

Flat annuities or flexible pension schemes: the influence of expected expenses and (dis)trust in pension funds.

Carin van der Crujisen and Nicole Jonker (DNB)  
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\*Any opinions and conclusions expressed herein are those of the authors and do not necessarily represent the views of DNB or the ESCB.

# 1. Introduction

Increased choice:

- Retirement age
- Exchange partner's pension for higher monthly pension
- Pattern (flat, high-low, low-high)

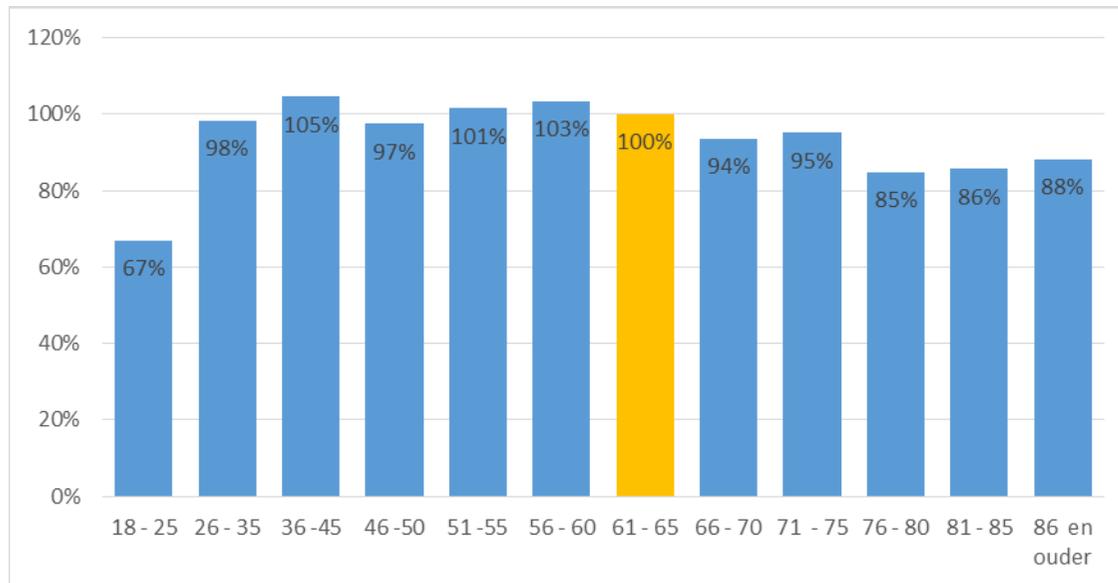
Discussion:

- Immediate receipt of part of the accrued pension rights at retirement age in exchange of a lower monthly pension (lump sum).

# Consumption by age



# Expenses per capita decline during retirement



- Just after retirement expenses in stores decrease, but on car usage increase.
- At age 75 expenses on service providers go up and on car usage go down
- A high-low pattern or lump sum payment seems to fit expenses well.

# Research question

- To what extent does offering choices with respect to pension patterns match people's preferences and what drives these preferences?
- In this research we focus on:
  - (1) The pattern (flat, high-low, low-high)
  - (2) Lump sum (no, partial, full)
- Special attention to the influence of expected expenses and trust in one's pension fund.

## 2. Data

- Consumer survey among members CentERpanel (25+)
- November 2015, response rate: 84.5%, 2082 complete responses
- About 1745 participants in pension funds

Questions about:

- Pattern preferences pension pay outs and underlying reasons
- Expected expenses during retirement
- Pension funds: trust, financial health, provision of information
- Information respondent: risk aversion, financial literacy, time preference, health, demographic characteristics

### 3. Expected expenses



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# People below 65 expect to spend less when retired

	Expected expenses <b>65-74</b> years, compared to current situation	Expected expenses <b>75+</b> years, compared to current situation
Total expenses	--	--
<i>Category</i>		
Recurrent payments	-	--
Food and drinks	-	-
Fuel, car maintenance, taxes	-	--
Clothing	-	--
Durable goods	-	--
Public transport and taxis	stable	+
Restaurants, cafes and recreation	+	-
Health care	+++	+++
Service providers	+	+
Holidays	+	-

# People between 65 and 74 spend less than before retirement...

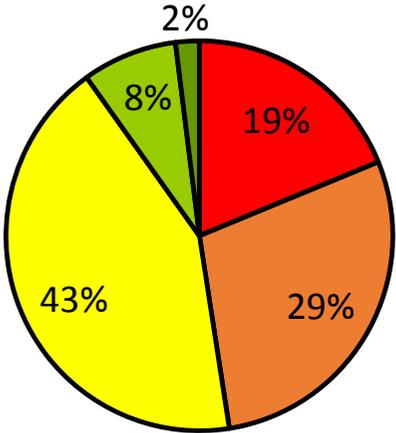
	Current expenses when compared to pre-retirement
Total expenses	-
<i>Category</i>	
Recurrent payments	stable
Food and drinks	-
Fuel, car maintenance, taxes	--
Clothing	----
Durable goods	--
Public transport and taxis	--
Restaurants, cafes and recreation	--
Health care	++
Service providers	-
Holidays	-

...and expect further declines.

