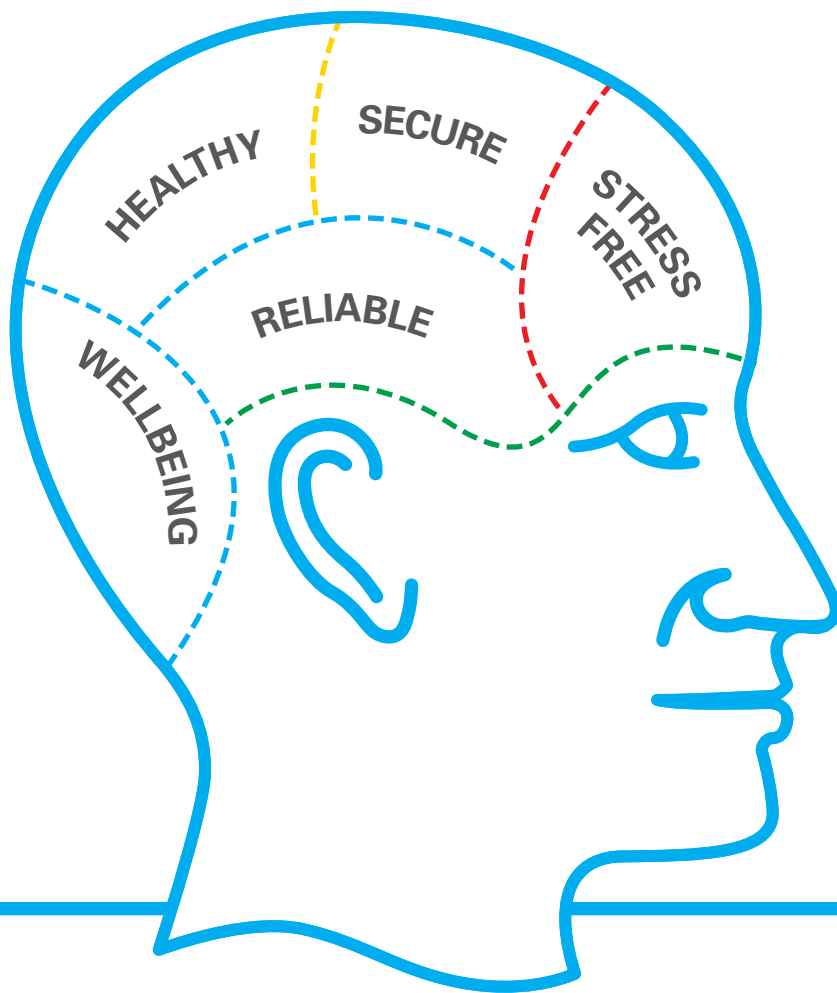


The retirement income riddle:

New perspectives on how we make financial choices and their impact on our wellbeing



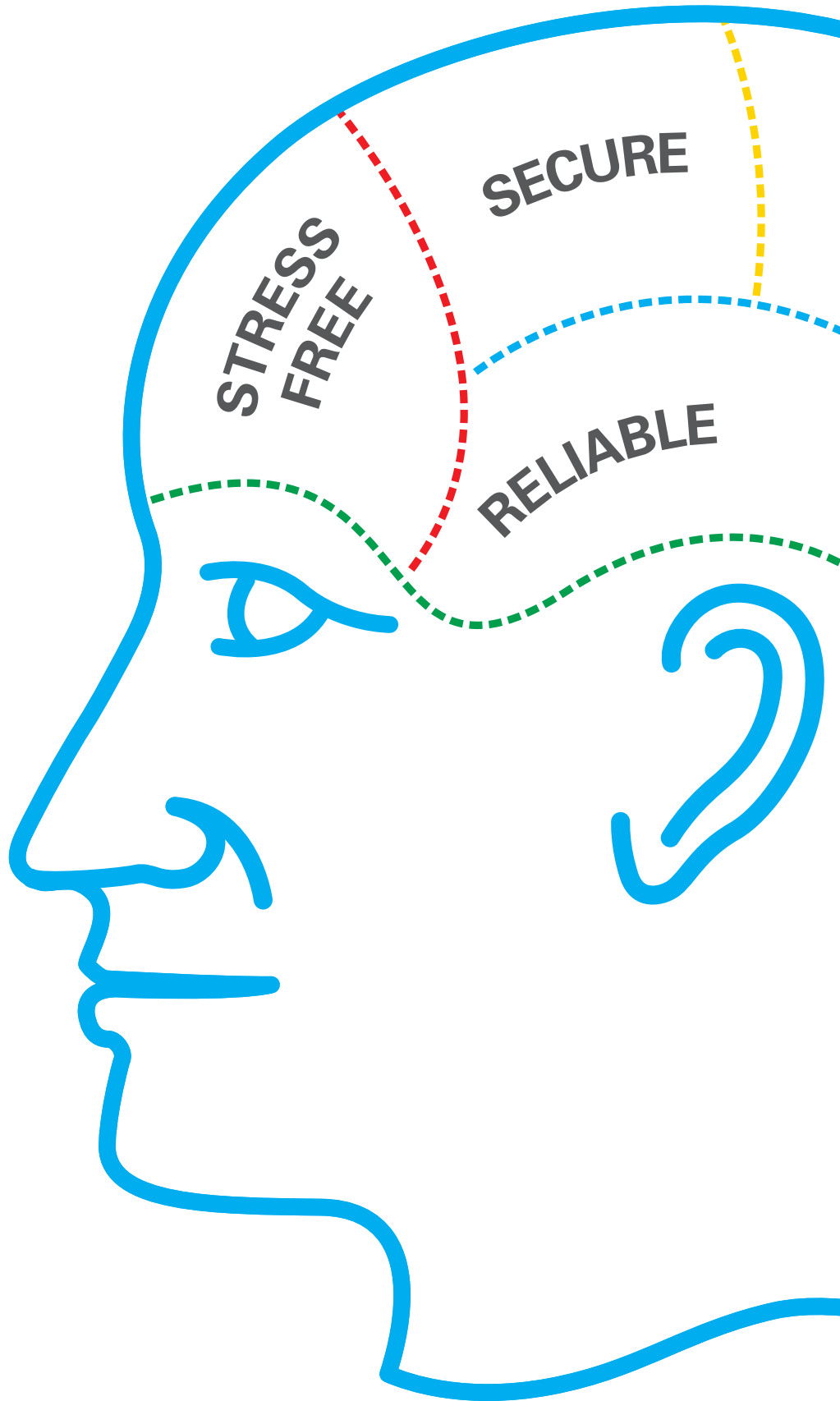
Demos research commissioned
by Legal & General

DEMOS

**Legal &
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Introduction



Emma Byron

Managing Director,

Retail Retirement Income at Legal & General

Within a few decades there could be 20 million different plans for 20 million over-65s.¹ Carriage-clock retirement is over, replaced by bespoke journeys where the retiree is in the driving seat.

