



**Briefing Paper BP4/2018**

**How do older people make decisions about their retirement income and assets? – a review of the literature**

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**Introduction**

There is increasing onus on older people to make complex decisions about financial planning and financial products, as governments seek to individualise responsibility (and risk) for retirement security. The recent Pension Schemes Act 2015, along with the Taxation of Pensions Act 2014, have given individuals more flexibility and choice over how they access their Defined Contribution pension savings. People approaching or in retirement now have a range of options, including taking the entire pension pot as a lump sum, keeping the fund invested, or purchasing an annuity, but there are growing concerns among the financial services industry, consumer groups, and policy makers that individuals are not making informed decisions when deciding what to do with their pension savings. For instance, government-provided information and guidance appears to be having a limited impact, with just 1 in 10 over 50s accessing the Pension Wise service to help them decide how to decumulate assets<sup>1</sup>, while a recent FCA report also indicates that an increasing number of people are entering income drawdown arrangements without taking financial advice or shopping around<sup>2</sup>. Reports of fraud and scam activity targeting DC pension savers since the freedoms were introduced has also fuelled concerns that there may be a number of

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<sup>1</sup> Just (2017) **Lighting Pension Pathways: Guiding pension savers through 'Freedom and Choice'**. Available from: [http://www.actuarialpost.co.uk/downloads/cat\\_1/Just-Lighting%20Pension%20Pathways%20REPORT.pdf](http://www.actuarialpost.co.uk/downloads/cat_1/Just-Lighting%20Pension%20Pathways%20REPORT.pdf) [Accessed 29 September 2017]

<sup>2</sup> FCA (2017) **Retirement Outcomes Review: Interim Report**. London: FCA

unintended consequences resulting from the pension policy reforms<sup>3</sup>. This is one of the key issues underpinning the recently announced Work and Pensions Committee inquiry into whether and how far the reforms are achieving their objectives<sup>4</sup>.

There is a contradiction between the libertarian paternalism policy for pension wealth accumulation (automatic enrolment), and the assumption that older people are best placed to make complex financial decisions at the decumulation stage, without any requirement to seek professional decision-making support. This is most visible when we look at current government policy underpinning housing asset and pension asset decisions. Following the FSA's Mortgage Market Review, professional financial advice became mandatory for all but high net-worth individuals and mortgage professionals when purchasing a mortgage<sup>5</sup>. Yet, there is no such requirement to seek professional financial advice in order to think through the nature and consequences of pension decumulation decisions. This inconsistency has been pointed out by Just<sup>6</sup> in their recent report, *Lighting Pension Pathways*, which calls for the implementation of default guidance to support informed decision-making.

Despite these developing issues and concerns around how retirees decumulate their wealth, very little is known about the decision making process. So what *do* we know about older people's financial decision-making? This briefing paper summarises the findings of a scoping study (drawing on UK and international literature) to investigate what is already known (or indeed not known) about older people's retirement income and asset decision-making, with a particular emphasis on the role of financial advice. The literature search was conducted primarily through the Social Sciences Citations Index (SSCI) database, as well as the ProQuest database, between August and October 2017. After the initial search turned up few relevant studies on SSCI, the search terms were expanded and produced over 10,000 results. These results were narrowed down to around 500 potentially relevant studies, but following an

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<sup>3</sup> Age UK Research (2015) **Financial Abuse Evidence Review**. [online] Available from: [https://www.ageuk.org.uk/globalassets/age-uk/documents/reports-and-publications/reports-and-briefings/money-matters/financial\\_abuse\\_evidence\\_review-nov\\_2015.pdf](https://www.ageuk.org.uk/globalassets/age-uk/documents/reports-and-publications/reports-and-briefings/money-matters/financial_abuse_evidence_review-nov_2015.pdf) [Accessed 29 Sept 2017]

<sup>4</sup> Parliament UK (2017) **Pension freedoms inquiry launched**. [online] Available from: <https://www.parliament.uk/business/committees/committees-a-z/commons-select/work-and-pensions-committee/news-parliament-2017/pension-freedoms-launch-17-19/> [Accessed 26 Sept 2017]

<sup>5</sup> FSA (2011). **Mortgage Market Review: Proposed Package of Reforms**, CP11/31 [online] Available from: [www.fsa.gov.uk/library/policy/cp/2011/11\\_31.shtml](http://www.fsa.gov.uk/library/policy/cp/2011/11_31.shtml) [Accessed 26 Sept 2017]

<sup>6</sup> Just (2017) **Lighting Pension Pathways: Guiding pension savers through 'Freedom and Choice'**. [online] Available from: [http://www.actuarialpost.co.uk/downloads/cat\\_1/Just-Lighting%20Pension%20Pathways%20REPORT.pdf](http://www.actuarialpost.co.uk/downloads/cat_1/Just-Lighting%20Pension%20Pathways%20REPORT.pdf) [Accessed 29 Sept 2017]

initial reading of abstracts and introductions, this figure reduced significantly to around 30 documents.

