

Summary

Retiring – Why so complicated? (RiR 2014:13)



Retiring – why so complicated

The Swedish National Audit Office has audited the formulation of and information concerning the choices an individual is faced with at the time of retirement. There are a large number of choices to consider within both national retirement pension and occupational pension. These choices are in turn of importance for how the pension is disbursed and how large the pension will be during an individual's time as a pensioner.

Audit background

Reasons: The choices an individual is faced with upon entering the retirement are significant to their finances throughout their time as a pensioner. The choices exist within both the national retirement pension and the occupational pension, and the individual must consider the totality of the accrued pension. Earlier studies have pointed to the choice of retirement age being complex. This concerns deciding when pension is to be paid out, and how much of it, which can be difficult due to many factors affecting the economic consequences of the pension withdrawal. Furthermore, few are aware of the difference in returns and risk-taking inherent in the choice between unit-linked insurance and traditional insurance. In recent years the proportion who take out their occupational pension for a limited time has increased, which can lead to difficulties managing their economy in old age. Aside from this, the audit is motivated by research in behavioural economics that shows that it is possible to gain significant increases in efficiency for both individuals and society by carefully and consciously formulating the choices individuals are faced with. The pension area is identified as an especially relevant area for such measures, due to the choices being made infrequently and often being of a long-term nature.

Aim: The aim has been to audit whether the State has promoted conditions to enable the overall pension system¹ to give the individual sufficient opportunities to make good pension choices. The audit includes an analysis of the overall pension system's design with regard to choices and information upon entering retirement. The audit takes as its point of departure the perspective of the soon to be pensioner and the choices they meet in connection with retirement.

Implementation: A point of departure for the audit has been research indicating that many tend to be uninterested or unaware when they make their choices. The Swedish National Audit Office has carried out analyses of the most important information concerning different choices in the overall pension system. The Swedish National Audit Office has analysed extensive data material in order to examine the choices made and what role the design of different alternatives plays in the choices of the individual. In the audit, interviews have been conducted with representatives for the



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Swedish Pension Agency, the Swedish Financial Supervision Authority (Finansinspektionen), and officials responsible at the Ministry of Health and Social Affairs. Interviews have also been conducted with representatives of the parties on the labour market responsible for the drafting of the occupational pension agreements, a number of companies involved in administering pensions, choice centres, pensioner's organisations, Minpension.se [“My Pension”; Swedish-language pension portal] and the Swedish Consumers' Insurance Bureau.

Audit results

The audit shows that there exists a significant degree of complexity facing an individual about to retire, and that this expresses itself in a variety of ways. The Swedish National Audit Office has carried out its analysis with regard to four overarching choices, described below.

The choice of age of retirement is when the pension is taken out. This choice is complicated by the tax system's complex structure for the period of transition from working life to retirement. Moreover, national retirement pension and occupational pension have completely different systems for applying for pension, which prevents a comprehensive way of handling the withdrawal of pensions.

The choice of withdrawal profile is how pension withdrawals are to be distributed over time. That is to say, whether much of the pension is to be taken out early on or if the distribution is to be more even over the individual's life. Individuals who wish to change their withdrawal profile have a great deal of freedom regarding temporary withdrawals, for example, though this freedom is difficult to grasp. At the same time, the financial advantages and disadvantages of the distribution of payments are affected by assumptions concerning life spans and forecasted interest in a way that is difficult to calculate.

The choice of administration of the pension capital is complex, and many do not adopt an active stance with regard to the choice of the placement of their pension. Many find it hard to manage this administration as pensioners, while they are at the same time dependent on the pension for their income.

The choice of protection for survivors is only briefly mentioned in the information received upon entering retirement, in spite of it being especially important that the individual makes an active decision with regard to this (since it is closely connected to their own family situation). The choice is of considerable financial importance, as this protection becomes more costly when the individual reaches an old age.

The overall conclusion of the Swedish National Audit Office is that the State has not taken sufficient responsibility for the whole of the pension system by initiating a decrease in the complexity of the overall pension system. The present division between the State and the parties of the labour market has led to a state of disharmony between the national retirement pension and the



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occupational pension. This has resulted in deficiencies in the formulation of different choices and in the information concerning the consequences of different choices within both the national retirement pension and the occupational pension. The individual has thus not been afforded ample opportunity to make good choices when entering retirement.

Deficiencies in the pension system limit individuals' ability to make good choices

The audit shows that entering retirement signifies a transition between saving and receiving payments, resulting in the exposure of the individual to a number of choices, influencing factors and consequences of different choices which makes it hard to handle the situation. Research from recent years surveying how human beings function when faced with choices indicates that the complexity of sets of rules and regulations serves decrease the tendency to make conscious choices.

The complexity of the system serves to decrease the tendency to make conscious choices

In the audit, an observation is made that a number of choices require in-depth knowledge of the system and the associated consequences in order for them to be made in a conscious manner. There are many partially contradictory differences in alternatives and rules, primarily between national retirement pension and occupational pension, but also between different occupational pension agreements. Several results in the audit show that individuals are often passive in their choices, and that the complexity of the system is largely responsible for this passiveness.

Included in these results is the observation that the incentives that mean to promote a longer working life are complicated during the period in which most people retire. At present there is insufficient information and opportunity to calculate – in a manner which is easy to grasp – the different tax effects that affect the results of a longer working life. Individuals who do not understand or are unable to access information concerning the effect on their private economy likely do not consider the financial incentive in their retirement decisions. The results also point to that difficult choices often mean that many individuals make their choices without being aware of the consequences. This in turn means that influence due to how a choice is designed, known as 'choice architecture', may have a very large impact. Analyses of changes in default options in forms shows that this design has a considerably greater influence than factors such as the education or economy of the individual. They also show that the design of the occupational pension agreements may lead to many being unaware of their choices at the time of retirement, without being able to change their minds at a later date.