This means big changes to retirement income: having a “one-size-fits-all” retirement income plan is yesterday’s solution to yesterday’s problem. A new age of retirement that includes work, relationships, ambition, contribution and disruption needs financial services to match.

The reforms of 2015 were a step in this direction, but to get the best out of the pensions system, we need to understand much more about the impact that financial choices can have on people’s retirement journey. Using that comprehension, we must engage with our customers in a new way.

It is still early days, and the reforms are settling into a pension landscape that is still evolving, but it is clear that more could be done to help people shape their retirement effectively.

This report looks at the contradictions in retirement income planning, including why, with such great ambitions for retired life, are so few people taking the time to strategise, think, gather information,

seek qualified advice about how to get an income to deliver their dream?

Research shows that consumers are typically either extracting the entire amount or passively defaulting into an income drawdown arrangement with their existing pension provider.² Why are people not always considering annuities, when often they are the right choice to form part of their retirement income plan?

What rings alarm bells for us at Legal & General, is that many consumers are potentially choosing options which are not good for their wellbeing. Furthermore, many seem to be defaulting to their existing provider, rather than considering all options and all providers.

With any extension of freedom comes choice and new questions. For the first time, in many instances, people are having to consider issues as varied as later life care, longevity, tax, investment performance and charges. It is clear that, in the face of this situation, many people need help to learn new skills, and receive guidance about the potential consequences of their financial choices.

The new research published in this report considers these consequences. Demos has looked at the English Longitudinal Survey of Ageing and found that there is a correlation between health and wellbeing, and the retirement income choices people make.

As a company with 180 years’ history, helping people have a good retirement, Legal & General want to do more to help UK retirees make informed choices about what they want, and how they might be able to achieve it.

¹ <https://www.ons.gov.uk/peoplepopulationandcommunity/birthsdeathsandmarriages/ageing/articles/livinglongerhowourpopulationischangingandwhyitmatters/2018-08-13>

² <https://www.fca.org.uk/publication/data/data-bulletin-issue-14.pdf>

Executive summary

Recent research found that over-55s spend more time buying a car than deciding how to use their pension.³ The Baby Boomers and their children, Generation X, have big plans for retirement, that encompass everything from work to volunteering; finding new loves to kindling old friendships. Ambitions for retirement are soaring, yet financial conversations have not yet caught up.

We have undertaken research that explores the relationship people have with their pension savings, and their finances in general, and how that affects their health and wellbeing, financial security, and life satisfaction and quality.

Much of our analysis is concerned with consumer behaviour after the introduction of the pension reforms in 2015, when the then Government introduced changes to the rules on Defined Contribution (DC) savings.

In particular, we have built on the findings from a number of studies that explore the link between secure income and people's experience of retirement. This includes the work of the Joseph Rowntree Foundation, which explored themes of happiness and secure income for life.

In our study we have built on this work by commissioning Demos to analyse a dataset from Wave 7 (2014-15) of the English Longitudinal Survey of Ageing (ELSA), prior to the introduction of the reforms. We believe this highlights that there could be a significant impact on consumer wellbeing, post pension freedoms.

The analysis concluded that for those retirees on modest or poor incomes (as represented by the bottom 50% of income levels) who were invested in an income drawdown arrangement, almost one in five (19%) said they had not enjoyed their life over the past week. This contrasts with those people from the same income bracket who had taken out an annuity. Only 8% of these people said that they had not enjoyed their life over the preceding week.

In the three years since the pension reforms came into effect, over 436,000 pensioners have invested in a drawdown arrangement. Only 187,000 have taken out an annuity.⁴

Our analysis suggests that there are potentially 50,000 people in this lower income bracket who may have made such a choice and who may now be finding life more difficult as a result.

Whether this is through a lack of poor advice, or because it was the easiest action, some people appear to have entered drawdown arrangements without fully appreciating what it would mean. For those on lower incomes, where there is a reduced capacity for loss, data suggests that for some people, annuities have been replaced by other solutions – even though, for many, the underlying needs and wants from a product solution haven't changed. Many people, certainly on lower incomes, still want, need and can benefit from a guaranteed income for life.

³ <https://www.legalandgeneralgroup.com/media-centre/press-releases/over-55s-spend-more-time-buying-a-car-than-deciding-how-to-use-their-pension/>

⁴ FCA Data Bulletin September 2018 Retrieved from <https://www.fca.org.uk/data/data-bulletin-issue-14>

Power to the people

Big global trends are driving changes to the UK's pension system: in a few decades there will be 20 million retirees in the UK⁵ the "DB to DC" switch continues as corporations seek to better manage their pensions risk.⁶ UK public spending has dropped from nearly 48% of GDP to nearer 41% since 2010⁷ and lastly, search, comparison and review technology is beginning to redefine the way consumers make buying choices.⁸

The mega-trends have shifted responsibility from the state to the individual, and this can be seen in the evolution of the UK's pensions system. Begun under the 1997-2010 Labour Government, auto-enrolment into workplace savings has reversed the decline of pension saving dramatically.⁹ The Coalition Government introduced the new state pension to replace means-tested top-ups with a basic rate, while simultaneously pushing the state pension age closer to 70.¹⁰ The end of the default retirement age has sparked a big increase in the number of over-65s who are working.

Provided with more freedom to choose, the post-2015 retirees have done just that: 1.5 million DC pension pots have been accessed and twice as many DC pension pots were used for drawdown as for an annuity, and 32% were accessed without advice.¹¹

The role of pension freedoms and why they were introduced

April 2015 marked one of the greatest changes to the UK's pensions landscape in recent times. For a number of years, Governments have been faced with a growing, ageing population, and while life expectancy continued to rise, private pension savings were in fact falling.¹²

Additionally, a sustained period of low interest rates had a disastrous effect on gilt yields and, as a result, annuity rates. Private pension holders were increasingly exposed to changes in bond yields because of the decline of Defined Benefit (DB) schemes. In the late 1990s and early 2000s, providers had rapidly moved from offering DB pensions to the more flexible DC pensions. DC pensions are easier to move from one employer to the next, but also make the consumer assume a degree of risk.¹³ The rise of DC pensions meant individuals, rather than employers, have had to absorb the effect of falling bond yields, through a decline in annuity rates. Very few people actively shopped around for the best deal, even though they were legally entitled to do so. Eight in ten consumers would have been able to get a better deal on the open market, the FCA found in 2013.¹⁴

5 <https://www.ons.gov.uk/peoplepopulationandcommunity/birthsdeathsandmarriages/ageing/articles/livinglongerhowourpopulationischangingandwhyitmatters/2018-08-13>

6 <http://www.pensionspolicyinstitute.org.uk/briefing-notes/briefing-note-2-the-shift-from-defined-benefit-to-defined-contribution>

