study.

The analysis has found that around half of retirees engage in planned saving, despite being in the ‘decumulation phase’ of their life. There is also strong evidence of indirect, accidental saving, with individuals increasingly likely to report they have money left over in their current account at the end of the money as they age; however, many individuals then simply leave this money in their current account. Such behaviours must be set against an increasing tendency to report rainy-day saving as individuals age, and that risk of unforeseen expenditure motivates planned saving.

11. Financial engagement

Key results:

- **The main economic trend that individuals keep an eye on is changes in interest rates, including 50% of DC pre-retirees;**
- **Around one in three DC pre-retirees and DC retirees keep an eye on changes in inflation, although again, overall propensity declines with age. Less than one quarter of low-income DC retirees monitor inflation;**
- **Just 16% of the 65+ age group keeps an eye on changes in the stock market. Although propensity again declines with age, it is higher (25%) among DC pre-retirees and DC retirees, although very low (11%) among low-income DC retirees;**
- **Just 8% of the 65+ population keeps an eye on financial product best buy tables. Once more, propensity declines with age, is higher (13%) among the DC retiree group, but lower (4%) among the low-income DC retiree group;**
- **Conversely, nearly 30% of DC pre-retirees and DC retirees do not keep an eye on any economic trends, rising to 39% of all individuals aged 65+ and 41% of low-income DC retirees. More widely, the propensity to not monitor any economic or financial changes rises with age to 57% of the 85+ group.**

11.1. Introduction

The 'Freedom and Choice' changes to rules on DC pension savings in the UK announced in Budget 2014 place much greater personal responsibility on individual DC savers to use their pension savings to fund income and consumption in retirement, and secure value for money.

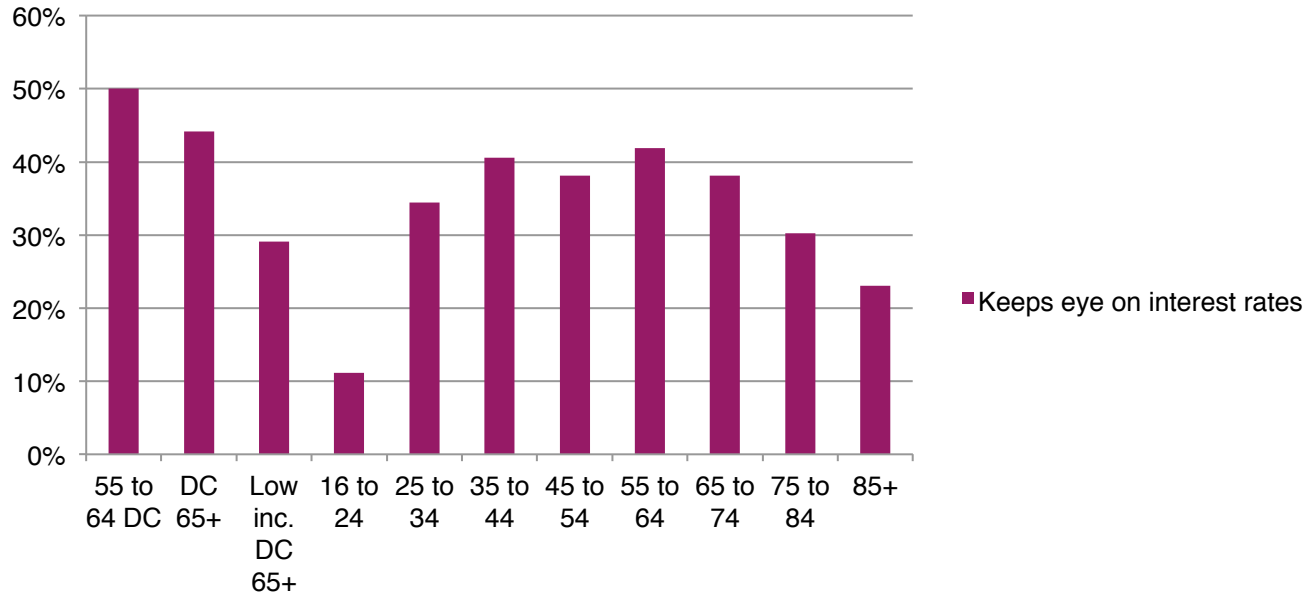
To be effective at managing their income and savings in retirement, individuals will need to keep an eye on economic trends, and the performance of different savings and investment products. The propensity to keep an eye on such indicators will clearly reflect motivational factors: for example, homeowners with variable rate mortgages may be highly motivated to keep an eye on changes in interest rates, relative to other groups. Nevertheless, if the government hopes that DC retirees will engage in active financial management following the Freedom and Choice changes, the prevalence of financial engagement may need to extend considerably.

