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Many over-55s can't cope with pension freedoms – it may now be time to scrap them

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'Not such a great idea.' Oleg Govnev

Author

David Comerford

Program Director, MSc Behavioural Science, University of Stirling

For decades, the UK pensions industry could have been described as sleepy: a lack of vim and vigour borne of long time-scales and limited innovation. Come April 2015, everything changed. The UK government scrapped the system that all but forced retirees without final salary schemes to buy an annuity with the money they had saved in their pension plans. Instead, those reaching the age of 55 were suddenly gifted "pensions freedom" to invest, cash-in or annuitise their savings.

These reforms could equally, if less attractively, have been termed as "imposing pensions responsibility". Overnight, UK retirees found themselves responsible for managing their own pensions wealth – a complex decision with profound long-term consequences. Getting it wrong could mean running out of money just when you need it for social care, or potentially dying with a full bank account, having missed out on experiences you could have affordably enjoyed.

In practice, people do not seem to be coping well with these responsibilities. It was reported earlier in 2019 that since the reforms, around a million people had cashed out £23 billion in pensions savings – often harming their financial future in the process. And according to research that I have just co-published, the system that the government brought in to help advise retirees may actually be making things worse.

What happened next

Nobody saw these pensions freedoms reforms coming when they were introduced, including the pensions industry, regulators and consumer watchdogs. Myself and my co-reseacher Jenny Robinson, a behavioural economist at Irrational Insights, could find no evidence of pre-testing on whether the general public wanted control of their pensions, how they would behave or what factors might affect their choices.

The reforms were widely criticised, including by experts writing in The Conversation. Commentators correctly predicted that the UK would mirror other countries like the US, where people given these choices tend to buy fewer annuities than is economically optimal, and instead choose to cash out.

A variety of reasons have been suggested for this. These include behavioural factors such as what are known as time-inconsistent preferences, in which we essentially opt for jam for today. Many of us are also horrified by the prospect of exchanging a large sum of money for a series of small cheques.

'Mmmm time-inconsistency.' Alter-Ego

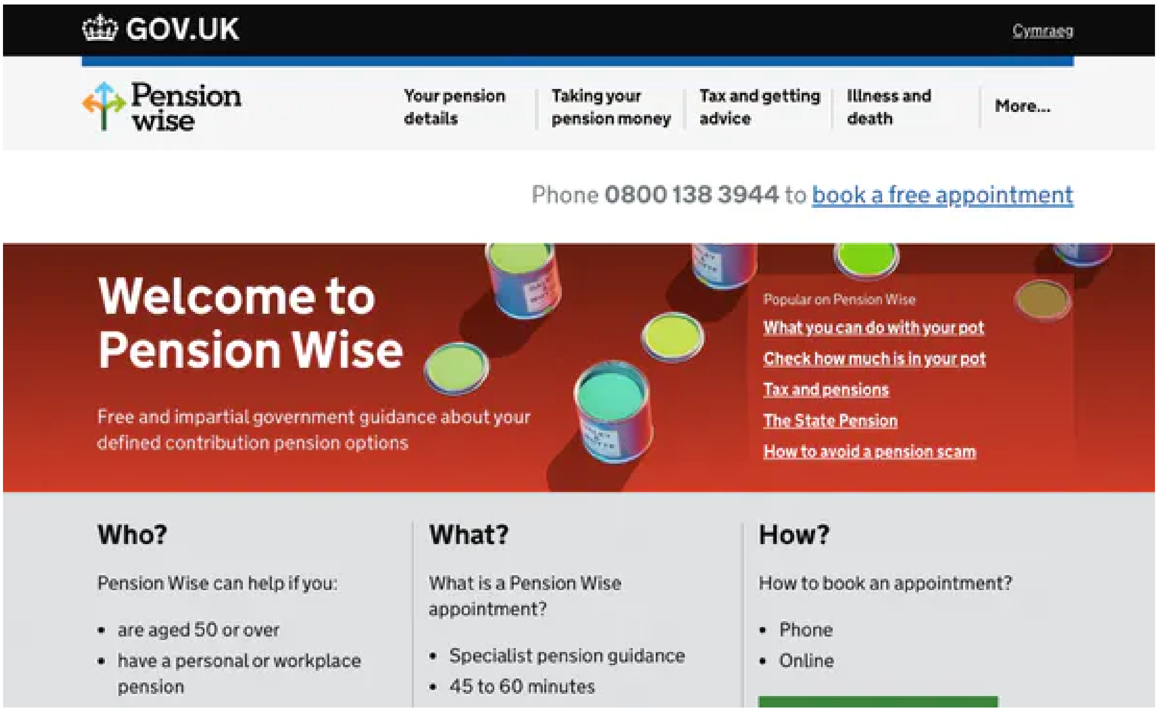
Added to these are rational factors such as trivial monthly incomes from small pension pots and poor value for money, in a world where savings are producing much lower returns than they used to.

