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International Lessons: DC pensions and retirement

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International DC retirement markets

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- What do retirees do with their DC pension pots in other countries?
  - Savers *do not have* to buy annuities in Australia, Ireland, New Zealand, United States
- What does the retirement income market look like – what products have developed and prospered?
- What has driven consumer behaviour in those markets?
- What are the implications for the future of the UK market?

Overview: Countries with different levels of annuitisation

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		Restricted accessing of DC savings	Flexibility of annuity products	Variety of other products: e.g. drawdown	High annuity rates/ MWRs	Annuities perceived as a "good deal"	State pension	Means-tested pension
High annuitisation	Switzerland (80%)				●	●	●	●
	Chile (70%)	●	●	●	●	●		●
	Singapore (not available)	●			●	●		
Medium annuitisation	Israel (not available)	●	●	●	●	●	●	
	Denmark (50%)	●	●		not available	not available	●	●
	Ireland (30%)	●		●			●	●
Low annuitisation	Australia (2-10%)			●				●
	New Zealand (0%)						●	
	USA (<2% pensioner income)		●	●			●	

Observations from overseas experience

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- In countries where there is no compulsory annuitisation, rates tend to remain low (<50%)
- ***Unless*** individuals are offered higher annuity rates than would have been expected given market conditions
- An example is Switzerland where rates are regulated and considered to be generous compared to low interest rates, and given low mortality rates

Observations about annuities

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- Mismatch between stated preferences for a guaranteed income and expectations around behaviour under the new pension flexibilities
- Research to ascertain the most important features of a retirement product found that 64% of respondents specified a guaranteed income for life as the top feature
- This compared to 31% who specified getting as much income as possible as the top feature*

*https://www.partnership.co.uk/home/press/press-releases/an-annuity-by-any-other-name-would-smell-more-sweet-/

Various factors have been identified as influencing popularity of annuities

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- Bequest motives
- Tax and Regulatory factors
- Level of trust of the financial sector
- Understanding around longevity
- Adverse selection
- Availability of products such as long-term bonds

Australia – overview

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- Means-tested state 'Age Pension' and mandatory employer contributions into 'My Super' DC pension schemes (minimum employer contributions of 9%)
- Individuals are able to access DC savings after the minimum pension age which is transitioning between age 55 and 60
- DC system is widely seen to be well-funded
- But interaction between My Super and the Age Pension is considered problematic

Australia – DC market

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- Low use of target date/lifetime funds
- Annuities historically been perceived as not offering good value
- Interaction of annuities with the Age pension identified in the past as factor limiting willingness of providers to develop new products
- But Government is currently consulting on compulsory annuitisation (Murray Review)

Australia – behaviour

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- Half of assets are paid out as lump sums
- Remaining half are paid out as an income stream, through 'pension accounts' similar to Flexible Drawdown (minimum distributions are at 5% of the account but vary by age)
- There are concerns around the interaction of My Super with the Age Pension, specifically that:
  - Individuals will increase pre-retirement indebtedness
  - Individuals will run down private pensions to become eligible for the Age Pension and associated benefits

Ireland – overview

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- Both contributory and means-tested state pension – state pension payable from age 66
- Individuals contribute to private pensions on a voluntary basis
- Individuals who meet the Minimum Income Requirement of €12,700 per year can purchase an Approved Retirement Fund (ARF), similar to income drawdown. Otherwise, individuals can purchase an Approved Minimum Retirement Fund (AMRF) - they cannot withdraw their original investment
- AMRFs automatically become ARFs at age 75

Ireland – DC market

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- The Irish annuities market has been portrayed as lacking innovation with strict regulation being identified as one of the causes of this:
  - An annuity had to be paid for the annuitant's lifetime
  - An annuity payable to a surviving dependent could not be higher than that payable to the annuitant
  - Other than payments arising from the operation of the guarantee period, no lump sum benefit could be paid on the death of the annuitant

Ireland – behaviour

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- In 2007 around 30% of those retiring with private pension savings were reported to purchase an annuity
- It has been reported that individuals have opted for ARFs over annuities because of the flexibility they offer and because annuities are perceived as giving poor value*

Source: Rusconi, R. (2008) *Review of the Irish Annuities Market*

New Zealand – overview

- Generous, non means-tested residency based flat rate state pension
- KiwiSaver – voluntary private pension scheme with an automatic enrolment feature (don't opt-out, can't opt-out) – introduced in 2007
- State pension can be accessed at age 65 while KiwiSaver savings can be accessed at age 65 *or* 5 years after the individual started to save in KiwiSaver, if later
- Historically there was a concern that household saving was low and declining – KiwiSaver represented a response to increase the savings of the target population

New Zealand – DC market

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- The New Zealand annuities market has been portrayed as being in a 'death spiral', due to adverse selection and a shrinking longevity pool.*
- The way in which New Zealand annuities have been taxed has also been identified as a factor in the low take-up of annuities

* Strategic Society (2014) New Annuity era

New Zealand – behaviour

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- In 2008, 3,277 annuities were in place, with the majority of annuitants aged over 75*
- Amounts accrued to date under KiwiSaver have been relatively small; however, research estimated that around three quarters of KiwiSaver members will have made a full withdrawal within 5 years.**

*Source: New Zealand Investment Savings and Insurance Association in Strategic Society (2014) *New Annuity Era*
** Source: Inland Revenue (2013) *KiwiSaver, early retirement withdrawal survey*

New Zealand – behaviour

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- Early research found that, based on the target population, 81% have already withdrawn only lump sums and intend to draw only lump sums*
- Half of respondents had spent or wanted to spend their KiwiSaver savings in the near future – holiday were a major item**

*or if they have not made any withdrawals, intend to draw lump sums only
** Source: Inland Revenue (2013) *KiwiSaver, early retirement withdrawal survey*

New Zealand – behaviour

- 15% of members have or will use KiwiSaver savings to pay off a mortgage or other debt*
- Over half of respondents have or planned to put their KiwiSaver savings into other savings or investments
- Reasons for re-investment largely centre on a desire for a better return or security of savings.

* **Source: Inland Revenue (2013)** ***KiwiSaver, early retirement withdrawal survey***

United States – overview

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- Earnings-related state pension
- Private pensions, some of which are workplace pensions (including 401k schemes)
- The official retirement age is 65 while private pensions can be accessed from the age of 59.5 onwards

United States – DC market

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- While annuities are not popular, the relative size of the US population means that the number of people purchasing annuities is sufficient to create a sizeable market and availability of many types of annuities.

United States – behaviour

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- People in the US are more likely to use “annuities” during the accumulation phase as well as in retirement, as products such as deferred annuities allow flexible and tax-advantaged ways to save
- The lifetime annuities market in the US is small with lack of interest being attributed to the lack of bequest options, large fund sizes, ‘adverse selection’ and consumer concerns about developing health problems in later life

Considerations for the UK DC market

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- Consumer research suggests that individuals still rate a secure, predictable and guaranteed income highly
- *However,* they also underestimate their life expectancy – so may see annuities as poor value
- The UK arguably has most similarities with Ireland in the sense that it has changed the regime at a point when it has an established annuities market

Considerations for the UK DC market

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- Personal factors can have an impact on choices around retirement income
- UK annuities market has offered innovative products and choice in the past but suffered from low take up – will more guidance/advice make a difference?
- Annuitisation of *at least part* of the pension pot may make sense for some individuals so that they receive a regular guaranteed income
- *However,* most people will already receive a regular guaranteed income at some level in the form of the state pension and (for those in their fifties/sixties now) from their DB pensions