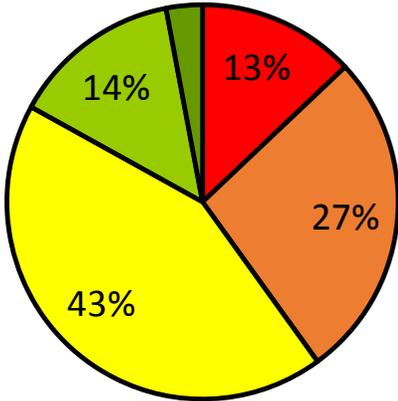
	<b>Expected expenses</b> when aged 75+, compared to current situation
Total expenses	-
<i>Category</i>	
Recurrent payments	stable
Food and drinks	--
Fuel, car maintenance, taxes	--
Clothing	--
Durable goods	--
Public transport and taxis	-
Restaurants, cafes and recreation	--
Health care	+++
Service providers	stable
Holidays	--

# Low spending partly caused by lower than expected pension?

Actual pension income compared to expected pension income



Actual spending compared to expected spending



- much less
- less
- as much
- more
- much more

## 4. Pattern preferences

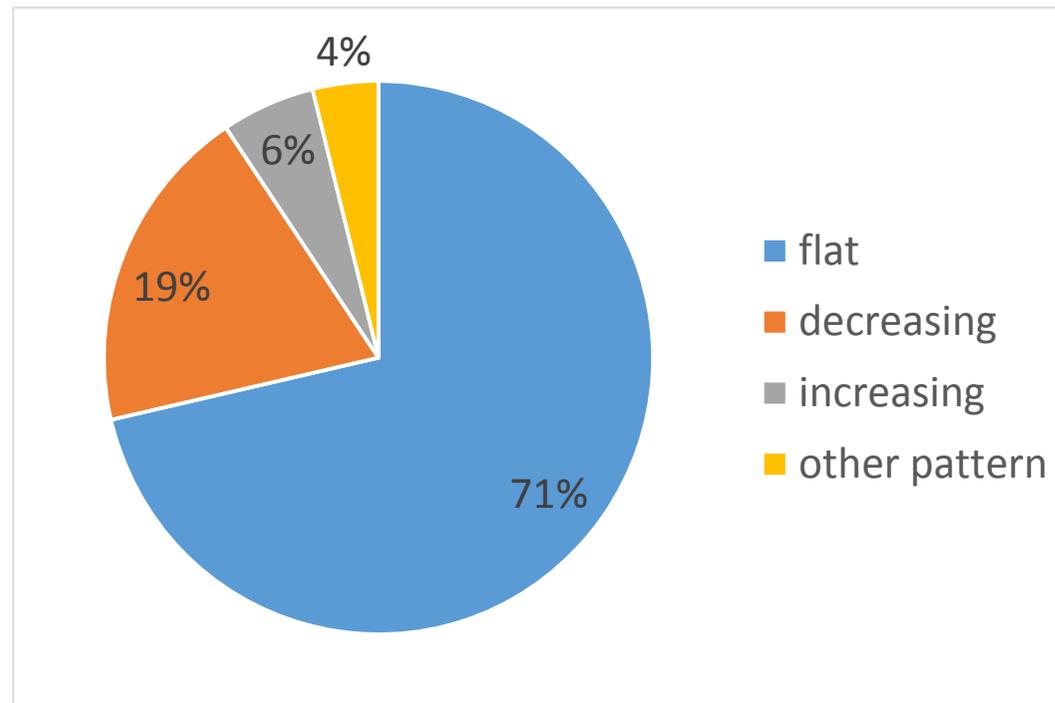


# Flat pension well-suited for most people but offering choice fulfils a need

People with pension rights:

- 29% want a flexible pattern
- 17% want a lump sum

# 29% want a flexible pattern



# Who prefers a high-low pension?

Regression results workers with pension rights  
(Binomial logit, base: flat annuity)