7 <https://tradingeconomics.com/united-kingdom/government-spending-to-gdp>

8 <https://www.prnewswire.com/news-releases/global-price-comparison-websites-pcw-market-2016-2020-with-focus-on-the-uk-market-300487923.html>

9 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/712812/workplace-pension-participation-and-saving-ends-2007-2017.pdf

10 <https://www.gov.uk/government/news/500-days-to-go-until-biggest-state-pension-overhaul-in-generations>

11 <https://www.fca.org.uk/publication/market-studies/ms16-1-3.pdf>

12 Ibid

13 Pensions Commission (2005). A New Pension Settlement for the Twenty-First Century. The Second Report of the Pensions Commission. London: Department for Work and Pensions

14 Financial Conduct Authority (2014). TR14/2. Thematic Review of Annuities. Retrieved from <https://www.fca.org.uk/publications/thematic-reviews/tr14-2-%E2%80%93-thematic-review-annuities>

Reforms

In July 2010, in response to this situation, the Government launched a consultation on proposals for reform. The Government's objective was to "re-invigorate private pensions saving, by giving people greater flexibility to choose the retirement options that are best for them".¹⁵

The Coalition Government (2010-15) introduced a series of policies to remedy the situation. One key measure was auto-enrolment, which required employers to automatically enrol workers into a workplace pension and make minimum contributions. This scheme was first introduced in October 2012 and it has led to a sustained rise in pension savings: figures indicate that 62% of individuals now have a pension, rising to 78% of full-time employees.¹⁶

In advance of more radical policies introduced in April 2015, from March 2014 the Government introduced changes which increased the size of pension pot that could be taken as a lump sum, and introduced more flexibility into income drawdown arrangements.¹⁷ These actions were intended to promote different behaviours among pre-retirees and encourage them, through greater choice, to take a more active role in their retirement income planning and shop around.

In April 2015, the new rules were introduced. People were now presented with six options:

- Leaving the pension pot untouched
- Purchasing an annuity
- Getting an adjustable income (Flexi-Access Drawdown)
- Taking cash in chunks (Uncrystallised Funds Pension Lump Sum)
- Cashing in the whole pot in one go
- Mixing any of the options¹⁸

The main aim of these changes was to give people greater access to their pensions, and the ability to shop around for different investment opportunities. There was now no limit on how much income a person after the age of 55 could choose to take from drawdown funds, although there are tax implications.¹⁹



¹⁵ HM Treasury (2010). Removing the requirement to annuitise by age 75 (PU1025). Retrieved from https://www.plsa.co.uk/portals/0/Documents/0141_Compulsory_annuitisation_the_NAPP_response_to_HM_Treasurys_consultation_110910.pdf

¹⁶ Department for Work and Pensions (2012, 25 January). New timetable clarifies automatic enrolment starting dates (press release). Retrieved from <https://www.gov.uk/government/news/new-timetable-clarifies-automatic-enrolment-starting-dates>

¹⁷ House of Commons Library (2017). Pension flexibilities: the 'freedom and choice' reforms (CBP-06891). Retrieved from <http://researchbriefings.files.parliament.uk/documents/SN06891/SN06891.pdf>

¹⁸ Pensions Advisory Service Pension reform: Freedom and choice <https://www.pensionsadvisoryservice.org.uk/about-pensions/pension-reform/freedom-and-choice> Accessed 7 June 2018

¹⁹ House of Commons Library (2015). Pensions: Annuities (SN06552). <http://researchbriefings.files.parliament.uk/documents/SN06552/SN06552.pdf>

Consumer behaviour

The 2015 reforms handed control to people to choose how to use their pension savings, and in doing so it could be inferred that there was an underlying assumption that consumers would act logically and rationally to ensure they received good returns, and that they would actively participate in their financial planning. In reality, very few people are both inclined and able to carry out the necessary thorough search of all the options available. With greater choice comes greater complexity, and faced with such choice many consumers take the “path of least resistance”.²⁰ In the United States the work of Avenger et al (2005) found that for every ten funds that were added to the list of choices for 401K pension plans, participation rates fell by between 1.5% and 2%. More recently, a study by Mintel found that while 84% of DC pension holders like the idea of being able to take control of how they access their pension funds, 74% of pension investors find the various retirement income options confusing.²¹

If people are unable to make decisions on their own, then seeking professional advice is clearly an option. But, there is a disparity between what individuals are willing to pay for financial advice, and the reality of costs.²² The Pension Advice Allowance, designed to encourage people to seek professional advice,

has seen limited results.²³ Over-50s with a workplace or personal pension are now entitled to free advice from Pension Wise, but take-up remains low: an FCA report found that only about 10% of people accessing their pension are consulting Pension Wise.²⁴

So if consumers are unable or reluctant to access professional advice, then they rely on their own experience and knowledge to make appropriate decisions for the future. However, research has highlighted that many do not have the skills and knowledge to manage their finances optimally²⁵ and often rely on their personal networks of friends and family. People are often far from informed, because they cannot research or analyse the available options, because they don't want to, or simply because they do not place any relative value on the benefits from investing their time.²⁶ Studies conducted by the Pensions Policy Institute (PPI)²⁷ and the FCA²⁸ show that people often demonstrate short-termism in their thinking. They will opt for “good enough” even if it is not optimal, and they stop searching for alternatives once they encounter something that meets their expectations.²⁹ In the annuities market, 91% of individuals are aware of the need to “shop around”, but 57% stick with their current pension provider,³⁰ even though it is likely for many that this was not the best available rate.

20 Agnew and Szykman, 2005

21 Mintel, Aug 2018

22 <https://www.yourmoney.com/retirement/only-one-in-five-retirees-willing-to-pay-for-financial-advice/>

23 <https://www.ftadviser.com/your-industry/2018/05/09/advice-allowance-fails-to-fulfill-promise/>

24 Financial Conduct Authority (2017). Retirement Outcomes Review Interim Report (MS16/1.2), p36. Retrieved from <https://www.fca.org.uk/publication/market-studies/retirement-outcomes-review-interim-report.pdf>

25 McKechnie (1992), Lusardi (2015), Howlett et al (2008), Huhmann et al (2009), Finney and Hayes (2012) and Beckett (2006)

26 Lusardi, A (2015). Financial Literacy: Do people know the ABCs of finance? Public Understanding of Science. Vol 24(3) 260-271