The Swedish National Audit Office therefore points out that the freedom of choice in the pension system as a whole is in practice limited for most people, and that the design of default options is deficient when viewed from a holistic perspective. Individuals who wish to choose are not given enough opportunity to do so, and as a result miss out on the positive effects that freedom of choice would otherwise lead to if the individual could tailor their pension to their own preferences.



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The financial consequences for the individual are not made sufficiently clear in connection with choices

Several large pension information initiatives have been implemented since the current pension system was introduced. However, the Swedish National Audit Office's analysis of the information regarding choices given in connection with retirement point to a number of deficiencies. A general observation for both the national retirement pension and the occupational pension is that the financial consequences of the choices are seldom made clear in close connection with the choice itself. There is also a lack of information connecting choices in different pension insurances that share the same aims and function.

The State has not acted with sufficient responsibility to achieve a more coherent system

In the view of the Swedish National Audit Office, much of the complexity that the individual faces upon retiring is a result of the current division of roles between the State and the parties on the labour market. In this way, a comprehensive perspective on pensions with focus placed on the individual has fallen between the cracks. Among the actors responsible for the pension system, the Swedish National Audit Office believes that the State has the greatest responsibility for leading the development process, due to the State being the only actor responsible for all citizens and the economy of society as a whole. The development of the pension systems, the labour market and the general development of society means that with time the pension systems experience an increasing pressure for change. The Swedish National Audit Office therefore believes that the State must accept its responsibility to lead the development towards necessary changes in order to enable the pension system to become better adapted to individuals' ability to handle it.

The State has not taken measures to simplify regulations or create calculation tools adapted for use by individuals

The Swedish National Audit Office has not perceived the State as having worked for a more coherent and easily graspable process for taking out pension or for decreasing the level of complexity in influencing factors and consequences characterising these choices. It is important that the opportunities to simplify the regulations and the choice architecture are considered in greater detail when the pension system is up for review. In the view of the Swedish National Audit Office, the ambitious efforts to inform on part of the State may be necessary but not sufficient to meet the complexity of the system. A solution therefore necessitates simplifications by decreasing the complexity of the rules and the differences in design between the national retirement pension and the occupational pension, and between different occupational pension agreements. Another way of achieving simplification in the system is to give individuals practical tools to enable them to handle the existing diversification in regulations and terms and conditions in various choice situations. Considering the diversity of factors influencing the results of different choices, it is likely that user-friendly simulation tools with a comprehensive perspective on pension would



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make choices easier. This would help those who lack the prerequisite knowledge by having more complex calculations summarised in an easily understood fashion.

The State has not taken an overall responsibility for the different choices that must be coordinated

The element of flexibility in the national retirement pension and in the occupational pension differs in several basic respects. For the individual, the lack of coordination of regulations leads to inconsistency in the flexibility, which in turn increases the level of complexity and the risk of erroneous choices. One shortcoming is that the individual is unable to cancel payments or change associated choices once they have started to take out occupational pension. The Government could facilitate and hasten urgent changes in the area of occupational pension by adjusting the limitations on withdrawal of occupational pension in the Income Tax Act.

The State has not paid attention to the necessary conditions for individuals to be able to act rationally in response to increased life expectancies

In the ongoing review of the pension system it has been concluded that working life has to be lengthened. This is due to a longer average life span, which also creates a need for support over a longer life span as a pensioner. Due to the architecture of the choices for temporary withdrawals and the information concerning these, the individual has been granted far-reaching opportunities to act in a short-sighted manner, without the consequences of the choices being made sufficiently clear. Research indicates that it is common to underestimate one's own life span. Initially, the temporary withdrawals were intended as a complement to the lifelong withdrawals. Today, what appears to be a simple choice of making a temporary withdrawal can lead to the individual cancelling the insurance for a long life which constitutes one of the most basic justifications for obligatory pension systems. Beyond this, the differences in pension paid out may amount to hundreds of thousands of kronor.

The State has not paid attention to the need to design choices so that they provide everyone with sufficient security in old age

The results of the audit point to the choice of administration of the pension capital being especially difficult to handle. The Swedish National Audit Office's analysis of how pensioners that take out premium pension remaining in the unit-linked insurance manage their capital reveals that nine out of ten are completely inactive in the administration of their pension. The result indicates that an individual who has made an active choice at some point in their life does not necessarily make active choices later in life. This entails a risk that the pension capital will be incorrectly invested during their time as a pensioner; a risk that may have greater consequences for future pensioners as the premium pension system approaches a complete phase in.



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The Government should act with greater responsibility

Within the framework of the current division of roles, the State has initiated measures and acted as a driving force behind various information efforts, for example the forecast page Minpension.se. However, individuals retiring still face a difficult situation due to the design of the overall pension system and it is the view of the Swedish National Audit Office that the Government should act with greater responsibility in this regard. Furthermore, it has taken much too long to implement important changes in the overall pension system. In the view of the Swedish National Audit Office, the pensions constitutes an area in need of agreements aimed at a more coherent system based on the perspective of the individual. If the Government cannot reach agreements with sufficiently ambitious and quick measures to decrease the complexity of the system, individuals entering retirement will suffer as a consequence of this.

The National Audit Office's recommendations

To the Government

- The Government should accept a more pronounced overall responsibility for the pension system, based on a citizen perspective
- Initiate the development of a coherent application process for the overall pension system
- Eliminate present legal obstacles to stopping or changing initiated payments of occupational pension
- Limit the ability to make temporary withdrawals within obligatory pension systems
- Consider an automatic risk adjustment as a default option in the premium pension system at the time of retirement.

To the Swedish Pension Agency

- Analyse how the design of different choices affects the individual