## What decisions are older people (not) making?

### ***Annuity and Pension Freedoms***

The first and most prominent decision that a retiree (with a private pension) will make will be to decide how to cash in on their defined contribution pension savings. Since April 2015, it has been possible for those aged 55 and over to withdraw part or all of their pension wealth, with the first 25% tax free and the remainder subject to marginal income tax rates under new pension freedom rules. From its introduction to October 2017 over £14.2 billion has been withdrawn by an estimated 916,000 individuals<sup>7</sup>. Individuals can also purchase an annuity with all of their pension fund or the remainder after an initial withdrawal (a continuation of the primary option for drawing on personal pension funds prior to the introduction of the pension freedoms).

### ***Bequests***

Notwithstanding evidence of some shift in attitudes, leaving a bequest remains a common wish for retirees, even if individuals do not have any heirs to pass their wealth on to<sup>8</sup>. The decision to leave a bequest can be seen as sitting in tension with asset-based welfare policy, with such motives leading to an unwillingness to use up assets, including housing equity (perhaps via reverse mortgage mechanisms<sup>9,10</sup>), and an inclination to save rather than spend more generally<sup>11</sup>. As such, older people can hold substantial assets even into old age, rather than use the assets to finance retirement needs<sup>12</sup>. However, individuals may be more willing to spend inheritance on home improvements and leisure compared to other financial needs<sup>13</sup>.

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<sup>7</sup> HMRC (2017) **Flexible Payments from Pensions: October 2017: Official Statistics**. Available from: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/631129/Pensions\\_Flexibility\\_July\\_2017.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/631129/Pensions_Flexibility_July_2017.pdf) [Accessed 28 Oct 2017]

<sup>8</sup>Kopczuk, W. and Lupton, J. P. (2007) To Leave or Not to Leave: The Distribution of Bequest Motives. **The Review of Economic Studies**, 74(1): 207-235

<sup>9</sup> Davidoff, T., Gerhard, P. and Post, T. (2017) Reverse mortgages: What homeowners (don't) know and how it matters. **Journal of Economic Behavior and Organization**, 133: 151-171

<sup>10</sup>Nakajima, M. and Telyukova, I. A. (2017) Reverse Mortgage Loans: A Quantitative Analysis. **Journal of Finance**, 72(2): 911-950

<sup>11</sup> Kopczuk, W. and Lupton, J. P. (2007) To Leave or Not to Leave: The Distribution of Bequest Motives. **The Review of Economic Studies**, 74(1): 207-235

<sup>12</sup> Van Ooijen, R., Alessie, R. and Kalwij, A. (2015) Saving Behavior and Portfolio Choice After Retirement. **De Economist**, 163(3): 353-404

<sup>13</sup> Price, D., Bisdee, D., Daly, T., Livsey, L. and Higgs, P. (2014) Financial planning for social care in later life: the 'shadow' of fourth age dependency. **Ageing & Society**, 34: 388-410

Although leaving a bequest may seem simple, the process can be complex in practice, and individuals may be waiting unnecessarily to pass their wealth on and may be doing so inefficiently without seeking professional advice.

### ***Lifetime Mortgages (LMs) and Equity Release Products (ERPs)***

Retired people are increasingly expected to finance their care (and general later life) needs using their assets, potentially through products like LMs<sup>14</sup>. In general, these products operate by taking out a loan against the value of property to release its equity as a lump sum or income whilst the owner has the right to remain in the property. There is often confusion and negative misconceptions about these products, which has largely led to their low take up despite their potential to support older people<sup>15</sup>, and the UK equity release market remains small at less than 2 per cent of the mainstream/residential mortgage market. However, the UK market is growing with sales of equity release plans exceeding £2bn for the first time in 2016, and the largest number of new plans (27,500) sold since 2008<sup>16</sup>.