27 Pensions Policy Institute: Consumer engagement: barriers and biases (February 2017)

28 Financial Conduct Authority (2014) TR14/2. Thematic Review of Annuities (October 2014)

29 Simon, HA (1956). Rational Choice and the Structure of the Environment. Psychological Review

30 <https://www.fca.org.uk/publication/data/data-bulletin-issue-14.pdf>

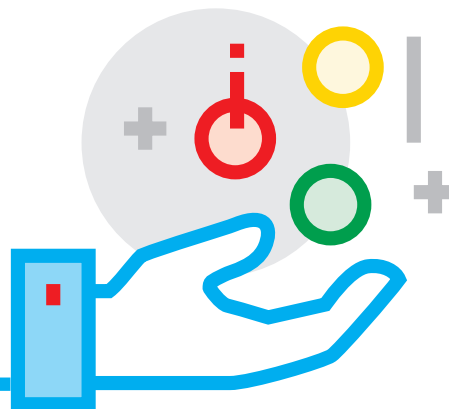
The income retirement riddle

For decades, economists have puzzled over the way people make decisions about their retirement incomes; as one economics professor wrote in 2012:

/// Few retirees annuitize any wealth, a fact that has so far defied explanation within the standard framework of forward-looking, expected utility-maximizing agents. ///³¹

There is a body of evidence to suggest that far from being poor value, annuities are, in the language of the economists, “optimal choices” for many people.³² As we get older, on the whole people have less appetite for risk. Annuities can offer stability by guaranteeing an income for life, and thereby addressing investment and longevity risk.

This disparity baffles many economists. Low annuitisation rates have attracted the attention of several prize-winning economists, one of whom even addressed the topic in his Nobel Prize acceptance speech.³³ Behavioural economists Benartzi, Previtro and Thaler wrote, “Adding some behavioural factors only deepens the puzzle, because annuities have the potential to solve some complex problems with which individuals struggle, like when to retire and how much they can spend each year in retirement, and thus they might be expected to be attractive for that reason as well.”³⁴



31 Lockwood, LM (2012). Bequest motives and the annuity puzzle. *Review of economic dynamics*, 15(2), 226-243

32 Yaari, ME (1965). Uncertain lifetime, life insurance, and the theory of the consumer. *The Review of Economic Studies*, 32(2), 137-150

33 Benartzi, S, Previtro, A & Thaler, RH (2011). Annuitization puzzles. *Journal of Economic Perspectives*, 25(4), 143-64

34 Ibid

So, why do people not choose to annuitise?

- **Provider Trust?** Qualitative research by the FCA has suggested that those who switched from annuities to full withdrawal, may be motivated by a mistrust of pension providers in general, rather than any specific dislike of annuities.³⁵
- **Control.** Many people prefer to control their money themselves. But this fails to explain why, even if we exclude full withdrawal, other pension products still outperform annuities.
- **Flexibility.** Another factor may be lack of flexibility. US researchers have suggested that when there is a high probability of large medical expenses, annuities may become a sub-optimal option.³⁶ It is hard to imagine, however, that this would serve to explain the UK situation, where large medical expenses are less of a threat thanks to the NHS.
- **Legacy.** While annuities are guaranteed during a person's lifetime, unless specifically requested, they do not leave a residual inheritance to pass on.
- **Behavioural bias.** There is a wealth of evidence to suggest that pension choices are not wholly rational.³⁷ In their work on annuity demand theory, Davidoff, Brown and Diamond conclude, "limited annuity purchases are plausibly due to psychological or behavioural biases".³⁸
- **Underestimates of longevity.** The Institute of Fiscal Studies compared Office for National Statistics' life expectancy data with the survey results and found widespread "survival pessimism" at all ages. This may make individuals reluctant to buy annuities, as people think that they will live shorter lives than they are statistically likely to; about two thirds of individuals in their 60s would think an annuity priced according to average survival chances is a poor deal.³⁹
- **Hyperbolic discounting.** "When people assign values to future pay-outs, the discount rate used to evaluate intertemporal choice is not fixed but varies in line with the length of the delay period, size and signs of the benefits. This effect is called hyperbolic discounting and is interpreted as 'temporal myopia'."⁴⁰

Despite the volume of research available, the riddle remains. However, the UK has seen big changes in its pension system over the past two decades, and the research that follows in this paper adds another vector to our understanding of people's choices.

35 Financial Conduct Authority (2017). Retirement Outcomes Review Interim Report (MS16/1.2) <https://www.fca.org.uk/publication/market-studies/retirement-outcomes-review-interim-report.pdf>

36 Davidoff, T, Brown, JR & Diamond, PA (2005). Annuities and individual welfare. *American Economic Review*, 95(5), 1573-1590

37 Benartzi, S & Thaler, R (2007). Heuristics and biases in retirement savings behavior. *Journal of Economic perspectives*, 21(3), 81-104

38 Ibid

39 Institute for Fiscal Studies (2018). Subjective expectations of survival and economic behaviour (W18/14) <https://www.ifs.org.uk/uploads/WP201814.pdf>

40 Chen, A, Haberman, S & Thomas, S (2016). Why the deferred annuity makes sense. Paper presented at the International Actuarial Association Life Colloquium, 23-24 October 2017, Barcelona, Spain. <https://www.ifs.org.uk/uploads/WP201814.pdf>

Wellbeing impacts: a new perspective

What are the ongoing impacts of people's choices at retirement?

Our research is designed to explore the "retirement income riddle", and the way that consumers have behaved since pension freedoms, and it provides some important new evidence.

The research undertaken by Demos considered the emotional impact of retirement decision-making on customers' current lives, and whether the choices customers make at retirement have any lasting impacts on their wellbeing.

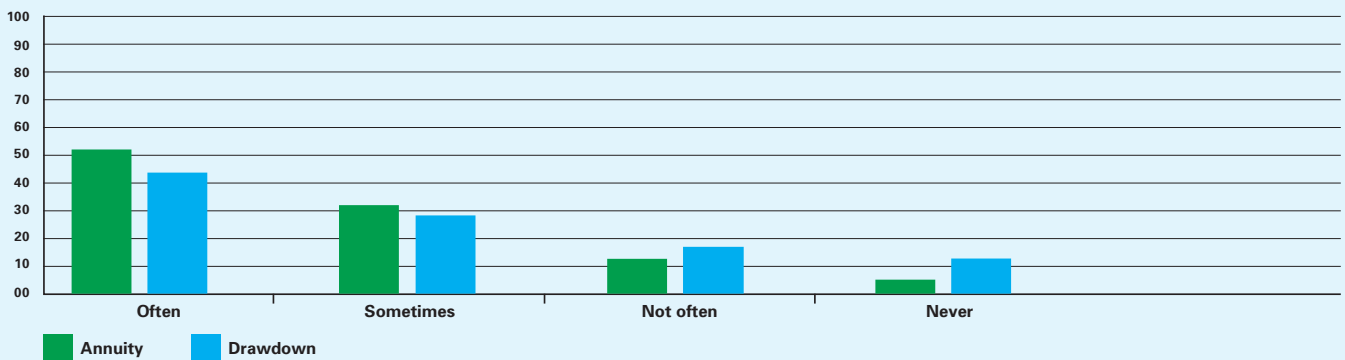
The key findings from the Demos regression analysis of the ELSA data concern the decision-making process and outcomes of people in the lower half of the income distribution.



