LCP INSIGHT CLARITY ADVICE

LCP on point

How getting pension freedoms wrong could cost you your benefit

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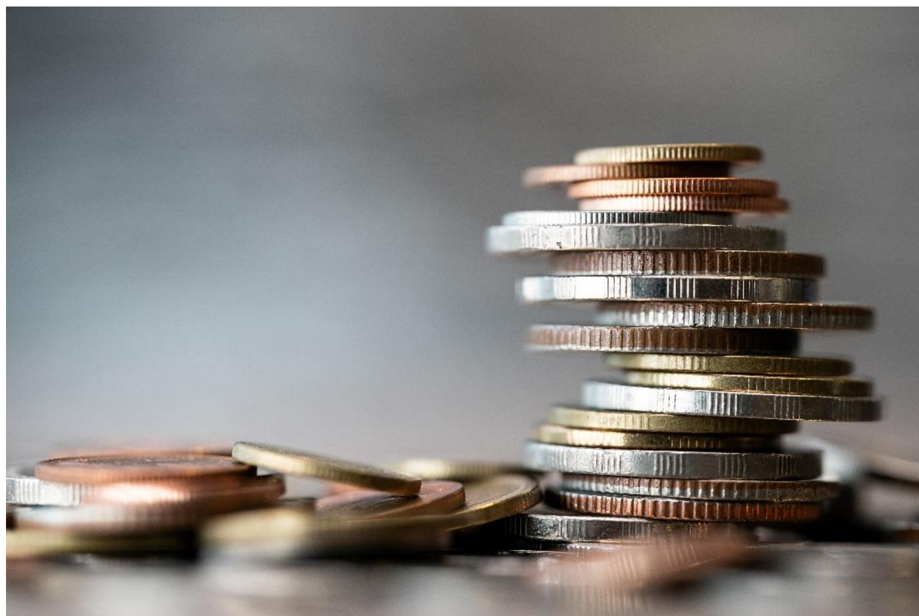

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Executive Summary

The greater freedom around accessing pensions introduced in 2015 have been hugely popular. In the last two years alone, more than a million people aged 55 or above have accessed a pension pot in a wide variety of ways, commonly taking the full amount in cash or going into a flexible drawdown arrangement.

But there has so far been very little focus on how these pension withdrawals may interact with the means-tested benefits system.

The amount of support provided by benefits such as Universal Credit or Pension Credit is reduced where claimants have capital or have regular income coming in. In some cases, for example, where capital exceeds a certain threshold, a claimant can be entirely disqualified from benefit.

It follows from this that those who are on benefits need to think carefully before accessing their pensions and need to appreciate how the way in which they take their pension (for example as a regular income or as a lump sum) could affect their benefit. With over a million people on income-related benefits in the 55-65 age group alone, this could clearly be a significant issue.

Yet there is remarkably little help or support for people in making these choices. At this report shows, the benefits system is highly complex including:

- Different rules for those above and below pension age
- Different rules across different benefits in how income and capital are treated
- Differences from one local authority to the next

Scheme members are unlikely to be able to find information on these issues from their pension scheme or provider and even official ‘guidance’ sources such as Pension Wise generally signpost people away to potentially complex benefit calculator sites. It can be very hard for individual members to obtain factual information about the consequences of different ways of accessing their pension pots, and even harder to know the best thing to do. This is especially true when those who are on benefit are also in debt and need to understand whether using pension balances to clear debts would be advisable or not.

This paper argues that this situation has to change. With growing numbers of people taking advantage of pension freedoms, the interactions with means-tested benefits will become steadily more apparent. Members may even challenge providers or schemes who allowed them to take their pension in a way that proved financially detrimental without offering any warning or support. It is time for the industry, regulators and government to be proactive in tackling this issue before it becomes a new pensions scandal.

01 Background

Two big changes in recent years have led to an explosion in the number of people considering accessing modest Defined Contribution (DC) pension pots:

- **Automatic enrolment**, which has brought ten million people into workplace pension saving since 2012; the large majority of these new savers are saving into DC pensions; many of those newly enrolled are lower paid, and are making only modest contributions; until Automatic Enrolment has had time to get established, many of the DC pots generated will be small;

- **Pension Freedoms**, which now give people far more choice over what they do with DC pension pots once they are aged 55[1]; for example, since 2015 over 1.5 million DC pension pots have been cashed out in full, with the majority of these being worth under £20,000[2];

The combination of these two factors means that growing numbers of people aged 55 or above can now a) have a DC pension or more than one DC pension and b) have new choices about how they access it.

However, a significant minority of these people will also have a relatively low household income and may come within scope of the means-tested benefits system.