Analysis of WAS is able to show the extent to which different groups monitor economic and financial changes, and how such monitoring changes over the life course.

11.2. Monitoring of economic and financial changes

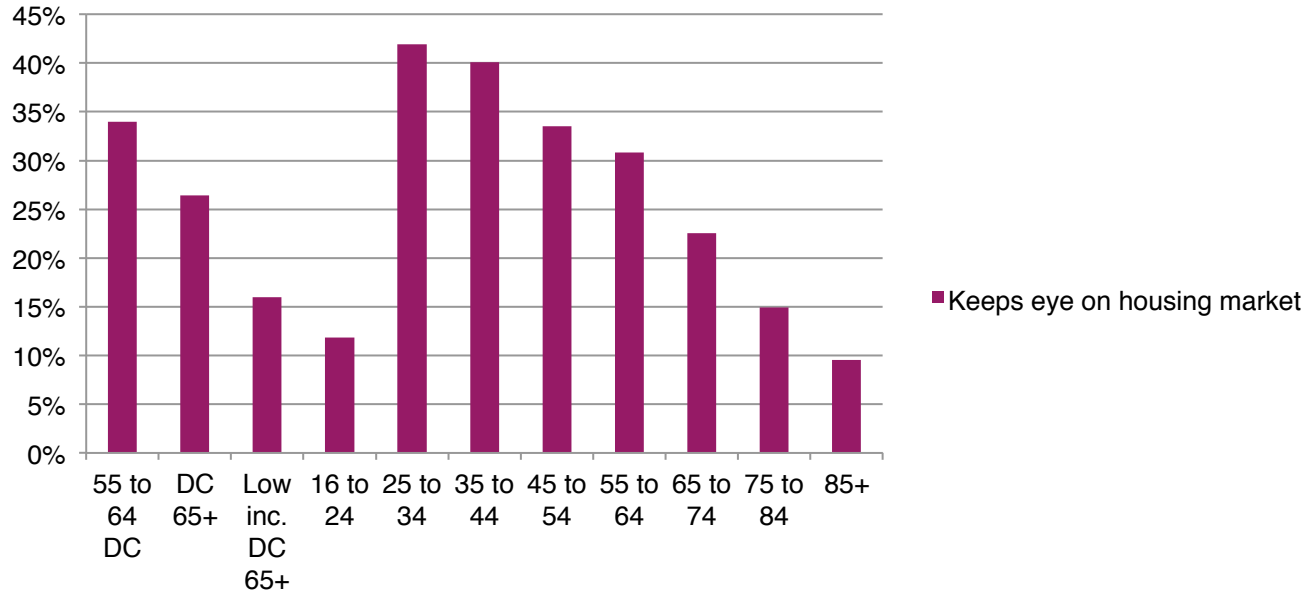
The principal economic trend that individuals monitor is interest rates, including 50% of DC pre-retirees who keep an eye on changes in interest rates, potentially reflecting the proportion in this group with liquid and mortgage debts to repay.

Whether keeps eye on changes in interest rates, 2010-2012 (WAS, Wave 3)