Drawdown pensions and lower incomes

Looking at people on more modest incomes, those with drawdown pensions are more than twice as likely to say they never feel free to plan for the future (12.5% compared to 4.95%).

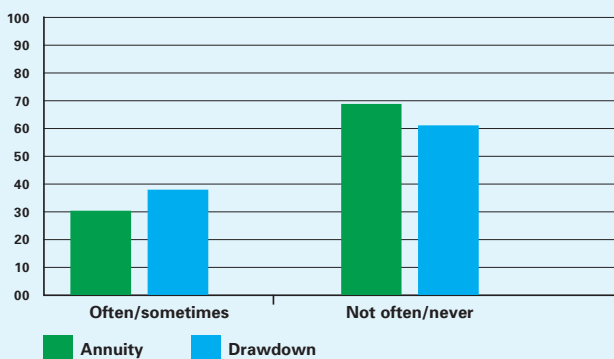
How often do you feel free to plan for the future?



Lack of control

Again, isolating the bottom half of the income distribution, people with drawdown pensions are also more likely to say they feel what happens to them is outside their control.

How often do you feel what happens to you is outside your control?

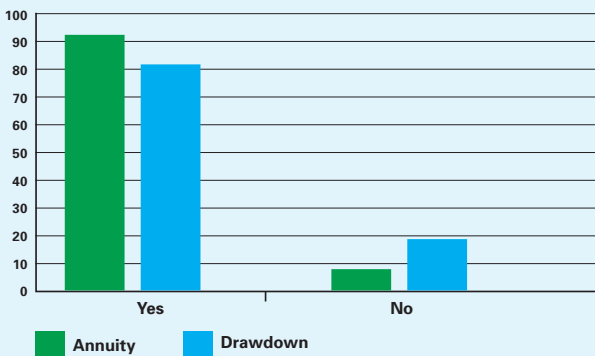


Signs of depressive symptoms?

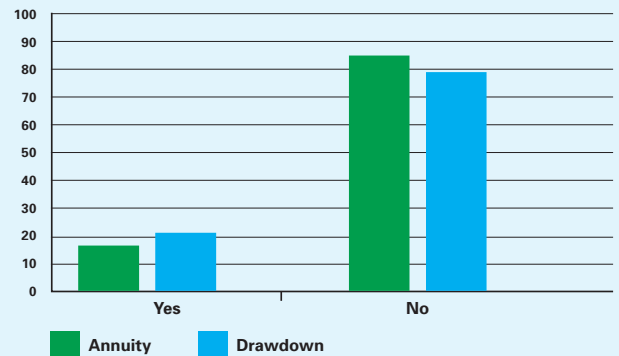
Looking at the bottom half of the income distribution, we also see that people with drawdown pensions are more likely to show signs of unhappiness and depression. In this group, people with drawdown pensions are more than twice as likely to say they did not enjoy their life over the past week.

This is a statistically significant difference. Among people with a lower income (lower half of the distribution) with a drawdown pension, almost one in five said they had not enjoyed their life over the past week. We see these results consistently across questions about happiness, life enjoyment, depressive symptoms and sadness over the past week.

Have you enjoyed life for much of the time during last week?



Have you felt sad for much of the time during last week?



The data prompts the question: is there a correlation between health and wellbeing and the retirement income choices that people have made?

- For those on lower incomes, almost one in five (19%) with drawdown said they had not enjoyed their life over the past week.
- This is more than double the amount for those in the same income group who bought an annuity (8%).
- And, given that in the three years since their introduction more than half a million individuals have taken out a drawdown arrangement, up to 50,000 of those on lower incomes have stated that they are “not enjoying” their daily life in retirement.

Moreover, those on lower incomes were more likely to say they had been “sad”, that they had felt “depressed” or “could not get going” in the past week. They were also more likely, if they had drawdown products rather than annuities, to agree with the statement “What happens to me is outside my control” and found it significantly harder to plan for the future.

At the start of this report we highlighted the “retirement income riddle”. The research, and our analysis, suggests that to understand the riddle we must look beyond personal finance, so that we can better understand people’s motivation, behaviour and experience.

For people whose income is in the lower half of the income distribution, there are significant findings regarding levels of control, planning, depressive symptoms and personal wellbeing.

When people have less of any resource, money included, the impact of its availability is felt more keenly. Put simply: if a person’s income is about, say £18,000, the change of £1,000 up or down (a change of 18%) would have a proportionally greater effect than an 18% change for someone whose income was £50,000. This in itself is a helpful observation in understanding the way people make decisions about their retirement plans.⁴¹

Moreover, this research suggests that an annuity can have a positive impact, particularly for lower earners, on their wellbeing, planning and sense of autonomy. Understanding the whole person, so that factors like wellbeing and control are taken into account, helps to resolve the retirement income riddle. The reality of decision-making is starting to bite.

41 For background see ‘Scarcity, why having too little means so much’, Mullainathan and Shafir 2013.

Conclusion

For decisions as complex as accessing pension savings, individuals should seek advice. As access to advice at a price people are willing to pay becomes increasingly limited, we see an increase in the percentage of customers making sweeping financial decisions about their retirement without guidance. The FCA notes in its 2017 report that, “The proportion of consumers who have purchased retirement income products without using regulated advice has grown since pension freedoms: drawdown products bought without advice have increased from 5% before the freedoms to 30% now.”⁴²

Without advice, many individuals may be taking out drawdown pensions without fully understanding them. The FCA’s Financial Lives Survey found that only half (51%) of those accessing their DC pension knew that buying an annuity would provide a guaranteed income for the rest of their life.⁴³ The FCA also found that many consumers were “not even aware what product they had, what the charges were or what they were invested in”.⁴⁴ As a result, they might “end up with an investment strategy that may not be suitable given the consumers’ risk tolerance and what they intend to do with their pots in the future”.⁴⁵

Both economic modelling studies and survey-based research suggest that annuities provide security, stability and a range of welfare benefits, and yet they remain under-utilised. For those that have purchased an annuity or utilised an income drawdown arrangement, has their choice been a wise one? Has it made them feel more secure about the future, or less so? Are they happy with the choice they have made, or unsure? These are the areas we wanted to explore.⁴⁶

Much of what has been written and talked about in the last three years has focused on what’s right and wrong about retirement income options. It is our belief that every individual should have a tailored solution: one that blends a number of products to meet their needs throughout their retirement journey.

In undertaking this research we believe we have found further evidence of the need to consider all options and the importance of including annuities in these – particularly for those on lower incomes.

As an industry we have a duty of care to support people in their decisions, to ensure they get the retirement they want, need and deserve. Providers, like ourselves, need to do more to help engage consumers and guide them to making better decisions. We hope this report, and our supporting activity with colleagues in the industry, enables this.