To give a flavour of the potential scale of this issue, Table 1 shows the latest figures for the number of people receiving Universal Credit[3], those receiving income-based Employment Support Allowance (ESA) and those receiving tax credits in the 55-59 and 60-64 age groups.

Table 1. Caseload for a) Universal Credit, b) income-based ESA and c) Tax credits by age group

Age Group	Universal Credit	ESA (income-based)	Tax credits
55-59	396,000	258,000	129,000
60 and above	383,000	287,000	211,000

Note: UC data is for July 2021; ESA data is for February 2021; Tax credits data is for April 2021. In all categories, partners of claimants are counted separately, as the joint benefit could be affected if either draws on a pension.

Source: DWP 'stat xplore' tool; tax credits administrative data and LCP FOI inquiry to HMRC.

As Table 1 shows, well over one and a half million people who are old enough to access a pension pot but under state pension age are in receipt of one of the main means-tested benefits. If any of these was considering accessing a DC pension, they would need to consider the interaction with their benefit entitlement. As this paper shows, this interaction is complex but could be highly significant for their benefit position.

[1] Normal minimum pension age is to rise to 57 in 2028
[2] Source: FCA Retirement Income Market Data
[3] Note that Universal Credit is being introduced on a phased basis, replacing legacy benefits including tax credits. DWP estimates that in 2021/22 there were 4.3m claimants (of all ages) on Universal Credit but that this will rise to 5.9m by 2025/26 when the phased introduction is largely complete.

The key benefits of relevance are:

- For those of working age:
  - Universal Credit (and 'legacy' means-tested benefits such as Jobseekers Allowance, Employment Support Allowance and tax credits);
  - Local council tax reduction schemes

- For those of pension age:
  - Pension Credit
  - Housing Benefit
  - Local council tax reduction schemes

The problem facing individuals who have to make these choices is that benefit rules are complex and different pension choices – such as leaving the money where it is, cashing it out in full, going into drawdown or buying an annuity – can have different implications for benefits. Some choices may be better than others, but the saver is unlikely to be familiar with the rules and neither is their pension provider. There is a risk that growing numbers of people could make poor choices around accessing their pensions and suffer financial detriment as a result unless something changes.

This paper seeks to do two main things:

a) To describe how the means-tested benefit system for those under pension age and those over pension age interacts with different 'pension freedoms' choices; for example, it shows

   - how taking your pension as income is treated differently to taking it as a lump sum,
   - how different benefits have different rules for the treatment of capital
   - how the rules are different for those under pension age and those over pension age
   - how some choices could result in complete disqualification from benefit

b) To review the 'customer journey' in cases like this, to identify the lack of support currently available to individuals facing these complex choices and to recommend reforms;

02 The system described

For those with a low household income and limited savings, various social security benefits exist to top up their income and/or to help with specific living costs such as rent or council tax. This section briefly describes the key benefits which would be of relevance to our target group. Note that, following recent rule changes, where either member of a couple is under pension age the whole household comes under the 'working age' benefits system.

A. People of working age

The main income-related benefit for people of working age is Universal Credit (UC).

UC combined six different predecessor benefits (income-based Jobseekers Allowance, income-based Employment and Support Allowance, Housing Benefit, Income Support, Working Tax Credits and Child Tax Credits) into a single monthly payment. UC is however gradually being phased in and there are still hundreds of thousands of people on 'legacy' benefits.

UC is a highly complex benefit, but the main features of relevance to this paper are:

- It has a standard monthly maximum amount which depends on household composition; it also includes an allowance towards rent;
- The amount of help is reduced for those with income above a minimum level. For earned income above a minimum threshold, help is reduced at a rate of 63p in the pound, whilst for unearned income (such as pensions), help is generally reduced pound-for-pound
- Account is taken of capital or savings; for every £250 of capital above a disregarded amount of £6,000, the claimant is deemed to be deriving an income of £1 per week (regardless of any actual return they are getting); if the claimant has savings over £16,000 they are disqualified from UC.

Legacy benefits such as income-based JSA, income-based ESA and housing benefit have their own rates of payment, treatment of earned and unearned income, and capital rules, but recipients of these benefits will have many of the same issues to consider when it comes to the consequences of tapping into their pension savings.

The other main form of means-tested support for people of working age is help with Council Tax. As described in the Box, Council Tax support has been substantially reformed in recent years. To add to the confusion, for those of working age there are now separate systems in each English local authority.