To its credit, HM Treasury was not totally blind to the possibility that people would need guidance on managing their pension wealth: as part of the reforms, it established a free-to-use pensions advice website called Pension Wise. As it turns out, however, apparently sensible advice can have perverse consequences.

One of the Pension Wise recommendations is to consider how long your pension wealth needs to last. This seems logical, given that one of the main advantages of an annuity is that it guarantees an income until death. Jenny Robinson conducted an experiment on over 2,000 UK residents for her MSc behavioural science dissertation to see how they reacted to this advice in practice.

Her respondents matched the UK population in terms of education, gender, age and social class. By not concentrating on the 55-plus people who currently enjoy the UK's pension freedoms, she was able to get an insight into how people will make decisions in future. Having said that, there was no significant difference in the choices of the 55-plus age group in the experiment and the sample group as a whole.

Jenny, who also provided some input for this article, asked the respondents to choose between an annuity and cashing out their pension – it made sense to give them a binary choice, since although there are more options in real life, it would be impossible to account for all of them. Some respondents were asked to consider their life expectancy immediately prior to making their choice. To our surprise, this made people *more likely* to cash out.



The government pension advice agency. Pension Wise

It didn't help that an unregulated "pensions advice" industry sprang up after the reforms. It was cold-calling customers and arguably exploiting their lack of experience with such decisions. In 2018, as many as 180 people reported losses averaging £82,000 to Action Fraud. At the beginning of 2019, this cold-calling was banned by the Financial Conduct Authority (FCA).

There are plenty more scams in the pipeline, however. These include inappropriate exotic investments, fraudulent transfers and early access to savings – all accompanied with hefty fees, and often tax penalties. It has been reported that up to 100,000 people with final salary schemes have been encouraged to cash out or into high-risk investments, potentially costing them £4 billion.

An open goal

Recent research by the FCA and The Pensions Regulator suggests, rather strangely, that the people most at risk from scams are not the least educated, but those with a university degree. They are 40% more likely to accept free pension advice and 21% more likely to cash out as a result. Clearly, the state cannot assume that education and knowledge will protect against conniving scammers.

Nor is good financial advice necessarily going to protect people from making poor pension decisions. Recent research by Canada Life showed that over two-thirds of customers who have accessed their pensions since 2015 haven't taken any independent financial advice. The same proportion also failed to shop around before buying either an annuity or a drawdown product from their pension provider.

It is clear that pensions freedoms have created vast opportunities for customer detriment. Yet so far during the UK election, none of the parties have had much to say on this subject: most discussion on pensions has been around protecting the state pension age and compensating women who lost out on state pension payouts when the retirement age was raised.

On pension freedoms, there is an urgent need for state intervention to address fraud, to improve customer take up of advice and to find behaviourally informed ways to help people navigate the choices they are offered. Or else, it may be time to roll back on pensions freedom altogether.

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