



# **EXECUTIVE SUMMARY - Study on the performance and adequacy of pension decumulation practices in four EU countries**



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## **Objective and scope of the study**

The objective of this study is to look at pension decumulation from the perspective of consumers. Research generally focuses on pension accumulation practices from an industry perspective and less is known about consumers' choices. The objective of this study is to fill this gap.

To do so, consumers' decumulation practices are analysed in four countries: the United Kingdom, the Netherlands, Poland and Germany.

This study focuses on the decumulation products offered through Pillar II and Pillar III Defined Contributions schemes. In these schemes, consumers have to choose how to decumulate their pension pots.

The decumulation products covered in this study are

- Annuities (lifetime, time-limited, guaranteed, deferred...): guaranteed fixed or variable benefit payments at regular intervals until the death of the annuitant or the end of a specified period of time.
- Drawdown products: the retiree is able to choose the amount to withdraw each year from the retirement capital (which can continue to be invested). Upon the death of the retiree, remaining amounts are paid to beneficiaries.
- Lump sums: a single payment at retirement which enables the beneficiary to use the money at his own will.
- Hybrid products having both a drawdown component and an annuity component.

## **Information sources**

Various sources of information have been used.

A desk research was performed on 43 articles and information collected:

- provides an overview of existing decumulation products in each market
- allows to identify the most common decumulation products
- enables to understand consumer behaviour and factors affecting their choices
- gives an overview of national debates in each country of the study.

The information collected through this desk research was completed by interviews with stakeholders. In each country analysed, at least 5 stakeholders were interviewed and at least one of the interviewees was a representative of a consumer organisation.

Quantitative data (annuity rates, mortality tables,...) were also collected to determine the economic value of the various pension decumulation products identified. The economic value was assessed by the Money Worth Ratio (MWR).

Using all the information collected, the set of product choices in each country was qualified with respect to four dimensions, its economic value but also the guarantees it provides (eg. capital protection) and its coverage against longevity and inflation risks. Following this first analysis it was possible to characterise the choices available to consumers to decumulate their pension pot and to compare the different products available. Then, looking at the most often chosen decumulation products, consumer choices were qualified. Having examined consumer choices, the study looks at the

factors behind these choices (information, financial advice, market structure and regulation).

## Overview of customer decumulation practices

The range of decumulation products offered to consumers depends on the regulations in the country considered. In the UK, tax incentives contribute to the development of the pension decumulation market and consumers have access to a full range of decumulation products, whereas in other countries regulation limits consumer choices. In Germany and Poland, decumulation products are accessible through specific pension schemes in which consumers have previously accumulated their pension savings. In the Netherlands, consumer choices are limited by pension and tax legislation and the mandatory nature of Pillar I DB schemes explains the small size of the market.

### Analysis of products

When choosing a decumulation product, consumers should not only consider its economic value but also the guarantees it provides and its coverage against different risks: longevity risk, capital protection, inflation risk.

The analysis of the features of the products offered in each country shows that:

- In the UK, escalating annuities offer the best coverage of risks (longevity and inflation risks) but do not offer a good value for money. There is a wide variety of products available to consumers that offer a good coverage of longevity risk as well as a good value for money.
- In Germany, guaranteed participating annuities offer good value for money and coverage of the longevity risk. On the other hand, drawdown products offer the possibility for customers to transfer their capital to beneficiaries after death. The mix of products available does not cover the inflation risk.
- In the Netherlands, lifetime annuities available to customers neither allow transferring capital to beneficiaries after death nor cover the inflation risk.
- In Poland, longevity risk is not addressed by the mix of decumulation products available to consumer.

The following table summarizes the most common annuity and non-annuity products in each country. This table was established based on interviews and data collected.

Country	Most common annuity products	Most common non-annuity products
UK	Lifetime annuity Guaranteed annuity Enhanced annuity	Lump sum Drawdown product
Germany	Guaranteed annuity with participation Lifetime annuity with participation Deferred annuity with participation	Lump sum Drawdown product
Netherlands	Lifetime annuity	NA
Poland	NA	Lump sum Drawdown product

In the UK, the most common annuity products are the guaranteed annuity and the enhanced annuity. The pension freedom reforms that took place in April 2015 offered more flexibility to consumers regarding their decumulation options. Consequently, the demand for annuities that had been the most popular decumulation options prior to the reform decreased dramatically while the demand for drawdown products and lump sum payments raised significantly. Recently, annuities and drawdowns represented almost equal sales volumes and lump sum payments decreased later after the reform.