Means-tested help with Council Tax bills

Prior to 2013/14, help with Council Tax bills for low-income households was delivered through a Council Tax Benefit scheme which was similar in many ways to Housing Benefit. Those on the lowest incomes could receive 100% Council Tax rebates, whilst those with incomes above basic benefit levels would see their support tapered away at a rate of 20p in the pound. Although Council Tax rates were set locally, Council Tax Benefit was a national system, operated on a standard basis across Great Britain[4].

In 2013/14 the Government scrapped Council Tax Benefit and moved to a localised system of support with Council Tax bills, with the rules passed to the Scottish and Welsh Governments and to English local authorities. The two main features of the transition were:

1. Local authorities were expected to provide broadly the same level of support to pensioners under the new system as under the old one
2. The amount of money passed over to cover Council Tax support was around 10% lower than it would have cost to continue the old system

A combination of these two factors meant that support with Council Tax bills for low income working age households became much less generous, with many areas operating a maximum rebate of under 100% (though with some offering discretionary top-ups to those who applied), and many applying tougher 'capital limits' than under the old system. In Scotland and Wales, a single system applies across each devolved nation, whilst in England arrangements can be different in each local authority.

The following examples are purely designed to give a flavour for how working age Council Tax support schemes can vary from area to area across England. An important common feature of each of the local authorities shown below which is highly relevant to our paper is that all operate a £6,000 capital limit above which no help is available.

Surrey Heath District Council – maximum benefit covers 70% of Band D council tax bills (See: Local Council Tax Support Scheme | SURREY HEATH BOROUGH COUNCIL)

Newcastle City Council – help is payable at one of four rates (90% / 85% / 50% / 25%) depending on income; (see: Council Tax Support 2019/2020 | Newcastle City Council)

South Gloucestershire Council – help is payable at one of five rates (80%/50%/30%/20%/10%) depending on income (see: Local council tax reduction | South Gloucestershire Council (southglos.gov.uk))

[4] Households in Northern Ireland still pay Domestic Rates and come under a separate system of Rates Rebates.

B. People of pension age

For single people over state pension age, or couples where both partners are over pension age, a different benefit system applies.

The main income-related benefit for people over pension age is Pension Credit. In the past there were two elements to Pension Credit:

- **A 'Guarantee Credit'** which sought to bring pensioners up to a minimum level of income; every pound of income from state or private pensions resulted in a pound-for-pound reduction in pension credit;
- **A 'Savings Credit'** which was designed to soften the negative impact of the pound-for-pound reduction in Guarantee Credit for those with pension savings; this operated on a complex tapered basis, but was intended to ensure that those on pension credit who had made voluntary savings when in work would be better off in retirement than those who had not.

With the introduction of the new state pension in 2016, the savings credit was abolished for new claims to pension credit. For the purposes of this paper, we assume that most of those considering accessing a pension for the first time in future, will have made a first claim for Pension Credit since 2016 and therefore the savings credit will be irrelevant to them.

Pension Credit has no absolute limit on capital, but those with capital over £10,000 are deemed to be generating an income of £1 for each £500 in capital above this threshold. Note that this 'imputed' rate of income from capital is half that which applies to those of working age and applies at a higher threshold.

However, pensioners cannot sit on large sums of untouched pension whilst claiming large amount in mean-tested benefits. Even if a pension pot remains untouched, those who claim benefits are treated *as if* they had used the pension to purchase an annuity or income for life. This 'imputed' income is then treated in the same way as any other private pension income.

Pensioners on Guarantee Credit are 'passported' to receiving maximum help with any rent and Council Tax bills. For those not on Guarantee Credit, and with income above Guarantee Credit levels, help is reduced at a rate of 65p in the pound for housing benefit and 20p in the pound for Council Tax help.

Can I just get rid of my capital to qualify for benefit?

Given that some benefits are not available at all to those with capital above certain limits, and given that even below those limits people with capital have a relatively high income imputed from that capital, benefit claimants may be tempted to find ways of disposing of capital in order to qualify for benefit.

The general approach taken by DWP and local authorities is to recognise that capital may be gradually run down in the normal course of events, especially for those on a tight budget, but to clamp down hard on those who are deemed to have artificially 'deprived' themselves of capital purely in order to qualify for benefit. In these cases, the claimant can be treated 'as if' they still have the capital even if they have disposed of it. But if capital is used to pay off an outstanding debt then this might not count as deliberate deprivation.