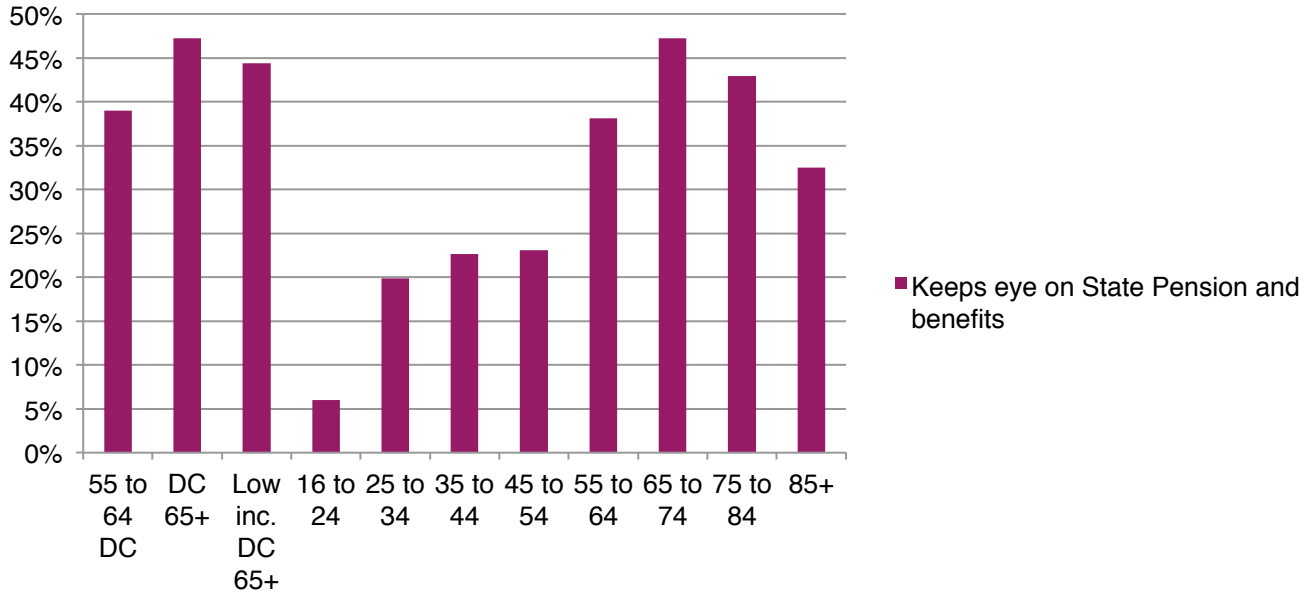
Many people also monitor changes in the housing market, peaking in the 25 to 34 age group (42%), when many individuals may be attempting to purchase their first home.

Whether keeps eye on changes in the housing market, 2010-2012 (WAS, Wave 3)



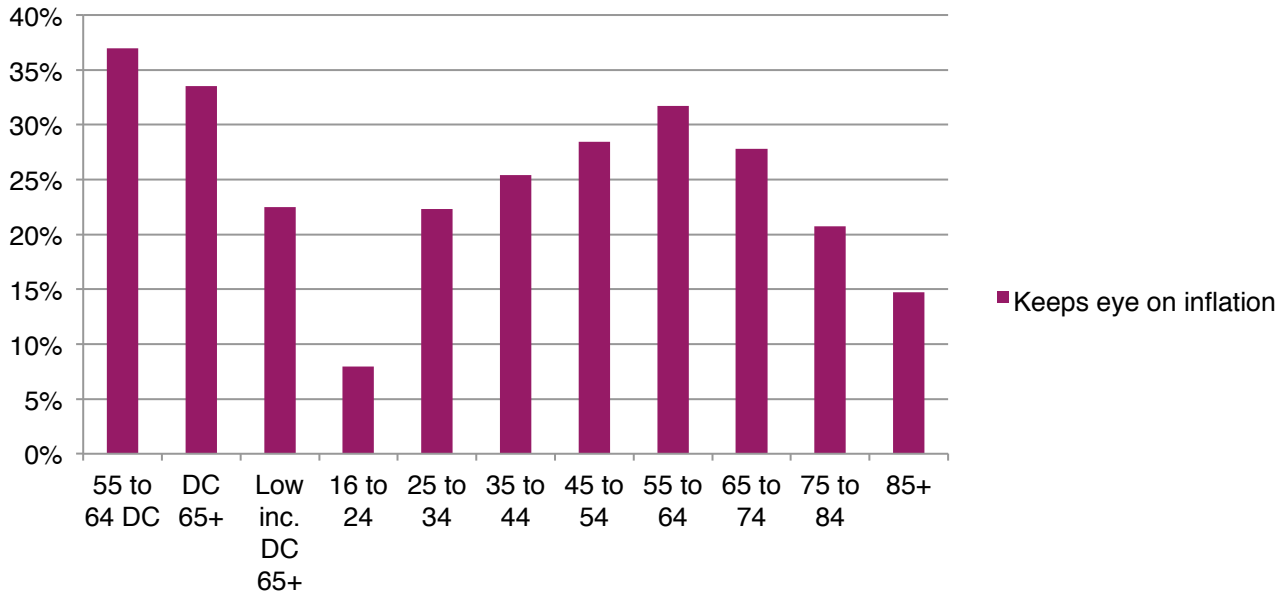
Monitoring of changes in State Pension and benefits is principally linked to age, including 44% of the 65+ age group, although this propensity does decline with age among those aged 65+.