42 FCA, Retirement income market study: interim report

43 The FCA’s Financial Lives Survey

44 The FCA’s Financial Lives Survey

45 The FCA’s Financial Lives Survey

46 Yogo, M (2016). Portfolio choice in retirement: Health risk and the demand for annuities, housing, and risky assets. *Journal of monetary economics*, 80, 17-34, cited in Benartzi, S, Previtro, A & Thaler, RH (2011). Annuitization puzzles. *Journal of Economic Perspectives*, 25(4), 143-64

Appendix

The detailed ELSA research

Data

For this study, Demos analysed a dataset from the English Longitudinal Survey of Ageing (ELSA), which is a longitudinal, multidisciplinary, social survey undertaken every two years, of a representative sample of the English population aged 50 and over. The most recent wave for which the complete pension and wellbeing data is available is Wave 7. Data for this wave was collected in 2014-15, prior to the introduction of the 2015 reform of pensions. Wave 7 contains 9,666 respondents.

Only individuals who live in non-institutional settings participate in the ELSA sample; i.e. it is essentially representative of older people who live “at home” in the community.

ELSA data is designed to be used for the investigation of a broad set of topics relevant to understanding the ageing process, including measures of health and mental wellbeing, financial security, and life satisfaction and quality.

Sample

For this study, we used a subset including only those who had indicated they had an annuity or a drawdown product, which limited the sample to 1,843 respondents.

Methodology

We generated a new variable to represent pension type, summarising information from ELSA Waves 2-7. This variable communicated whether the respondent had an annuity, a drawdown product, or neither. Those with a partial annuity (who had perhaps taken one pension as a drawdown and one as an annuity) were classed with the annuities, because the supplementary drawdown product typically involved only small amounts of money.

Then we ran regression analyses on the response variables that had previously been associated with annuities and wellbeing. Where the data was ordinal, we used a Mann-Whitney U test. In all regression analyses, we controlled for health, income (including asset income), education, age and gender.

We excluded all incomplete responses, as well as those who annuitised only in their 70s, to diminish any skew produced by forced annuitisation.

Lower and modest incomes were defined as the bottom 50% of the income distribution.

The numbers of pensioners who purchased annuities versus drawdown products in the UK in 2015-18 were obtained from the Financial Conduct Authority. Data is available for two of the three years since the reforms were introduced. We projected the average onto the third year, yielding the figures of 229,265 for annuities and 517,898 for drawdown products over the three-year period.

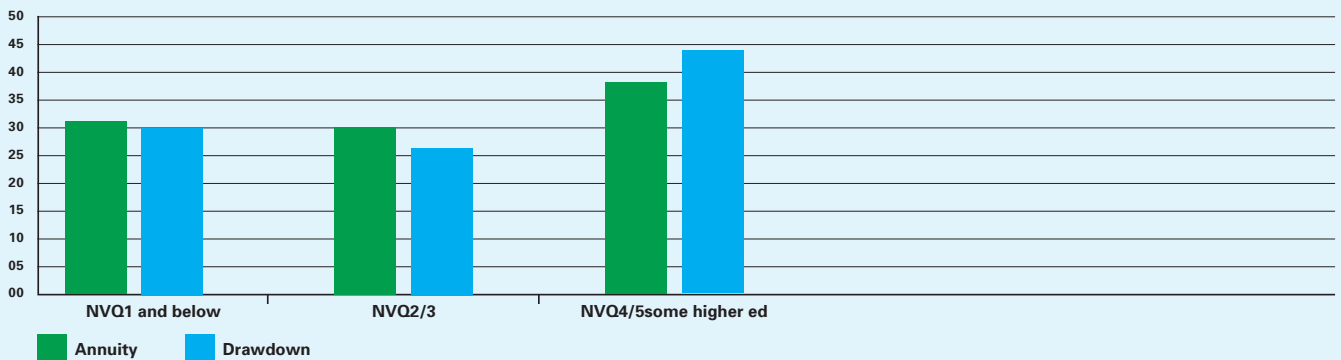
Descriptive analysis

To provide context for the findings of the regression analysis, we asked the question, “Who buys a drawdown pension?” As this is pre-pension freedoms, those who did opt for a drawdown pension are an unusual subset of all pensioners. Based on the ELSA data, there are statistically significant differences in terms of education, income and health, with healthier, richer and more educated people more likely to opt for a drawdown pension. Even if we control for these factors, this severely skews the results.

Education

At the higher education level, there is a marked difference in those that choose drawdown over a default option.

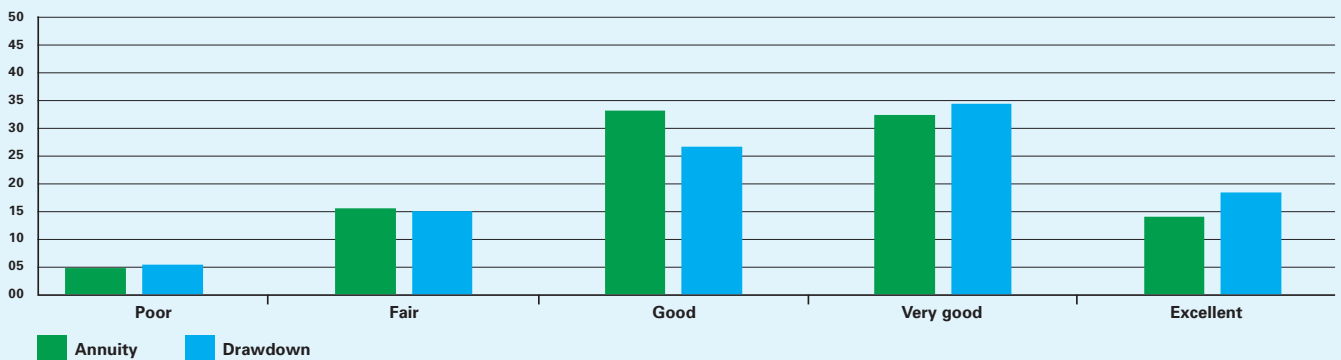
Figure 1: Educational background of people who purchase annuities vs people who purchase drawdowns



Health

Those who chose to purchase a drawdown pension were significantly more likely to rate their health as “very good” or “excellent”.

Figure 2: Self-reported health of people who purchase annuities vs people who purchase drawdowns.