The detailed guide for advisers to Pension Credit on the gov.uk website puts it like this:

> *"We may treat your customer as having notional capital if they got rid of capital to get Pension Credit or more Pension Credit – for example, if they knew they had too much money to get Pension Credit so gave some to a grandchild.*
>
> *We will not treat your customer as having notional capital if they used capital to repay or reduce a debt (for example, a mortgage) or to buy something which was reasonable in the circumstances (for example, replacing a car might be considered reasonable, buying a luxury car is probably not)".*
>
> (*Source:* A detailed guide to Pension Credit for advisers and others - GOV.UK (www.gov.uk))

The following illustrates how one local authority approaches Housing Benefit claims:

> *"For those who spend/dispose of capital - whilst it is not for us to tell others how to spend their money, we do need to consider the intention behind disposing of capital and whether it was done (in whole or in part) to obtain/retain/increase entitlement to HB or to reduce the financial burden with regards to funding an adult social care package. We also need to consider if the person knew what they were doing and had thought about the consequences beforehand, along with their personal circumstances (i.e. their mental state and capabilities).*
>
> *Across the HB / Council Tax Reduction and the adult social care assessments, we would look at each case on its merits with regards to potential deprivation of capital. In the main, if someone can evidence having used capital to pay off existing debts, or to make necessary home improvements (e.g. to install much-needed double glazing) it would be deemed as acceptable, whereas spending a large sum on a holiday is more likely to be seen as deprivation, but again we'd look at the intent etc. A more common reason is where capital is gifted to an adult child/grandchild, and as above we would investigate further the reasoning behind this action".*

(Source: email from anonymised local authority to Steve Webb, June 2021)

These comments from an English local authority show that there are no hard and fast rules on whether taking a capital sum from a pension will affect benefit entitlement or not.

Similarly, when it comes to the DWP's guidance for Universal Credit claims, the focus is very much on the intention of the individual. If someone deliberately deprives themselves of capital and "obtaining UC formed a positive part of the planning" then they could be penalised. But if it is clear that someone did not (or could not) appreciate what they were doing, or couldn't appreciate the consequences of their action, it cannot be treated as deprivation.

This is clearly a grey area where decision-makers in central and local government will be making judgments based on an assessment of what was in the mind of the claimant when they used their capital. People who access their pensions therefore need to be equipped to make their decisions in a well-informed way rather than accidentally stumble across problems with their benefits when they have already taken an irreversible decision.

03 Pension Freedoms – what are the options?

Under pension freedoms, individuals who have reached minimum pension age[5] can access their DC pension pot in a variety of ways.

These include:

- Buy an annuity or income for life
- Take a tax free lump sum and put the rest into drawdown, to be withdrawn as required, subject to tax;
- Put the whole fund into drawdown and take 'chunks' as required, each one a mix of 25% tax free and the rest taxed (this is known as 'uncrystallised funds pension lump sum' or UFPLS);
- Full encashment, with 25% taken tax free and the balance subject to income tax

The FCA publishes regular statistics on the choices being made by those who access their pension for the first time. These statistics are broken down by pot size, and for our purposes it seems sensible to focus on those with smaller pension pots as those on means-tested benefits are more likely to have smaller pension savings[6].

The charts on the next page show the choice made by those a) with pots under £10,000 and b) with pots of £10,000-£29,000 in the latest six month period.

As the charts show, whether for pots under £10k or pots from £10k to £29k, taking the whole amount out in full is the most common choice. Perhaps not surprisingly, this is particularly true for the very smallest pots where options such as buying an annuity may not even be possible in some cases.

[5] This is current age 55, but will rise to age 57 in 2028 under current government plans.
[6] Note that this issue will also affect those who have rights in an occupational pension scheme and exercise their 'pension freedoms'. Data on the ages and pot sizes of those who make withdrawals from such schemes are less readily available, so we concentrate here on FCA regulated products which account for the majority of withdrawals of interest to us.