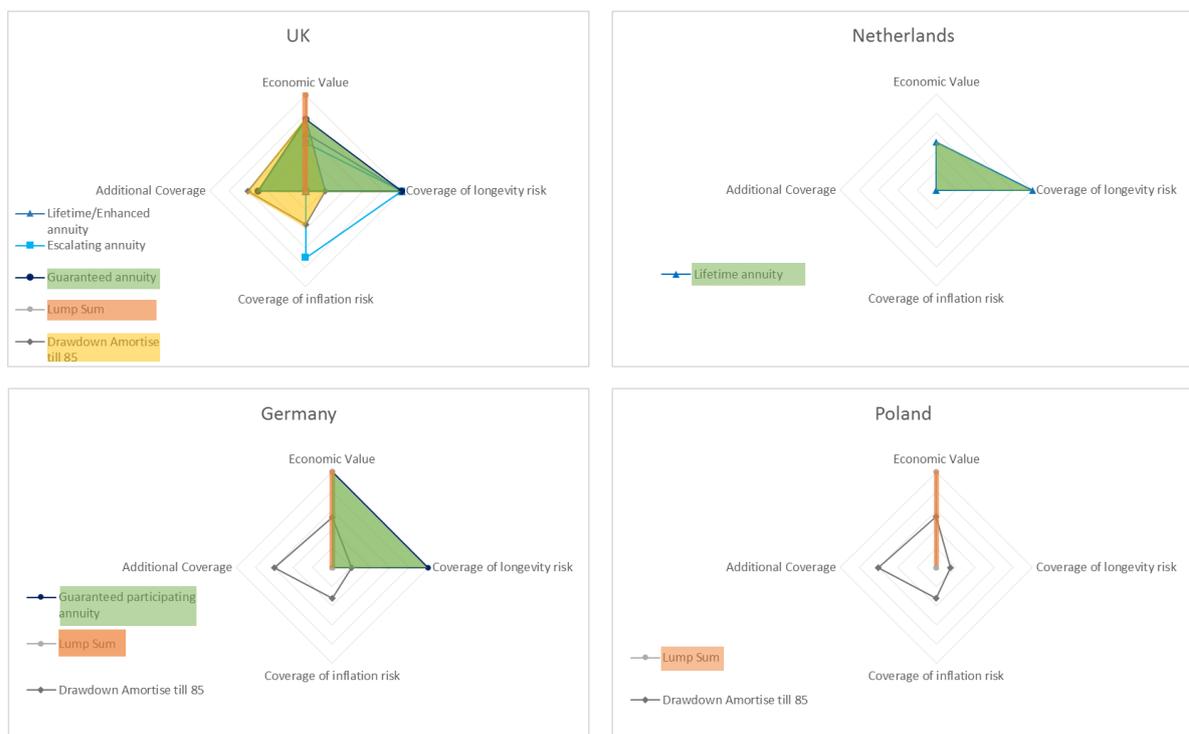
In Germany, according to stakeholders, the most common decumulation option for pension insurance contracts is the lump sum while the most common annuity product for all pension schemes is a guaranteed annuity with participation.

In the Netherlands, lifetime annuities are mandatory although lump sums can be used to decumulate very small pension pots.

In Poland, the lump sum is the most popular option offered by both occupational pension schemes and individual schemes.

#### Adequacy of consumer choices

The following diagrams highlight the economic value and risk coverage of the most frequently-chosen products.



The above figure reveals that:

- In the UK, consumers favour guaranteed annuities and drawdown products that are more attractive in terms of value for money and allow transfer of a part of their capital to beneficiaries after death. The fact that escalating annuities are not preferred over other decumulation products may be explained, at least in part, by the low value for money of these products.
- In Germany, consumers prefer guaranteed annuities over drawdown products which can be explained either by the fact that the bequest motive is not a strong driver of consumer decisions and/or that drawdown products are not perceived as sufficiently attractive financially and in terms of risk coverage.