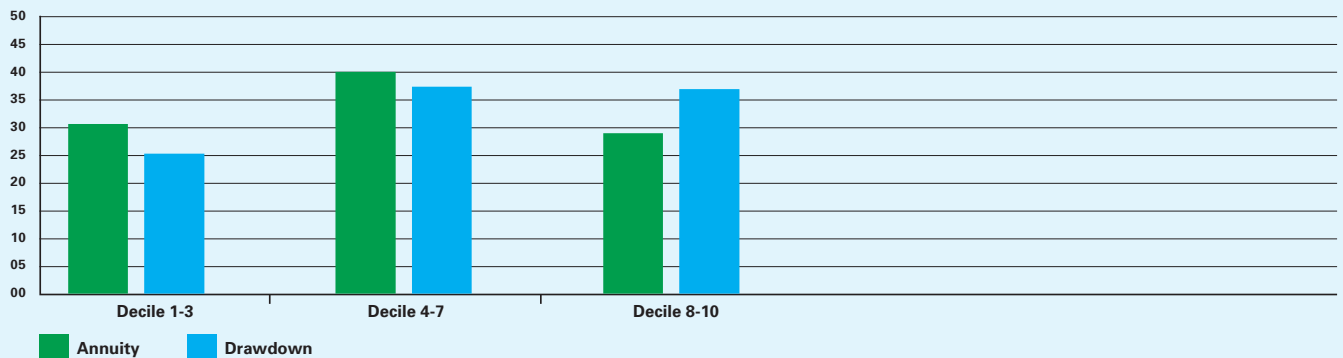


Appendix

Income

The data suggests that those who purchase drawdowns are slightly more likely to be in the 8th-10th decile, and less likely to be in the 1st-3rd.

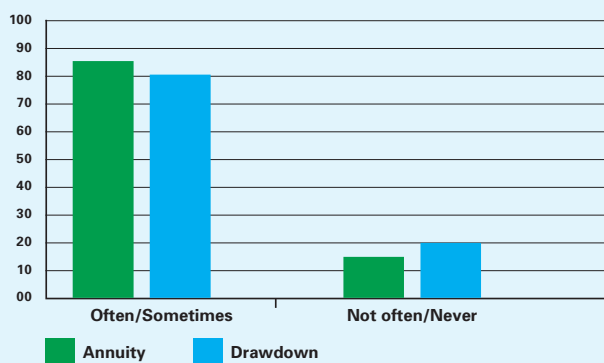
Figure 3: Income of people who purchase annuities vs people who purchase drawdowns.



On most measures of wellbeing, social participation and financial security, the crude figures seem to suggest that people with drawdown pensions do better, but these associations disappear when we control for health, wealth and education.

One measure that does come up as statistically significant is planning for the future. People with drawdown pensions find it significantly harder to plan for the future.

Figure 4: Responses to the question: "How often do you feel free to plan for the future?"



Regression analysis

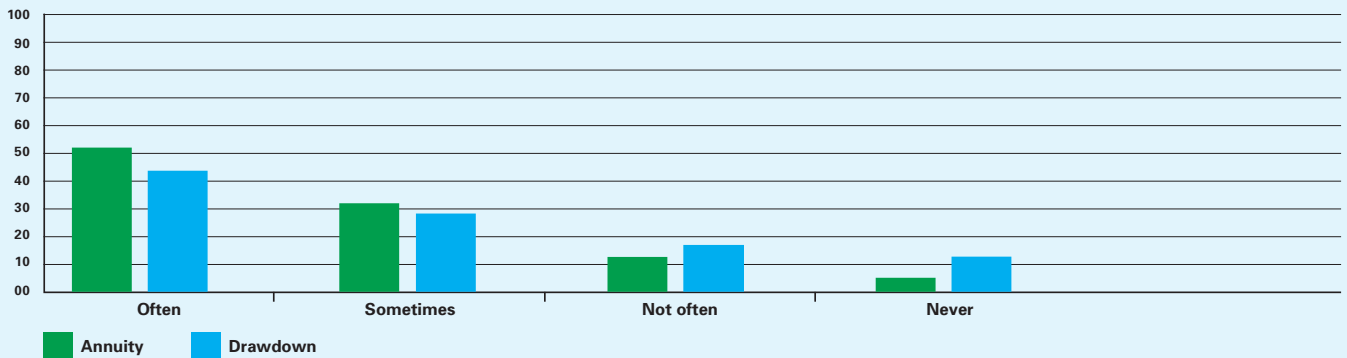
Overview

We isolated the lower half of the income distribution to assess the effects of pension choice for people on more modest incomes.

Drawdown pensions and lower incomes

Looking at people on more modest incomes, those with drawdown pensions are more than twice as likely to say they never feel free to plan for the future (12.5% compared to 4.95%).

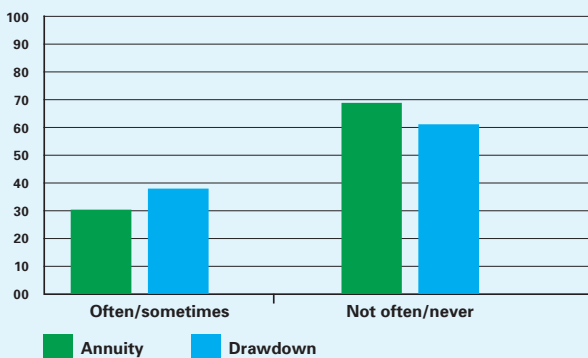
Figure 5: Responses to the question: "How often do you feel free to plan for the future?" (Bottom half of income distribution only).



Lack of control

Again isolating the bottom half of the income distribution, people with drawdown pensions are also more likely to say they feel what happens to them is outside their control.

Figure 6: Responses to the question, "How often do you feel what happens to you is outside your control?" (Bottom half of income distribution only).



Appendix

Depressive symptoms

Looking at the bottom half of the income distribution, we also see that people on drawdown pensions are more likely to show signs of unhappiness and depression. In this group, people with drawdown pensions are more than twice as likely to say they did not enjoy their life over the past

week. This is a statistically significant difference. Among people with a lower income (bottom half) with a drawdown pension, almost one in five said they had not enjoyed their life over the past week. We see these results consistently across questions about happiness, life enjoyment, depressive symptoms and sadness over the past week.

Figure 7: Responses to the question, "Have you enjoyed life for much of the time during last week?" (Bottom half of income distribution).

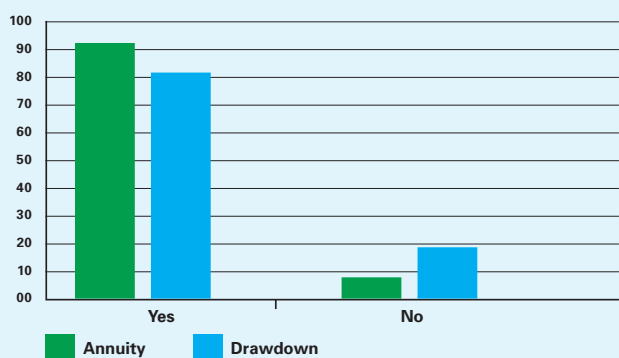


Figure 8: Responses to the question, "Have you felt depressed for much of the time during last week?" (Bottom half of income distribution).