### ***Other financial decisions and commitments***

A growing proportion of older people are carrying mortgages into retirement, with 1 in 4 people retiring in 2017 expecting to have outstanding mortgage commitments<sup>17</sup>. Debts can create additional financial pressures in retirement, with conflicting interests between bequest motives and financial institutions in repaying these debts. And whilst decisions being taken have been explored to some extent, decisions that are not being taken are also important. Most importantly, financial decisions regarding later life social care are much less prominent in the minds of retirees or actively undertaken as they are seen as a black hole expense and improbable<sup>18</sup>.

### ***Summary***

Older people have to make several financial decisions in retirement, managing competing interests and complex products. Growing complexity of financial products, increased longevity, and declining financial capability with old age increase the probability of making

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<sup>14</sup> House of Lords Select Committee on Public Service and Demographic Change (2013). **Ready for Ageing?** London: The Stationery Office

<sup>15</sup> O'Mahony, L. F. and Overton, L. E. (2014) Financial Advice, Differentiated Consumers, and the Regulation of Equity release Transactions. **Journal of Law and Society**, 41(3): 446-469

<sup>16</sup> Equity Release Council (2017) **Equity release rebooted: the future of housing equity as retirement income**. Available from: <http://www.equityreleasecouncil.com/document-library/equity-release-rebooted-white-paper-april-2017/> [Accessed 16 August 2017]

<sup>17</sup> Jones, R. (2017) One in four UK retirees burdened by unpaid mortgage or other debts. **The Guardian**, Friday 17th February. Available from: <https://www.theguardian.com/money/2017/feb/17/one-in-four-uk-retirees-burdened-by-unpaid-mortgage-or-other-debts> [Accessed 16 August 2017]

<sup>18</sup> Price, D., Bisdee, D., Daly, T., Livsey, L. and Higgs, P. (2014) Financial planning for social care in later life: the 'shadow' of fourth age dependency. **Ageing & Society**, 34: 388-410

poor or sub-optimal financial decisions, being less able to predict future needs, or make behavioural changes needed to meet them. Often decisions cannot be made in isolation, and a holistic approach needs to be taken when making financial decisions.

### **The process of making financial decisions**

Little is known about the financial decision-making pathways of older people, or the general population for that matter<sup>19</sup>. No explicit research on this topic was found over the course of this scoping study, but there were a number of related issues linked to the decision-making process.

#### ***Prompts and Barriers***

Focussing on the main decisions discussed in the previous section, and in addition to seeking professional financial advice, there are several factors that can prompt and increase the likelihood of older people taking these decisions. One such prompt is medical history and parents' health in retirement, with those in poor health and or those who had parents who did not survive long into retirement being more likely to take out their whole pension or opt for the shortest annuitisation period<sup>20</sup>. However, other prompts can be less drastic. For instance, individuals are more likely to take out a reverse/lifetime mortgage if they know someone else who has taken one out, and such peer effects have also been found to increase product knowledge and familiarity<sup>21</sup>. However, there is limited research on what prompts older people to seek professional advice. An initial evaluation of the Pension Wise service showed that individuals were most likely to make an appointment to find out information on pension options (90%) or pensions and retirement more generally (83%), what specifically made them book an appointment is unknown.

The barriers to seeking professional financial advice are better understood, though not necessarily in a UK context<sup>22</sup>. Research carried out in the Netherlands looked specifically at older people's advice seeking behaviour, showing that there are significant levels of anxiety when dealing with, and approaching, professional financial advisers. This can make individuals

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<sup>19</sup> Lusardi, A., Mitchell, O. S. and Curto, V. (2014) Financial literacy and financial sophistication in the older population. **Journal of Pension Economics & Finance**, 13(4): 347-366

<sup>20</sup> Hagen, J. (2015) The determinants of annuitization: evidence from Sweden. **International Tax and Public Finance**, 22(4): 549-578

<sup>21</sup> Davidoff, T., Gerhard, P. and Post, T. (2017) Reverse mortgages: What homeowners (don't) know and how it matters. **Journal of Economic Behavior and Organization**, 133: 151-171

<sup>22</sup> Moss, John Gordon Robert (2015) Personal financial planning advice: barriers to access. Ph.D. thesis, University of Birmingham <http://etheses.bham.ac.uk/6016/1/Moss15PhD.pdf>

less likely to consult a financial advisor, with 32 per cent of Dutch individuals reporting moderate to severe adviser anxiety, compared to 11 per cent who felt little or no anxiety<sup>23</sup>. In the UK context, The FCA'S Financial Advice Market Review suggested that the costs of consulting independent financial advisers can also act as a deterrent, and it is now possible for individuals in the UK to withdraw £500 from their DC savings for pensions or retirement advice through the newly constituted 'Pensions Advice Allowance'<sup>24</sup>.