## Positive effect:

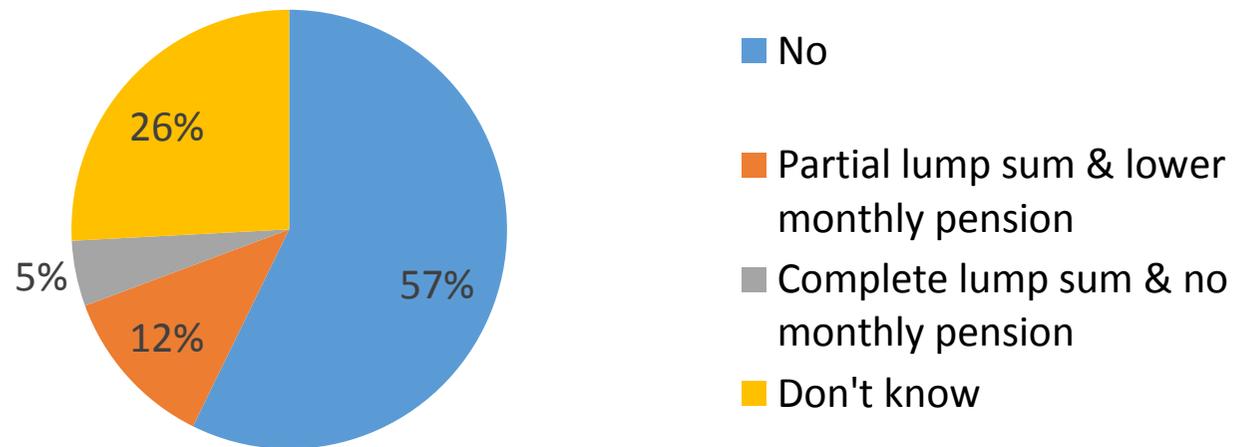
- Decreasing expenses during retirement on car usage : + 6%-points
- Decreasing expenses during retirement on holidays : + 7%-points
- Income high : + 10%-points
- Income unknown : + 16%-points
- Wealth high : + 8%-points
- Age <= 34 : + 10%-points
- Having children : + 9%-points

## Negative effect:

- Being risk averse :- 6%-points
- Difficulties managing household finances :- 22%-points
- Urbanisation degree :- 2%-points
- Save to leave bequest :- 3%-points

# 17% want a lump sum

Suppose you could receive part of your accrued pension immediately when you retire. Would you want that?



*Note:* Question pensioners: "Suppose you could receive part of your remaining pension immediately. Would you want that?"

# Who prefers a (partial) lump sum?

Regression results workers with pension rights (Binomial logit, base: flat annuity)

## Positive effect:

- Decreasing expenses during retirement on car usage : + 7%-points
- High time rate of preference : + 5%-points
- Risk taker : + 17%-points
- Financial literacy : + 15%-points

## Negative effect:

- 55-64 years (*reference group: 45-54 years*) :- 14%-points
- Relatively much health care expected to need :- 13%-points
- Self-assessed likelihood to reach the age of 75 :- 2%-points
- Urbanisation degree :- 3%-points
- Trust own pension fund :- 7%-points
- Information about pensions in newspaper :- 12%-points

## 5. Trust in pension fund

Regression results workers with pension rights (Binomial logit, base: trust=yes )

Positive effect:

- High income : +8%-points
- Information from pension fund : +7%-points
- Information about own pension : +7%-points

Negative effect:

- Pension funds in financial problems : -13%-points
- Cut pension benefits : -11%-points
- Age  $\leq 34$  (ref. age 45- 54) : -12%-points
- Wealth: low : -7%-points
- Wealth: unknown : -17%-points
- Urbanisation degree : -3%-points

## 6. Conclusion

- Current *defaults* well-suited for most people with pension rights.
- Offering choice about pension pattern fulfils a need. Ranking of interest:
  1. High-low pension
  2. Partial lump sum
  3. Low-high pension
  4. Complete lump sum
- Preference is driven by expected expenditures, trust in pension funds.
- Trust in pension fund declines in case the pension funds runs into financial problems  
=>What's the impact on pension funds if during financial crises pensioners opt more often for lump sum?

# Thank you for your attention! Questions?



Carin van der Cruijzen: [c.a.b.van.der.cruijzen@dnb.nl](mailto:c.a.b.van.der.cruijzen@dnb.nl)

Nicole Jonker: [n.jonker@dnb.nl](mailto:n.jonker@dnb.nl)

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# Limited knowledge about pensions

- During the past year...
  - ...39% did not hear anything about pension options.
  - ...35% of the people with pension rights did not collect/receive information on own pension.



# Most people don't know pattern options

Does (one of) your pension fund(s) offer the possibility to vary the level of the pension benefit during retirement?

Age	25-34	35-44	45-54	55-64	65-74	≥75	all
Yes	3%	6%	8%	27%	21%	5%	15%
No	12%	20%	19%	19%	41%	48%	27%
Don't know	85%	73%	73%	54%	38%	47%	58%