Chart 1. Pension Freedoms choices – pots under £10k, Oct 19 – Mar 20

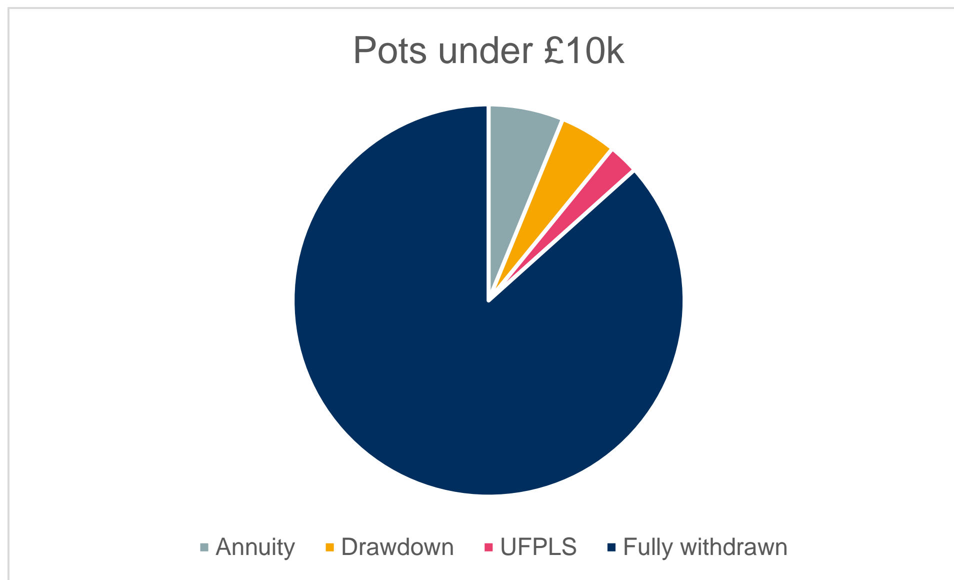
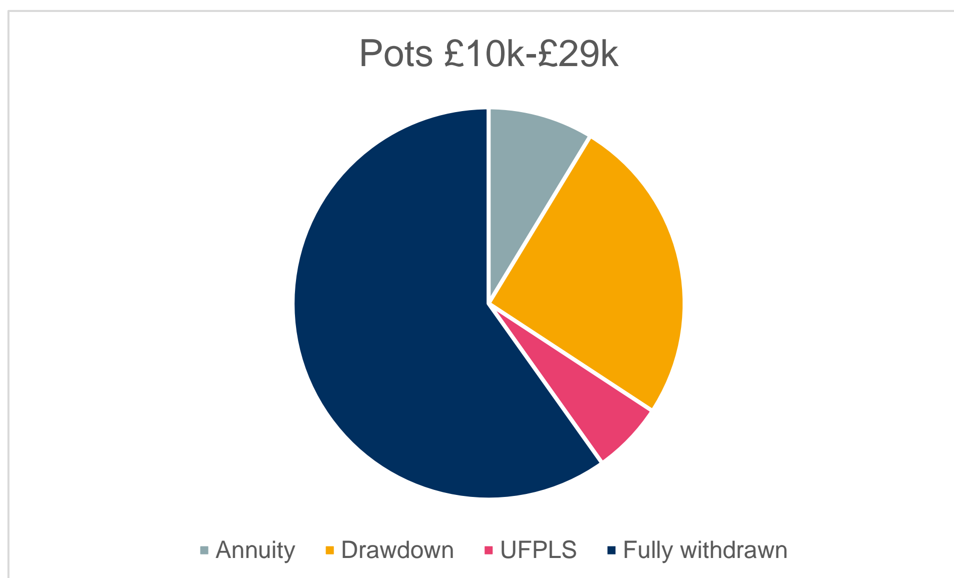


Chart 2. Pension Freedoms choices – pots £10k-£29k, Oct 19 – Mar 20



Source: Authors' calculations based on FCA Retirement Income Market data (Retirement income market data 2019/20 | FCA)

The number of people in these various categories is shown in Table 2.

Table 2. Pension freedoms choices made by savers with pots a) under £10k and b) £10k-£29k

	Annuity	Drawdown	UFPLS	Fully withdrawn	TOTAL
Under £10k	**8,049**	**6,115**	**3,238**	**112,671**	130,073
£10k-£30k	**6,271**	**18,414**	**4,266**	**43,151**	72,102

Source: As Chart 1

As we will see in the next section, some ways of taking pension pots can have a much bigger impact on benefit entitlement than others, but this may not be apparent to the saver who phones up his or her pension provider to access their money. By the time they have taken the money and made their decision, this is often irreversible but can have long-term and unforeseen consequences for their benefits.

We believe that the interaction with working age benefits and Universal Credit in particular is likely to be of greatest importance. This is because for those who 'cash out' their pot in full, the large majority are in the 55-64 age group and would be within the working age benefit regime. This is shown in Table 3, this time for all pot sizes, and not just those under £30k.

Table 3. Age distribution of those fully encashing their pensions (including pots of all sizes)

Age Range	Number cashing out in full
Under 55	1,824
55-64	132,278
65-74	37,659
75+	2,654
All Ages	174,415

Source: As Chart 1

04 How are pensions treated in the means-tested benefits system?

Under the age of 55, money locked up in a pension is ignored by the means-tested benefits system. For example, in theory, you can have a million pound pension pot but still receive Universal Credit.

Once you are 55 but still under pension age, money inside a pension pot is still ignored. But if you take money out of a pension, the impact depends on how you take it.