Whether keeps eye on changes in State Pension and benefits, 2010-2012 (WAS, Wave 3)



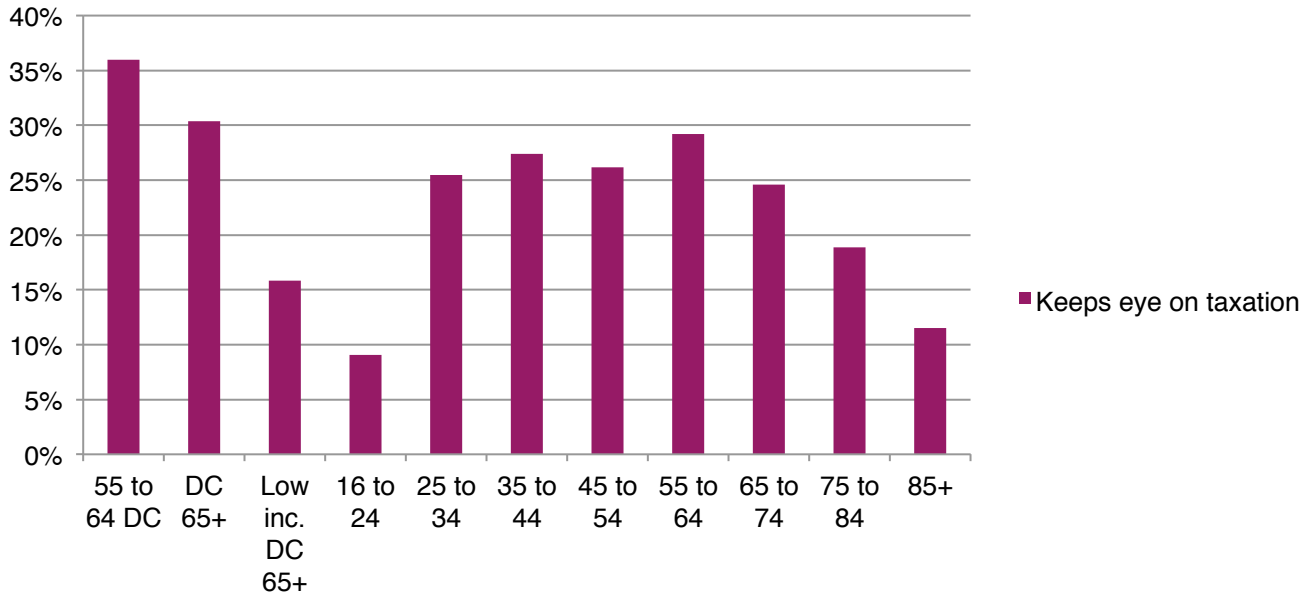
Around one in three DC pre-retirees and DC retirees keep an eye on changes in inflation, although again, overall propensity declines with age.

Whether keeps eye on changes in inflation, 2010-2012 (WAS, Wave 3)



