Legal & General Investment Management
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Tax-free cash putting retirements at risk

- **Savers confuse pension pots for savings accounts, which may have a detrimental impact on retirement**
- **76% do not intend to use their TFC for retirement income**
- **Nearly a third (28%) access pensions pots while still in 'accumulation' phase**
- **Female pensions savers are over 10% more likely to sacrifice returns by taking cash at 55**

Britain's future pensioners are putting their retirement future at risk by withdrawing cash from their pension pots while still in the accumulation phase, according to a study by LGIM of more than 1,500 members of defined contribution pension schemes.

The research by the UK's largest DC workplace pensions provider reveals that 28% of members polled who either took a lump sum or a recurring income were still contributing to their pension pots. Nearly three-quarters of those who access their tax-free cash believe that the main purpose of their pension is to provide an income for life. However, 76% of respondents do not intend to use their tax-free cash to provide them with an income in retirement.

Over 50% of those who had withdrawn their lump sum said they did not need to take as much at that time and of those who decided to withdraw a lump sum, the most popular choice of what to do with it (27%) was to spend it on home repairs and improvements.

The tax-free aspect of taking a special lump sum at the age of 55 is a clear driver behind this behaviour. Nearly half (46%) would not have withdrawn their cash if it had not been tax free.

This is also implied by the timing of withdrawals. Among those polled who have withdrawn from their pension, more than a quarter (26%) did this as soon as possible at the age of 55 exactly, with many unaware of the potential for growth had they kept their money invested for longer.

Over half who had withdrawn their lump sum said they did not really need as much right away and that they could have taken less. Meanwhile nearly one-third (29%) said that they could have used other savings, instead of taking the lump sum out of their pension

This highlights that the decision of when to take cash from pension pots – and how much to take – is not often based on financial planning.

Rita Butler-Jones, co-head of Defined Contribution at LGIM, comments: ***"Rather than its original intention of incentivising saving, tax free cash allowances appear to have the opposite effect in practice – encouraging members of pension schemes to spend more before they retire and take their tax-free cash savings whilst they still have other sources of cash savings. This is a potentially very damaging situation for whole generations of future retirees. Freedom today is hurting freedom tomorrow.***

While minimising tax is often the driver of 'tax free withdrawals', in many cases it can actually lead to less tax efficient outcomes for members. Those who withdraw while still in the accumulation stage of their pension – which is the majority as mentioned above – compromise their 'Money Purchase Annual Allowance' (MPAA), which reduces the annual amount they can pay in to their pension each year, tax-free, from £40,000 to £4,000. This can have major tax implications for those still planning to put funds back into their pension pots.

Those with less in their pension are more susceptible to these trends. More than two thirds (68%) of those who have taken tax free cash from a larger pension pot (of over £250,000) have a plan so that their cash withdrawal provides them with an income in retirement. This compares to only 13% of those with less than £10,000 in their pension – two-thirds (65%) of whom haven't yet worked out what monthly income they will need in retirement. Over half (53%) of those with pots of less than £10,000 agreed with the statement that tax-free cash is 'there to spend, like a bonus or a windfall' compared to less than a third (30%) of those with pots of over £250,000.

But even among richer savers, there is an aversion to keeping their tax-free cash invested in their pension. While nearly half (48%) of those with pots of over £250,000 say they believe their lump sum is something to 'invest elsewhere, for better returns', those with pots of over £250,000 are three times more likely to keep their tax-free lump sum in cash rather than invest it (54% in cash savings versus 18% in a stocks and shares ISA or other investments).

Women are also more at risk from the side effects of tax-free cash. Female pensions savers are more likely to withdraw earlier (33% of women versus 22% men at aged 55) and to put their tax-free cash in a savings account, current account, or cash ISA to keep for a rainy day (29% women versus 19% men) leaving them vulnerable to accepting a low cash interest rate instead of an investment return in their pension for longer.

Rita Butler-Jones, co-head of Defined Contribution at LGIM, continued*: "Thinking seriously about pensions needs to start much earlier than the age of 50 or 55 and members need to consider their whole financial picture, including their existing savings, as possible sources of wealth. Pensions providers can help by giving members the confidence to not always opt for the 'cash under the mattress option', whether that is staying invested for longer or withdrawing in a more tax-efficient way, giving members more financial freedoms for longer."*

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Notes to editors:

Research Methodology

Research was conducted in August 2021, surveying 1,526 members of defined contribution (DC) pension schemes in the UK, aged 50 years and older.

About Legal & General Investment Management

Legal & General Investment Management is one of Europe's largest asset managers and a major global investor, with total assets under management of £1.3 trillion (€1.4 trillion, CHF 1.5 trillion, JPY 181 trillion, $1.7 trillion) [1]. We work with a wide range of global clients, including pension schemes, sovereign wealth funds, fund distributors and retail investors. Throughout the past 40 years we have built our business through understanding what matters most to our clients and transforming this insight into valuable, accessible investment products and solutions. We provide investment expertise across the full spectrum of asset classes including fixed income, equities, commercial property and cash. Our capabilities range from index-tracking and active strategies to liquidity management and liability-based risk management solutions.

[1]LGIM internal data as at 30 June 2021. The AUM disclosed aggregates the assets managed by LGIM in the UK, LGIMA in the US and LGIM Asia in Hong Kong. The AUM includes the value of securities and derivatives positions.

Key Risk Warning

The value of an investment and any income taken from it is not guaranteed and can go down as well as up; you may not get back the amount you originally invested.

Further information

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