Press Release

Few know what pension income they will receive and levels of engagement with annuity markets are low

A third of those approaching retirement report finding it impossible even to hazard a guess as to how much income they will receive from their private pensions. This is true of nearly 40% of those with defined contribution (DC) pensions.

Despite the fact that annuity rates vary widely, over the last decade over 70% of people with non-employer DC pension funds simply purchased an annuity from the provider with whom they held their pension. Purchasing externally has, however, been more common among those who might have had most to gain – including those who held more of their wealth in DC pensions.

These are among the main findings of a new report published today by researchers at the Institute for Fiscal Studies. This report has been supported by the National Association of Pension Funds, with co-funding from the Economic and Social Research Council.

The report, which uses data from the English Longitudinal Study of Ageing and the Wealth and Assets Survey to examine how DC pension members have approached and dealt with annuitisation decisions over the last decade, shows that:

- Nearly 60% of non-retired individuals aged between 50 and 64 report never having given any thought to how many years of retirement they might need to finance.
- Among those who had thought about how long their retirement would be, the average expectation was 20.6 years implying an average life expectancy of 83.3 years, which is younger than suggested by actuarial life tables.
- A third of private pension holders aged between 52 and State Pension Age were unable to provide even a rough estimate of how much income they expect to receive from their private pensions in retirement.
- Those with DC pensions seem to find it harder than DB pension holders to estimate how much income their pension will provide: 37% of DC pension holders aged 52 and over in 2010–11 were unable to provide a range within which they expected their pension income to lie, compared with 28% of DB pension holders in the same age group.
- There is also some evidence that, among those who are able to report an expected income, these expectations are more accurate for DB pension members than for DC pension members, with DC scheme members being over-optimistic on average. Half of DB scheme members who started drawing their pension income received an income that was between 75% and 111% of their previously expected level; meanwhile, half of DC scheme members received an income that was between 44% and 113% of their previously expected level.
Annuity rates, which determine what annual income is received from a given pot of money, vary considerably across different providers at any point in time. Yet 78% of annuitants remained with their original pension provider between 2002–03 and 2010–11.

Purchasing externally was somewhat more common among those who held a relatively large fraction of their wealth in DC pensions. However, even among this group, only 27% were found to purchase from an external provider.

In the future, more people will hold a greater fraction of their wealth in DC pensions. So purchasing externally could become more prevalent. On the other hand, as the coverage of DC schemes expands, more people with lower levels of education and numerical ability will become involved in this rather complex market. And we find that such people are less likely to buy an annuity from an external provider.

Gemma Tetlow, a Programme Director at the Institute for Fiscal Studies and one of the authors of the report, commented:

“Defined contribution pensions require people to make complex decisions both while they are accumulating their pension savings and when they want to start drawing an income. Understanding how people have been coping with annuitisation decisions over the last decade is important as policymakers consider and implement further reforms to this market.

A remarkable number of pension holders in their fifties and sixties appear to have little or no idea how much pension income they will receive, and this is more common among defined contribution pension holders than it is among defined benefit pension members. Shopping around for the best available annuity rate on retirement can significantly increase the income received from a given pension fund, yet the vast majority of annuitants still buy from their original pension provider. But we do find some evidence that those who might have had most to gain from shopping around – including those who hold more of their wealth in DC pensions – were more likely to have bought from an external provider.”

Mel Duffield, Head of Research and Strategic Policy at the National Association of Pension Funds, added:

“These new findings show that those approaching retirement are at real risk of disappointment if they are unrealistic about how long they are going to live and how much their pension pot will pay out when they come to convert it into an annuity. We know it is a very tough annuity market out there with gilt yields so low, but this is likely to be exacerbated by savers not realising how far their defined contribution pension will need to stretch.

What is particularly alarming is that over a third of those with a defined contribution pension who are approaching retirement cannot even hazard a guess at what sort of income that might get them. Given some of the complexities around pensions that may not be surprising, so policy makers and industry need to think about how we make it clearer to individuals how much they need to save to meet their expectations for retirement. This is particularly important with the introduction of automatic enrolment, bringing millions more saving into defined contribution pensions.”

ENDS

Notes to Editors:
1. “Expectations and experiences of retirement in defined contribution pensions: a study of older people in England” by Rowena Crawford and
2. For embargoed copies of the report or other queries, please contact Bonnie Brimstone on: 020 7291 4800 / 07730 667013 or bonnie_b@ifs.org.uk.

3. The report will be launched at an event on Friday 30 November hosted by the National Association of Pension Funds. For information, please contact Shiona Charlery on 020 7601 1725 or shiona.charlery@napf.co.uk.

4. This work was jointly funded by the National Association of Pension Funds and the Economic and Social Research Council under the auspices of the Centre for the Microeconomic Analysis of Public Policy (grant number ES/H021221/1).

5. The NAPF is the leading voice of workplace pensions in the UK. The NAPF speaks for 1,300 pension schemes with some 16 million members and assets of around £900 billion. NAPF members also include over 400 businesses providing essential services to the pensions sector.

6. The Economic and Social Research Council (ESRC) is the UK’s largest organisation for funding research on economic and social issues. It supports independent high quality research which has an impact on business, the public sector and the third sector. The ESRC’s total budget for 2012/13 is £205 million. At any one time the ESRC supports over 4,000 researchers and postgraduate students in academic institutions and independent research institutes. http://www.esrc.ac.uk/.