Low financial confidence, capability and knowledge can also be barriers to making financial decisions. Studies have found that retirees face declining financial capability with age<sup>25</sup>, and as such are less able to understand complex financial products<sup>26</sup>. This combination can delay financial decision making as well as create misperceptions about products<sup>27,28</sup>. Bequest motives can stop people making certain decisions if they believe it will affect their ability to pass wealth on, particularly in relation to reverse mortgage loans<sup>29</sup>. This contrasts with the expensive nature of later life care costs, which, coupled with the uncertainty of its necessity, means individuals may be inclined to avoid making financial decisions to save or engage with the possibility<sup>30,31</sup>.

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<sup>23</sup> Van Dalen, H. P., Henkens, K. and Hershey, D. A. (2016) Why do older adults avoid seeking financial advice? Adviser anxiety in the Netherlands. **Ageing & Society**, 37: 1268-1290

<sup>24</sup> HM Treasury (2017) **Introducing a Pensions Advice Allowance: consultation**. [online] Available from: <https://www.gov.uk/government/consultations/introducing-a-pensions-advice-allowance/introducing-a-pensions-advice-allowance-consultation> [Accessed 18 August 2017]

<sup>25</sup> Agarwal, S., Driscoll, J. C., Gabaix, X. and Laibson, D. (2009) The Age of Reason: Financial Decisions over the Life Cycle and Implications for Regulation. **Brookings Papers on Economic Activity**, 2009: 51-101

<sup>26</sup> Lusardi, A., Mitchell, O. S. and Curto, V. (2014) Financial literacy and financial sophistication in the older population. **Journal of Pension Economics & Finance**, 13(4): 347-366

<sup>27</sup> Davidoff, T., Gerhard, P. and Post, T. (2017) Reverse mortgages: What homeowners (don't) know and how it matters. **Journal of Economic Behavior and Organization**, 133: 151-171

<sup>28</sup> O'Mahony, L. F. and Overton, L. E. (2014) Financial Advice, Differentiated Consumers, and the Regulation of Equity release Transactions. **Journal of Law and Society**, 41(3): 446-469

<sup>29</sup> Nakajima, M. and Telyukova, I. A. (2017) Reverse Mortgage Loans: A Quantitative Analysis. **Journal of Finance**, 72(2): 911-950

<sup>30</sup> Price, D., Bisdee, D., Daly, T., Livsey, L. and Higgs, P. (2014) Financial planning for social care in later life: the 'shadow' of fourth age dependency. **Ageing & Society**, 34: 388-410

<sup>31</sup> Hoffman, A. K. and Jackson, H. E. (2013) Retiree Out-of-Pocket Healthcare Spending: A Study of Consumer Expectations and Policy Implications. **American Journal of Law & Medicine**, 39(1): 62-133

### **Information Sources and Financial Advice**

There is very limited research into how retirees seek professional financial advice, with the closest academic studies focussing on those close to retirement, rather than in retirement. The most significant research has come from government and industry. Focussing on a government review of Pension Wise, of people aged 55 and over and planning to retire in the next two years, just seven per cent used the free and impartial Pension Wise guidance service<sup>32</sup>. The support provided by Pension Wise (and that of the Money Advice Service and the Pension Service) was under Parliamentary review during 2017 as part of a plan to create a Single Financial Guidance Body covering all aspects of personal finance, and with the objective of improving people's ability to make informed financial decisions. The new body will go live in autumn 2018 and will be tasked with addressing financial capability issues facing consumers throughout their lives.<sup>33</sup>

Older people may also turn to those within their private spheres such as carers and family for financial information and aid. Such individuals can act as proxies and sources of financial information, being a bridge between professional and other informal sources and advice, often due to declining physical health<sup>34</sup> and or financial capability. Older people generally trust informal advisers due to their close connection, and are likely to believe that these individuals will act in their best interest<sup>35</sup>. However, there can be differences between countries and cultures, as seen in a study which identified UK female baby boomers being less willing to engage with and seek advice from informal sources than their Australian counterparts<sup>36</sup>.