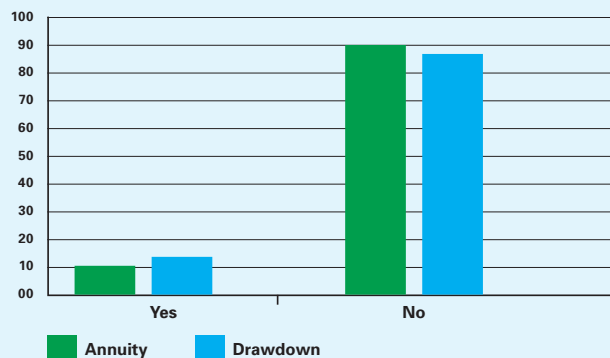


Figure 9: Responses to the question, "Have you felt sad for much of the time during last week?" (Bottom half).

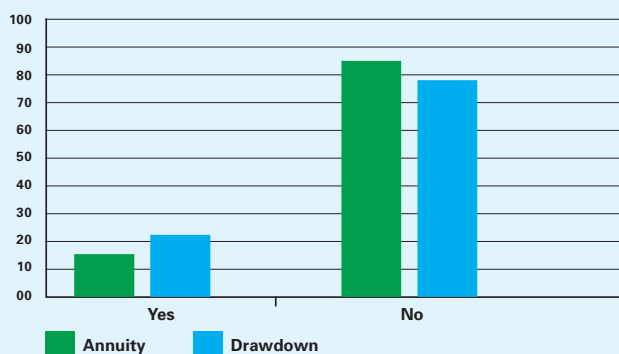
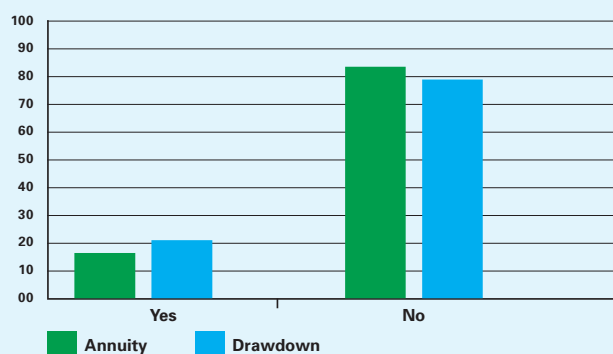


Figure 10: Responses to the question, "Have you felt you could not get going for much of the time during last week?" (Bottom half).



Findings

It is clear from the analysis that there is a correlation between health and wellbeing, and the retirement income choices that individuals have made. For those on lower incomes, almost one in five (19%) said they had not enjoyed their life over the past week. This is more than double the amount for those in the same income group who bought an annuity (8%). And, given that in the three years since their introduction more than half a million individuals have taken out a drawdown arrangement, up to 50,000 of those on lower incomes have stated that they are “not enjoying” their daily life in retirement. That’s a lot of people that aren’t necessarily as happy as they could be.

Those on lower incomes were more likely to say they had been “sad”, that they had felt “depressed” or “could not get going” in the past week. They were also more likely, if they had drawdown products rather than annuities, to agree with the statement “What happens to me is outside my control” and found it significantly harder to plan for the future.

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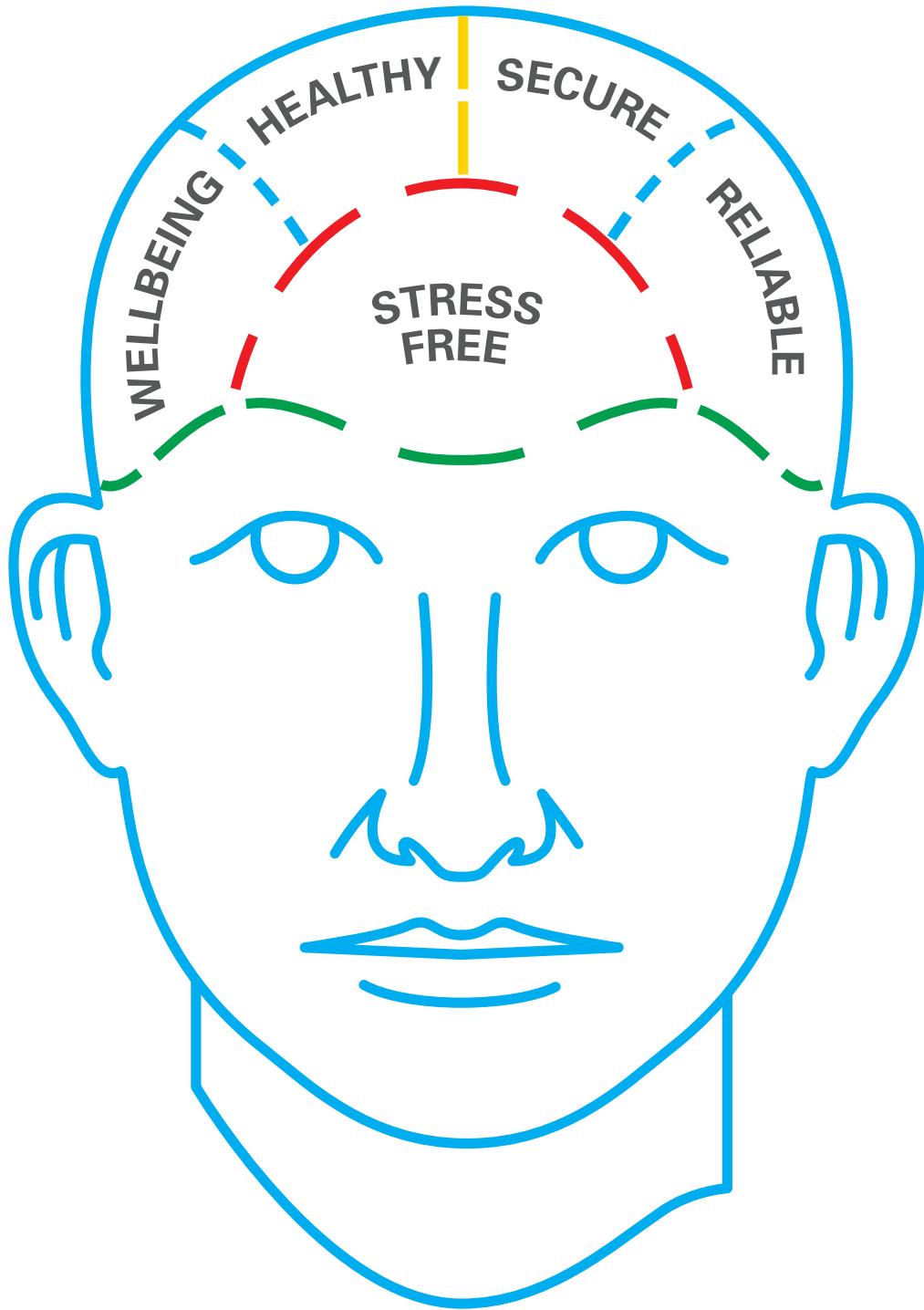
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