Means-tested benefits make a distinction between two types of money:

- Income received on a regular basis
- Capital (or 'wealth' or 'savings') where different rules apply

When accessing a pension, if you take a regular income (for example, by buying an annuity), then this income would be included in your total income when you are assessed for benefits.

If you take your whole pension out as a lump sum which then sits in a bank account or savings account then this would count towards your 'capital' when your eligibility is worked out.

If you move your pension into a drawdown account, one-off 'lumpy' withdrawals would be likely to be treated as part of your overall capital, but withdrawals on a regular pattern would generally be treated as income.

The same principles apply to those who are over pension age except that at this point the system no longer ignores money sitting untouched in a pension pot. Whilst there is no rule which forces you to take the money out, the authorities will 'deem' you to be drawing an income from any untouched money (as if you had bought an annuity) even though you have not chosen to do so.

The difference between whether your pension is taken as income or capital varies across different benefits as the table on the next page shows.

Even this simple table highlights the fact that whether you take your pension as income or capital, whether you are under or over pension age, and which benefit you are on, can make a big difference to the impact of your pension freedom choices.

	Income – impact of an extra £1 pension per week	Capital – impact of extra £1000
Working age		
• Universal credit	Reduces UC by £1 per week	Under £6,000 capital is ignored; from £6k to £16k, each £250 of capital is deemed to generate £1 per week of income; **over £16k you are disqualified from UC;**
• Council tax reduction schemes	Varies from area to area, but support often based on income bands; can lead to ‘cliff edge’ effects as income rises;	Can vary from area to area, but £6k cut-off common in England, £16k in Scotland and Wales
Pension age		
• Pension credit	Reduces ‘guarantee credit’ by £1 per week (assuming a new claim where savings credit has been abolished)	Under £10,000 capital is ignored; from £10k upwards each £500 of capital is deemed to generate £1 per week of income; there is no overall capital limit;
• Housing Benefit	Reduces help with rent by 65p in the £ for those not on pension credit	Under £10,000 capital is ignored; from £10k upwards each £500 of capital is deemed to generate £1 per week of income; absolute cut-off at £16k of capital except if on guarantee credit;
• Council tax reduction schemes	Income above pension credit level generally reduces council tax help by 20p in the £	Similar to Housing Benefit

05 Hypothetical case studies

To highlight the potential implications of the different choices which people might make, we provide in this section some simple case studies. In each case we refer to single people or couples as the rules would be the same in each case. But in practice we expect these issues to be more pronounced for single people as they are more likely to be within the scope of the means-tested benefits system.

Note that we are assuming for purposes of illustration in this section that lump sum capital withdrawals simply sit in the claimant's bank account for long enough to be of interest to the benefits authorities. As noted earlier, in practice, capital that simply goes 'in and out' for a legitimate reason such as paying off a debt, rather than with a view to manipulating the benefit system, should not affect someone's benefit position. However, deciding to take a regular income could have an immediate negative effect.

Case studies – working age

- *Single person or couple of working age on Universal Credit with £20,000 pension pot*

The table below shows how different options for using their pension pot would affect their Universal Credit.

Choice	Impact on UC
Leave money in pension pot	No effect on UC
Take the whole lot as a lump sum	**Disqualified as over £16k capital limit**
Buy an annuity of £15 per week	Reduces UC by £15 per week
Take £5k lump sum and move rest into drawdown	No impact on UC if no other capital, though withdrawals could affect UC

It is worth explaining this table in more detail:

a) Leave money in pension pot – as the individual is under pension age they are not required or expected to use their pension savings to support their standard of living, so this is ignored for Universal Credit purposes

b) Take the whole lot as a lump sum – in practice, this would mean £5,000 tax free plus £15,000 potentially taxed at 20%, leaving a total of £17,000 after tax. Because the capital limit for UC is £16,000 they would immediately be disqualified. As the £17,000 was

gradually used up, entitlement would be reinstated, but an 'imputed income' would be applied. A balance of £15,000, for example, would generate an imputed income of £36 per week, so £36 per week would be knocked off the Universal Credit they would otherwise get. Note that getting rid of the lump sum quickly might not help if the DWP judged that the individual had done this primarily to get more benefit.

c) Buy an annuity of £15 per week – annuities count as 'unearned income' and are deducted £-for-£ from Universal Credit; although the rest of your UC would be unaffected, turning a pension pot into an annuity whilst receiving UC generates no increase in your overall income

d) Take £5k lump sum and move the rest into drawdown – capital of under £6k is ignored, so if the £5k lump sum is the only capital that you have, this will have no impact on your UC; and as long as you are under pension age, the balance of your funds in drawdown are ignored; regular withdrawals from the drawdown pot would however be treated as income, whilst ad hoc 'lumpy' withdrawals would be assessed as capital.