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<sup>32</sup> Parliament UK (2017) **Pension freedoms inquiry launched**. [online] Available from: <https://www.parliament.uk/business/committees/committees-a-z/commons-select/work-and-pensions-committee/news-parliament-2017/pension-freedoms-launch-17-19/> [Accessed 26 September 2017]

<sup>33</sup> Royal ascent for the creation of the new Single Guidance Body was granted on 10 May 2018 - <https://services.parliament.uk/bills/2017-19/financialguidanceandclaims.html>

<sup>34</sup> Asla, T. M. and Williamson, K. (2015) Unexplored territory: information behaviour in the fourth age. **Information Research** [online], 20(1). Available from: <https://researchoutput.csu.edu.au/ws/portalfiles/portal/12464859> [Accessed 5 September 2017].

<sup>35</sup> Tilse, C., Setterlund, D., Wilson, J., and Rosenman, L. (2005) Older people's assets a contested site. **Australasian Journal on Ageing**, 24: 51-56

<sup>36</sup> Kopanidis, F. Z., Robinson, L. J. and Reid, M. (2014) State of Inertia: Psychological Preparation of Single Australian and UK Baby Boomer Women for Retirement Housing Change. **Journal of Women & Aging**, 26(3): 280-297

### ***Assisted and Substitute Decision Making***

Assisted and substitute decision making often involves family, carers and financial professionals and institutions either aiding or taking on financial decisions for the retiree. Research in 2005 found that around 1 in 10 working age Australians had helped someone over the age of 65 with financial matters in the past 12 months<sup>37</sup>. However, not only had these individuals in the private sphere helped in the decision making process, they had in many cases taken on the decision making altogether<sup>38</sup>. Although many studies have pointed out that older people have poorer financial capabilities than the wider population (in some aspects of financial capability in particular), there may be some conflict between managing declining financial capability and involving older people in their financial decisions, where decisions are taken away from those who are in fact quite capable of making them<sup>39</sup>. All of these issues are underexplored in the UK setting.

### ***Summary***

The issues outlined here have not solely addressed the financial decision-making process, but they highlight important aspects associated with older people's financial decision-making. There is little known about how, and if, intentions lead to actions, with much of the existing research focussing on associations between demographic variables at a quantitative level. As such, there is limited evidence on the decision making process and the role of financial advice within this. Though studies that model correlations between characteristics of older people and financial decisions are useful, these studies do not explore the reasons why individuals may have taken out these products, nor elaborate on the process by which financial decisions were taken. Evidence of how retirees make financial decisions and how they prioritise demands and seek to resolve them are therefore of policy importance.

### **Risks associated with Financial Decision Making in Retirement**

Having established what decisions older people make, or do not make, regarding their retirement income and assets, as well as outlining a number of issues associated with how these decisions are made, we now explore some of the risks involved in financial decision making in retirement.

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<sup>37</sup> Tilse, C., Setterlund, D., Wilson, J., and Rosenman, L. (2005) Older people's assets a contested site. **Australasian Journal on Ageing**, 24: 51-56

<sup>38</sup> Tilse, C., Wilson, J., Rosenman, L., Morrison, D. and McCawley, A. (2011) Managing older people's money: assisted and substitute decision making in residential aged-care. **Ageing & Society**, 31(1): 93-109

<sup>39</sup> Tilse, C., Wilson, J., Rosenman, L., Morrison, D. and McCawley, A. (2011) Managing older people's money: assisted and substitute decision making in residential aged-care. **Ageing & Society**, 31(1): 93-109



### ***Informal Asset Management and Financial Advice***

There are several problems with relying on informal asset managers and advisors. Firstly, these individuals may not possess financial qualifications or capability to effectively manage asset decisions, and may be unable to conduct thorough research without access to all available products that a professional financial adviser would have<sup>40</sup>. This lack of access and qualifications could lead to ineffective investing and or purchasing of unsuitable products. Furthermore, substitute decision making limits the involvement of the older person in deciding how to manage their financial assets, even if they are capable of making some decisions<sup>41</sup>.

There may also be conflicts of interest between parties, including care homes and next of kin, and as such, assets may not be managed in the interest or risk tolerance of the retiree. The preference amongst many older people to use informal asset managers and advisors can also leave them open to financial abuse, with no paper trail and formal recognition of transactions and no guarantee for these individuals to act in the interests of the retiree<sup>42</sup>.