- In the Netherlands, the only decumulation option available to consumers offers good value for money and covers longevity risk.
- In Poland, high consumer demand for the lump sum is in line with its high MWR compared to drawdown products.

Further analysis of the money worth ratio show that:

- MWR remains stable over time for different products considered in all the countries in our scope except for Germany where a significant increase in MWR can be observed between 2003 and 2016
- Shopping around is beneficial and a new retiree may obtain better value for money by purchasing a lifetime annuity from a provider other than his or her existing pension provider (MWR can increase up to 14% in the UK and up to 17% in the Netherlands)
- Pensioners with an average pension pot obtain a better value for money than those with a small pension pot.

## **Factors affecting consumer choice**

The study assesses whether consumer have enough information, access to financial advice when making their choice. It also regards whether the market structure affect customer choices. Finally it looks at the impact of regulation on those choices.

### *Information*

A great deal of information is available to consumers through disclosure requirements, publicly available information and online comparison tools. However, even if information is available, the complexity of the information and the lack of financial literacy make consumer choices difficult. In addition, the comparison tools available are not always efficient. For example, in the UK, they do not allow for comparison of different types of decumulation products (i.e. annuity and non-annuity products); in the Netherlands, tools only allow for comparison of products offered by the same types of providers.

### *Financial advice*

Financial advice can come from a variety of sources: pension fund administrators, providers of decumulation products, brokers and agents, independent financial advisers, governments and consumer associations. Given the generally limited understanding of and interest in pension matters, the regulation of financial advice is crucial to protect consumers. Different authorities ensure the proper functioning of financial markets. However, access to financial advice appears to be limited due to:

- The lack of access to advice for pensioners with small pension pots
- The cost of advice being perceived as high
- Low demand for financial advice.

Nevertheless, people unable to pay for financial advice can access general guidance that will inform them about the available options, without making specific product or provider recommendations.

### *Regulation*

Regulation may also affect the decumulation market. For example, the Gender Directive in effect since December 2012 may have had an impact on annuities. In the UK and in Germany, MWRs subsequent to the reform are higher for women and lower

for men. However, these changes in the MWR could possibly be explained by factors other than the Gender Directive.

#### *Market structure*

The market structure in the different countries of the study may also be a factor affecting the decumulation options to consumers. Limited evidence was collected on market structure however when available the information collected suggested that the market structure was rather competitive:

- In the UK the level of concentration is quite stable over the past years and indicators show a moderate level of competition.
- In the Netherlands, there is evidence of price competition.
- In Germany the market is relatively small due to the important role of social security in the retirement benefits.
- In Poland, DC schemes have been introduced recently and no significant features of competition in the market could be observed.

### **Looking forward**

There are many debates at the EU level that may affect the decumulation market:

- Product Oversight and Governance Arrangements (POG) are intended to address several issues such as the design of products having features aligned with the interest, objectives and characteristics of customers.
- There are discussions on the harmonisation of personal pension products within EU countries with the publication of consultation papers on the Pan-European Personal Pension product (PEPP) and on an EU Single Market for personal pension products (PPP).

In addition to discussions taking place at the European level, each country in the scope of the study is considering reforms that may affect its decumulation market in the future:

- In the UK, consumers have had more flexibility in their choice at retirement since the recent April 2015 reform. The lifetime ISA (Individual Savings Account) will be launched in April 2017. There are also other reforms being considered, such as the creation of a pension dashboard and the implementation of a secondary annuity market.
- In the Netherlands, possible reforms will focus on individualization in the design of the Dutch pension system. A proposal for mandatory individual DC pension contracts was made to Parliament in July 2015. In addition, recent legislation introduced variable annuities for DC plans.
- In Germany, there is a debate on the creation of "17b" sector-wide DC pension plans, where liabilities would no longer be the employer's responsibility but the responsibility of the sector-wide pension vehicle. There is also discussion underway on the introduction of automatic enrolment to improve pension coverage and make voluntary private pension plans more attractive.
- In Poland, the capital Development Program will aim to build a voluntary funded pension system in Poland. It has several goals, such as the introduction of a public system of voluntary saving for retirement in the corporate sector, the introduction of Individual Capital Plans (IPK) for micro-enterprises, the centralization of information on capital retirement programs, etc.

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