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

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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
People below 65 expect to spend less when retired

<table>
<thead>
<tr>
<th>Category</th>
<th>Expected expenses 65-74 years, compared to current situation</th>
<th>Expected expenses 75+ years, compared to current situation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total expenses</td>
<td>--</td>
<td>--</td>
</tr>
<tr>
<td>Recurrent payments</td>
<td>-</td>
<td>--</td>
</tr>
<tr>
<td>Food and drinks</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Fuel, car maintenance, taxes</td>
<td>-</td>
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</tr>
<tr>
<td>Clothing</td>
<td>-</td>
<td>--</td>
</tr>
<tr>
<td>Durable goods</td>
<td>-</td>
<td>--</td>
</tr>
<tr>
<td>Public transport and taxis</td>
<td>stable</td>
<td>+</td>
</tr>
<tr>
<td>Restaurants, cafes and recreation</td>
<td>+</td>
<td>-</td>
</tr>
<tr>
<td>Health care</td>
<td>+++</td>
<td>+++</td>
</tr>
<tr>
<td>Service providers</td>
<td>+</td>
<td>+</td>
</tr>
<tr>
<td>Holidays</td>
<td>+</td>
<td>-</td>
</tr>
</tbody>
</table>
People between 65 and 74 spend less than before retirement...

<table>
<thead>
<tr>
<th>Category</th>
<th>Current expenses when compared to pre-retirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total expenses</td>
<td>-</td>
</tr>
<tr>
<td><strong>Category</strong></td>
<td></td>
</tr>
<tr>
<td>Recurrent payments</td>
<td>stable</td>
</tr>
<tr>
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<td>Health care</td>
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<tr>
<td>Service providers</td>
<td>-</td>
</tr>
<tr>
<td>Holidays</td>
<td>-</td>
</tr>
</tbody>
</table>
...and expect further declines.

<table>
<thead>
<tr>
<th>Category</th>
<th>Expected expenses when aged 75+, compared to current situation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total expenses</td>
<td>-</td>
</tr>
<tr>
<td><strong>Recurrent payments</strong></td>
<td>stable</td>
</tr>
<tr>
<td>Food and drinks</td>
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<td>Fuel, car maintenance, taxes</td>
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<td>Service providers</td>
<td>stable</td>
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<tr>
<td>Holidays</td>
<td>--</td>
</tr>
</tbody>
</table>
Low spending partly caused by lower than expected pension?

**Actual pension income compared to expected pension income**
- 43%: much less
- 29%: less
- 19%: as much
- 8%: more
- 2%: much more

**Actual spending compared to expected spending**
- 43%: much less
- 27%: less
- 13%: as much
- 14%: more
- 2%: 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

- 71% flat
- 19% decreasing
- 6% increasing
- 4% other 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?

- No: 57%
- Partial lump sum & lower monthly pension: 26%
- Complete lump sum & no monthly pension: 12%
- Don't know: 5%

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 <=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?

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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?

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