### ***Financial Capability and Overconfidence***

Older people tend to become less financially capable, with studies showing declining proficiency with age<sup>43,44</sup>. This can be problematic if they 'chose' to manage their assets without consultation if they are unable to fully understand key product details or associated risks. This could explain why decisions are passed onto professionals and individuals in the private sphere, the problems of which have already been discussed. Linked to this is the notion of risk aversion, which can also be related to poor financial decision-making among older people<sup>45,46</sup>,

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<sup>40</sup> Pálsdóttir, Á. (2012) Relatives as supporters of elderly peoples' information behaviour. **Information Research** [online], 17(4). Available from: <http://www.informationr.net/ir/17-4/paper546.html#.WeCof2hSzlU> [Accessed 7 September 2017].

<sup>41</sup> Tilse, C., Setterlund, D., Wilson, J. and Rosenman, L. (2005) Minding the money: a growing responsibility for informal carers. **Ageing and Society**, 25(2): 215-227.

<sup>42</sup> Tilse, C., Setterlund, D., Wilson, J., and Rosenman, L. (2005) Older people's assets a contested site. **Australasian Journal on Ageing**, 24: 51-56

<sup>43</sup> Lusardi, A. (2012) Financial Literacy and Financial Decision-Making in Older Adults. **Generations**, 36(2), pp.25-32

<sup>44</sup> Agarwal, S., Driscoll, J. C., Gabaix, X. and Laibson, D. (2009) The Age of Reason: Financial Decisions over the Life Cycle and Implications for Regulation. **Brookings Papers on Economic Activity**, 2009: 51-101

<sup>45</sup> James, B. D., Boyle, P. A., Yu, L. and Bennett, D. A. (2013) Internet use and decision making in community-based older adults. **Frontiers in Psychology**, 4: 605

<sup>46</sup> Jianakoplos, N. A. and Bernasek, A. (2006) Financial Risk Taking by Age and Birth Cohort. **Southern Economic Journal**, 72(4): 981-1001

though it may be understandable given that older adults are less able to rebound from downturns in riskier assets, preferring simpler, but poorer performing, products.

Although older people tend to become risk averse and show declining financial capability, research by Just showed that UK retirees generally felt confident in managing their financial affairs<sup>47</sup>. This could indicate a contradiction developing as confidence does not necessarily indicate ability. Research in the US focussing on retired investors demonstrated an “overconfidence gap”, whereby investor confidence did not decline with financial capability<sup>48</sup>. As such, overconfident investors were more likely to hold riskier assets, making them more vulnerable to market volatility with less time to recover from bad investment choices. The same study also found that financial advice had a strong dampening effect on overconfidence, and could improve the financial outcomes of those who display an overconfidence gap. Generic financial advice could also act as preparation for older people to become more confident and engaged with professional advisors according to a UK study<sup>49</sup>.

### ***Pension Fraud and Financial Abuse***

Following on from the above, financial abuse and fraud are of serious concern for policy makers, industry and retirees. In the UK, it is estimated that between 1 and 2 per cent of those aged 65 and over have suffered financial abuse at some point, though this figure may be significantly higher if the definition of financial abuse is expanded<sup>50</sup>.

Given the preference for using informal asset managers, coupled with overconfidence gaps, and lack of engagement with generic advice, it is easier for retirees to suffer financial abuse. Consulting professional advisors may reduce or eliminate many of the routes to financial abuse in the private sphere, as professionals are held to codes of conduct and ethics, as well as public awareness and scrutiny. Financial advisors can also help individuals avoid abuse in the first place and recognise instances of abuse and fraudulent activity. There are large

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<sup>47</sup>Just (2017) **Lighting Pension Pathways: Guiding pension savers through ‘Freedom and Choice’**. [online] Available from: [http://www.actuarialpost.co.uk/downloads/cat\\_1/Just-Lighting%20Pension%20Pathways%20REPORT.pdf](http://www.actuarialpost.co.uk/downloads/cat_1/Just-Lighting%20Pension%20Pathways%20REPORT.pdf) [Accessed 29 September 2017]

<sup>48</sup>Pak, T. Y. and Chatterjee, S. (2016) Aging, overconfidence, and portfolio choice. **Journal of Behavioral and Experimental Finance**. 12: 112-122

<sup>49</sup>O'Mahony, L. F. and Overton, L. E. (2014) Financial Advice, Differentiated Consumers, and the Regulation of Equity release Transactions. **Journal of Law and Society**, 41(3): 446-469