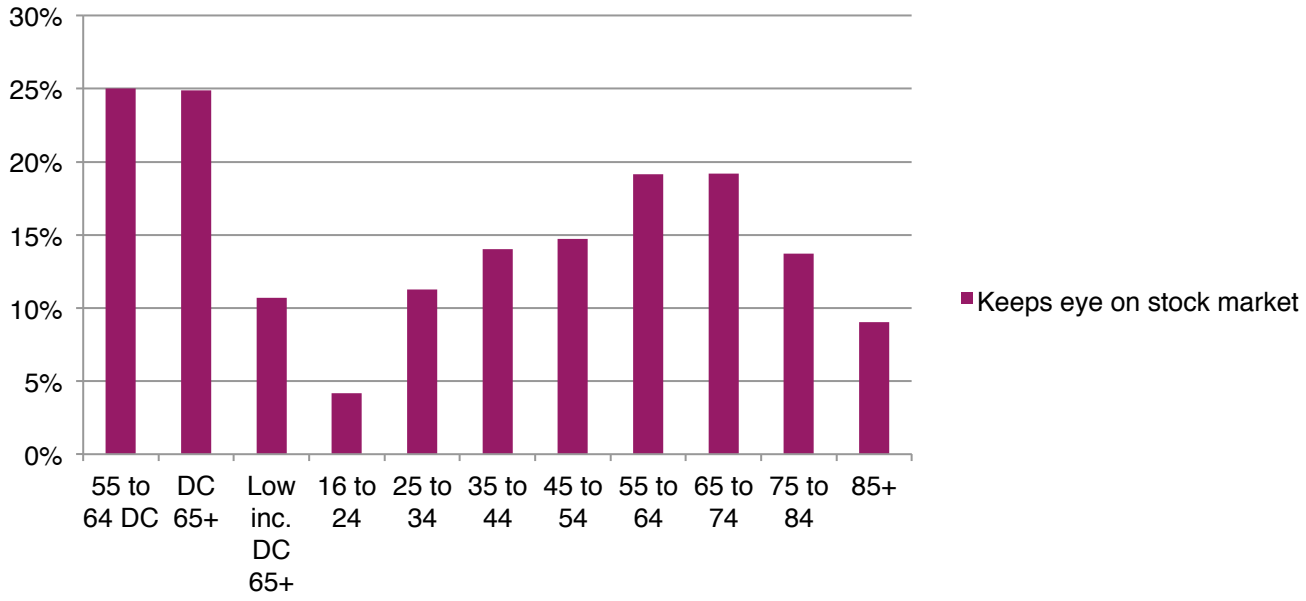
A similar pattern is observed across groups in relation to whether individuals keep an eye on changes in taxation.

Whether keeps eye on changes in taxation, 2010-2012 (WAS, Wave 3)



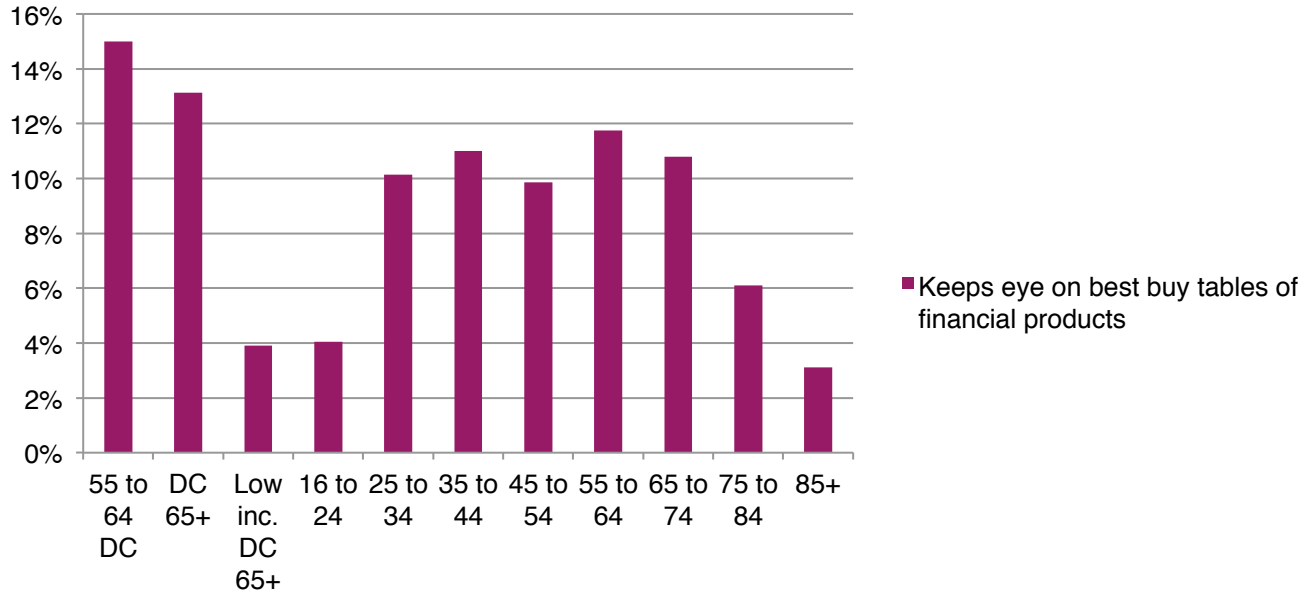
Just 16% of the 65+ age group keeps an eye on changes in the stock market. Although propensity again declines with age, it is higher (25%) among DC pre-retirees and DC retirees, although very low (11%) among low-income DC retirees.