This simple example shows the huge difference in outcomes for someone on the main working age benefit depending on how they exercise their pension freedoms. At one extreme, taking a small lump sum and leaving the rest can be done relatively safely and with no short-term impact on benefits. At the other, someone making the most popular choice with their pension – cashing it out in full – could wipe out their entire Universal Credit, whilst someone buying an annuity could see every pound clawed back in reduced benefit.

- *Single person or couple of working age on local Council Tax support with £20,000 pension pot*

As noted earlier, different Council Tax support schemes operate in each local authority across England. It is therefore not possible to say for certain how a decision to take a pension pot in a particular way would affect any given individual, as it will depend where they live. However, the following table gives some general indications:

Choice	**Impact on Council Tax help**
Leave money in pension pot	No impact on Council Tax help because under pension age
Take the whole lot as a lump sum	Many local authorities operate a £6k capital limit. In these areas, if pot after tax worth over £6k, **disqualified from Council Tax help**
Buy an annuity of £20 per week	Some areas operate a 'taper' system whereby a percentage of any extra income comes off Council Tax help. Others operate income 'bands', so increased income within the band may have no effect, but income which takes you into the next band could have a 'cliff-edge' effect in reducing help.
Take £5k lump sum and move rest into drawdown	No impact on Council Tax help if total capital under £6k.

It is clear from the description above that individuals currently getting help with their Council Tax and considering taking money out of their pension will need to find out from their local authority how this might affect the amount of help that they get. Pension schemes, pension providers and official guidance bodies such as Pension Wise or the Money and Pension Service are very unlikely to be able to supply up-to-date information that is accurate at the local authority level.

Case studies – pension age

There are two major differences for those over pension age:

- The benefits that are relevant to them are Pension Credit, Housing Benefit and Council Tax Support rather than Universal Credit and Council Tax Support

- Money sitting untouched in their pension pot is now ‘deemed’ to be generating an income

This second point leads to some rather strange consequences when individuals are making decisions about drawing on their pension.

The key points are:

- If an individual takes all of their pension and uses it to buy an annuity, the impact on their benefit position will depend on the actual annuity rate they secure compared with the ‘imputed’ income they were deemed to be capable of getting from the previously untouched money in their pension; if they secure a relatively large annuity (perhaps because they are in poor health) then this may generate more income than DWP was imputing from their pot; in this case their pension credit could fall; but if the annuity they secure by taking the money out is lower than the ‘imputed’ annuity then their pension credit could increase;

- If an individual takes a capital sum out of their pension but does not spend it, they will have a lower imputed annuity income (because the balance of their pension fund has gone down) but a potentially higher imputed income from capital held outside the pension. For example, beyond the first £10,000 of savings, an income of £1 per week is imputed in Pension Credit for each £500 of capital held outside the pension. This is well above the annuity rate which DWP would have been assuming for money held inside the pension, so if all the capital now counts then Pension Credit would fall. Conversely, if the individual has small total savings and the new addition keeps them under £10,000 then there would be *no* imputed income from capital. As the imputed annuity income from money in the pension pot would have gone down, the net impact would be to increase pension credit.

We have reflected these factors in the worked examples below, but the complexity of the rules shows that there is a real need for savers to be able to undertake ‘what if’ calculations *before* they make choices about what to do with their pension pot.

The two case studies below are a) for a person on Pension Credit (including the ‘Guarantee Credit’, which means that their rent and council tax are paid in full) and b) for a pensioner on a slightly higher income, so not entitled to Pension Credit, but receiving help with rent through the housing benefit system and council tax through a local council tax support scheme.

- *Single person or couple on Pension Credit with £20,000 pension pot and £6,000 in other savings*

As noted above, the situation with Pension Credit[7] is more complicated than with Universal Credit. Provided that they receive the 'Guarantee Credit' element of pension credit, they are automatically entitled to the maximum Housing Benefit and Council Tax Support, regardless of how much Pension Credit they receive.

In this case, because the person or couple is over pension age, the money inside their pension is now included in the assessment for benefit. If they leave money untouched inside their pension they are treated as if they had used it to buy a regular income and this 'imputed' income is allowed for in their means test.

Thereafter, when they decide to access their pension pot the first step in the calculation is to reduce the "imputed" income in proportion to the amount withdrawn (hence increasing their entitlement to pension credit).