<sup>50</sup>Age UK Research (2015) **Financial Abuse Evidence Review**. [online] Available from: [https://www.ageuk.org.uk/globalassets/age-uk/documents/reports-and-publications/reports-and-briefings/money-matters/financial\\_abuse\\_evidence\\_review-nov\\_2015.pdf](https://www.ageuk.org.uk/globalassets/age-uk/documents/reports-and-publications/reports-and-briefings/money-matters/financial_abuse_evidence_review-nov_2015.pdf) [Accessed 29 September 2017]

amounts of resources dedicated to helping older people avoid financial abuse and pension fraud. Yet the importance of professional advice to retirees, and why it is and is not sought in the UK, is unclear and under-researched despite its potential benefits.

### ***Myopia***

Myopia has been studied fairly extensively in younger cohorts, but there are few studies exploring the issue amongst retirees, though it is present amongst the cohort. Where this issue has been investigated, there was a significant lack of engagement in the idea of planning for end of life care and tended to be thought of as a waste of time and an overwhelming expense, both in the UK<sup>51</sup> and US<sup>52</sup>, where many overestimations overwhelmed individuals into a sense of powerlessness and paralysis. However, in the US study, the majority of participants severely underestimated future costs in relation to expert predictions, failing to plan for potential policy changes or unpredictable financial and health scenarios, whereas in the UK, some retirees were willing to downsize for shorter term plans such as leisure activities and home modifications.

Myopia may play a role, though not the sole role, in why people are taking out lump sums. There has been significant research into behavioural biases influencing financial decisions which demonstrates that individuals are drawn to instant gratification; however, individuals may make non-myopic withdrawal if they are likely not to gain from long term annuities, such as those with terminal illness<sup>53</sup>. Financial advice could convince retirees to delay gratification, raise awareness of potential risks to delaying decision making, and correct individuals' expectations of potential future costs. Yet, at what stage financial advice might be useful, and how useful individuals might find financial advice, is not known.

### ***Summary***

Given the number and complexity of decisions in retirement, older people face significant risks. In retirement, financial decisions can have serious consequences, given that individuals may be unable to recuperate losses from poor decisions, having less time to do so than those of working age. Of particular concern is the lack of formal financial consultation, declining financial capability and overconfidence in some instances, as well as myopic tendencies. How

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<sup>51</sup> Price, D., Bisdee, D., Daly, T., Livsey, L. and Higgs, P. (2014) Financial planning for social care in later life: the 'shadow' of fourth age dependency. **Ageing & Society**, 34: 388-410

<sup>52</sup> Hoffman, A. K. and Jackson, H. E. (2013) Retiree Out-of-Pocket Healthcare Spending: A Study of Consumer Expectations and Policy Implications. **American Journal of Law & Medicine**, 39(1): 62-133

<sup>53</sup> Hagen, J. (2015) The determinants of annuitization: evidence from Sweden. **International Tax and Public Finance**, 22(4): 549-578

individuals can minimise these risks with professional financial advice, nor how well received or accessible such advice is to retirees, is not well known in the UK.

## **Conclusion**

As stated at the beginning of this paper, around 916,000 individuals have released £14.2 billion under pension freedoms since 2015. Yet there is little known about how retired individuals come to the decision to take out these sums, with the Just report finding that more than nine out of ten retirees do not use the Government's Pension Wise service and its advice when making important decisions about pension savings.

Our research here suggests that retirees have to take out a series of complex and interrelated financial decisions in retirement, yet these decisions are often taken without the consultation of formal financial advice. Retirees are, for the most part, relying on their own judgement or the judgements of those close to them, when making retirement decisions. However, this study has identified several risks associated with such practice, including financial abuse, myopia and poor financial capability which can increase the likelihood of poor, or sub-optimal, financial decisions and outcomes.

The effects of the pension freedoms are only just starting to be revealed, and further investigation will be needed to establish their longer term effects on older people's retirement security. There is a lack of UK-based research on how decisions are made or passed onto others. In particular, the reasons why UK retirees choose, or do not choose, to consult professional advice remains unclear. Yet the complexity associated with making income and asset decisions in the new retirement landscape poses potentially significant risks to older people's financial wellbeing, giving rise to the growing importance of accessible and effective decision-making support.

***The views expressed in this Briefing Paper are the views of the author and do not necessarily represent the views of CHASM as an organisation or other CHASM members.***