Whether keeps eye on changes in stock market, 2010-2012 (WAS, Wave 3)



Just 8% of the 65+ population keeps an eye on financial product best buy tables. Once more, propensity declines with age, is higher (13%) among the DC retiree group, but lower (4%) among the low-income DC retiree group.

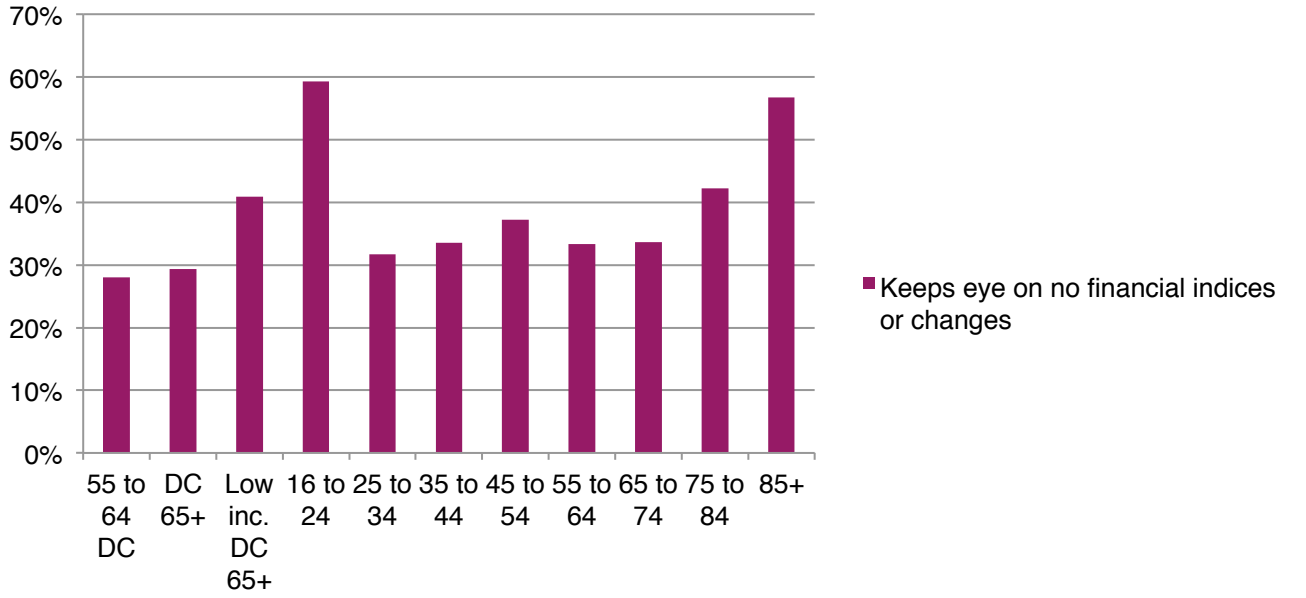
Whether keeps eye on changes in best buy tables of financial products, 2010-2012 (WAS, Wave 3)



Finally, analysis of WAS enables exploration of the percentage of different groups who keep an eye on no financial indices or changes in economic or financial trends.[16]

Nearly 30% of DC pre-retirees and DC-retirees do not keep an eye on any changes, rising to 39% of all individuals aged 65+ (not shown in chart) and 41% of low-income DC retirees. More widely, the propensity to not monitor any economic or financial changes rises with age to 57% of the 85+ group.

Whether keeps eye on <u>no</u> financial indices or changes, 2010-2012 (WAS, Wave 3)



[16] The full list comprises: Changes in interest rates; Changes in housing market; Changes in state pension, benefits; Changes in inflation; Changes in taxation; Changes in job market; Changes in stock market; Best buys in financial products

11.3. Conclusion

This chapter has reviewed varying levels of financial engagement among the groups of interest, and how levels of engagement vary over the life course.

It remains to be seen how individuals respond to the Freedom and Choice changes to rules on DC pension savings from the age of 55, and whether the choices made by individuals would require them to maintain high levels of financial engagement to secure optimal returns or income.

As well as low overall levels of financial engagement, the key finding from this analysis is that engagement declines with age: whatever decisions and financial behaviour that individuals engage in during their 60s may not extend into their 80s. This underlines again the importance of analysing the implications of the changes in terms of the whole life course.

In addition, it is noticeable that levels of financial engagement are low among low-income DC retirees, despite the marginal benefits and costs of remaining financial engaged being potentially higher for this group, e.g. monitoring interest rates in order to seek out higher returns.

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