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# Drivers of investment decisions in the decumulation phase

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International comparisons

European Pension Funds Congress

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18 November 2014

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European Pension Funds  
Congress

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# Choice in the retirement savings market

## What drives outcomes in the decumulation phase?

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- which retirement products do consumers choose at retirement?
- why do consumers select these products?
- how might these choices be influenced?

*This presentation is based on the findings of an Oxera study for the UK's Financial Conduct Authority, which is available here:*

*<http://www.fca.org.uk/your-fca/documents/the-retirement-income-market>*

# Do consumers choose annuities?

Annuitisation rate	Examples	Characteristics
High	Switzerland	<ul style="list-style-type: none"><li>• collective bargaining + default bias</li><li>• incentives for annuities</li><li>• limited choice available</li></ul>
Fairly high	Chile	<ul style="list-style-type: none"><li>• limited choice of products</li><li>• income drawdown a popular option</li></ul>
Medium	Ireland	<ul style="list-style-type: none"><li>• some restrictions on income drawdown, but remains a popular option</li><li>• increased choice led to growth of income drawdown/lump sums</li></ul>
Low	USA	<ul style="list-style-type: none"><li>• wide range of options</li><li>• few incentives or disincentives for annuities</li></ul>
Very low	Australia, New Zealand	<ul style="list-style-type: none"><li>• disincentives to take annuities from taxation/means-tested benefits</li></ul>

Source: Oxera.

# Features of the retirement income market

## Wide range of factors

### Supply-side

- regulatory and tax environment
- product range
- providers
- competitive dynamics
- barriers to entry
- innovation

### Distribution

- types of intermediaries
- role of accumulation providers
- role of independent financial advisers
- intermediation by government/regulator
- financial education
- provision of information on pension entitlements

### Demand-side

- the 'consumer journey' to retirement
- role of DC pension funds in providing retirement income
- drivers of consumer preferences
- consumer 'biases'
- perceptions of products and value for money
- importance of defaults

# Annuitisation rates

## Significant variation across countries

Country	Relative importance of DC pension	Regulation	Taxation	Take-up of lifetime annuities
Australia	Medium	Low	Low/neutral	<1%
New Zealand	Low	Low	Low	Zero
USA	Medium	Low	Neutral	9%
Canada	Low	Medium	Neutral	30%*
Ireland	Medium	Medium	Neutral	30%**
Switzerland	High	High	Low/neutral	80%
Denmark	Very high	High	Neutral	52%***
Netherlands	Low	Very high	Neutral	100%
Singapore	Very high	Very high	Neutral	100%
Chile	Very high	High	Neutral	60%
<b>UK (current)</b>	<b>Medium</b>	<b>High</b>	<b>Neutral</b>	<b>c. 75% (falling)</b>

Note: \* Lack of data for Canada—30% used here based on the volume of the annuities market. \*\* 30% for Ireland supported by the Pensions Authority as being a reasonable estimate, given lack of data. \*\*\* Data for Denmark is for lifetime annuities only, not fixed-term annuities. Source: Oxera.

# Consumer preferences, perceptions and behaviour

Preferences	Perceptions	Behaviour
<ul style="list-style-type: none"><li>• risk–return trade-off varies<ul style="list-style-type: none"><li>• with age and income/wealth</li><li>• annuities may be too low-risk?</li></ul></li></ul>	<ul style="list-style-type: none"><li>• annuities seen to offer poor value for money<ul style="list-style-type: none"><li>• low government bond yields</li></ul></li></ul>	<ul style="list-style-type: none"><li>• framing of consumer choice<ul style="list-style-type: none"><li>• investment returns ...</li><li>• ... versus securing a lifetime income</li></ul></li></ul>
<ul style="list-style-type: none"><li>• demand for upfront capital<ul style="list-style-type: none"><li>• for home improvements</li><li>• to pay off the mortgage</li></ul></li></ul>	<ul style="list-style-type: none"><li>• need for flexibility<ul style="list-style-type: none"><li>• unexpected medical bills</li></ul></li></ul>	<ul style="list-style-type: none"><li>• ‘myopic’ behaviour<ul style="list-style-type: none"><li>• underestimating life expectancy</li></ul></li></ul>
<ul style="list-style-type: none"><li>• desire to leave a bequest</li></ul>	<ul style="list-style-type: none"><li>• annuities are an unusual form of insurance<ul style="list-style-type: none"><li>• assets are lost on death</li></ul></li></ul>	<ul style="list-style-type: none"><li>• loss aversion<ul style="list-style-type: none"><li>• worry about leaving the money to the insurance company</li></ul></li></ul>
<ul style="list-style-type: none"><li>• incentives to choose ‘default’ options<ul style="list-style-type: none"><li>• preferential rates</li><li>• concern about risky alternatives</li></ul></li></ul>	<ul style="list-style-type: none"><li>• social norms</li></ul>	<ul style="list-style-type: none"><li>• inertia<ul style="list-style-type: none"><li>• low engagement, resulting in the default option</li></ul></li></ul>

# Product innovation responding to demand

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- some innovations aim to combine higher-risk assets earlier in life with some guaranteed income for later years
  - ‘longevity pensions’
  - variable annuities with a guaranteed minimum income
- annuity-type products may try to provide some flexibility
  - ‘modified guaranteed’ annuities—a series of term annuities
  - products that allow larger income streams upfront
- providers have also responded to demand for remaining assets at death
  - guaranteed payment periods
  - income drawdown-type products with an implicit or explicit payment for longevity insurance

# Government initiatives

## ‘Nudges’ and other responses to consumer demand

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- most regulation is through taxation and product approval
  - but there is no clear definition of a ‘good outcome’
- encouraging default options that are suitable for a wide market
  - many people appear to choose the ‘de facto’ default option
- mandating products that meet consumer preferences
  - in more regulated systems—e.g. allowing bequests, guaranteed periods
- providing guidance to consumers
  - e.g. retirement planners, framing decisions in terms of lifetime incomes
- helping consumers to ‘shop around’
  - but there may be a trade-off between price comparison and product innovation

# Concluding thoughts

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- without incentives, consumer demand for annuities could be limited
- but there remains a debate about what is a 'good' outcome
- there is a need for more consumer research into the decisions people make at retirement
- market design is at the heart of this debate on retirement products

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