The second step is to decide how their capital and income position has changed because of the action they take, for example:

Choice	Impact on Pension Credit (PC)
Buy an annuity of £25 per week	Their PC will change by the difference between the imputed income and the annuity they have bought. For example, if the original imputed income was £20 per week, their PC will reduce by £5 per week.
Take whole pot as a lump sum and put it in the bank	If pot after tax worth £17k, now have £23k in the bank. Income of £26 per week is imputed from the £13k over the threshold. As original imputed income was £20 per week, this action will lead to a reduction of £6 per week in PC.
Take £4k lump sum and put it in the bank leave rest in drawdown	Savings at the £10k threshold, so no imputed income from capital outside the pension. Pension pot reduced by 1/5th, reducing the imputed income in proportion. PC will thus increase by £4 per week

If the change in their actual or imputed income above is enough to eliminate their entitlement to Pension Credit then their entitlement to Housing Benefit and Council Tax Benefit may also reduce or even be eliminated.

[7] We assume for purposes of this example that the claim to Pension Credit was made after April 2016 at which point the 'savings credit' element had been abolished.

- *Single person or couple on Housing Benefit (HB) and Council Tax Support (CTS) (but not Pension Credit) with £20,000 pension pot and £6,000 in other savings*

Although Housing Benefit has been rolled into Universal Credit for people of working age, for those of pension age there remains a separate housing benefit system. The main features to be aware of are:

- For pensioners on housing benefit / council tax help only (and not Pension Credit), there is an absolute capital limit at £16k; apart from this, capital rules are as per Pension Credit so the first £10k is ignored;

- Housing benefit operates a “taper” of 65p in the pound on income above Pension Credit levels, whilst Council Tax Support operates a “taper” of 20p in the pound on income above Pension Credit levels. This means the effective taper is 85p in the pound above pension Credit levels, rather than £ for £ below it.

As with the previous example, untouched savings within the pension are now deemed to be generating an income. Assuming that someone is in receipt of HB and CTS and an imputed income is included in their assessment, the table below shows summarises the impact on their benefits based on some of the different choices they could make:

Choice	Impact on Housing Benefit (HB) and CTS
Buy an annuity of £25 per week	Their HB & CTS will change in line with the difference between the imputed income and annuity. So, if the original imputed income was £20 per week the income used in the calculations has increased by £5 per week and HB will reduce by £3.25 per week and CTS by £1 per week
Take whole pot as a lump sum and put it in the bank	If pot after tax worth £17k, now have £23k in the bank. As this is over the £16k capital limit they are now **disqualified from HB and CTS.**
Take £4k lump sum and put it in the bank leave rest in drawdown	Savings at the £10k threshold, so no imputed income from capital outside the pension. Pension pot reduced by 1/5th, reducing the imputed income in proportion. HB will thus increase by £2.60 per week and CTS by £0.80 per week (£4 reduction in assessed income @ 65% or 20%).

The fact that Housing Benefit and Council Tax Support operate a combined ‘taper’ of 85p in the pound for income above basic benefit levels rather than pound-for-pound withdrawal as with Pension Credit means that the implications of pension withdrawals for those on HB & CTS can be less serious. But the absolute capital limit means it is still possible to wipe out all benefit entitlement by making the wrong choice. Conversely, by making the right choice they may increase their HB & CTS benefits (or even make themselves eligible for Pension Credit).

06 The individual customer journey

We have shown in the last section some of the complexities around how pension choices can interact with the means-tested benefits system.

Given these complexities, it might be assumed that individuals can find out what impact their choices will make on their different benefits before they make a final decision. Sadly, the reality is very different. In this section we describe the normal process when someone is considering accessing their pension and highlight the way in which the current system provides too little support.

The first point to make here is that there is relatively little hard evidence on the numbers of people affected by this issue. We know how many people in the relevant age groups are on benefits, we know how many people in these age groups make different sorts of pension withdrawals (at least for the contract-based world) but we do not know the overlap between these two groups.

In terms of the experience of the individual saver, the sequence of events which leads up to a decision to take pension could include:

- They receive a “wake up” pack from age 50 (as the process was changed in 2019, this is not true for those currently reaching age 55) with a similar pack also issued at age 55; the pack includes current fund value, options, covering withdrawal and continuation, and a flyer describing the Pension Wise (PW) service (soon to become MoneyHelper – bringing together PW, MAS and TPAS under one brand).

- If they want to access their pension, the first point of contact for those seeking to make a withdrawal is their pension provider. Whilst all providers are required to make a referral to PW, take-up is relatively low. Some providers offer in-house guidance whilst others rely on the referral to PW. One problem at this point in the process is that customers may have already made up their minds and so don’t take guidance. Among those prepared to consider an appointment, the waiting time for a referral can be off-putting and further reduce take-up;

- Where a customer does secure an appointment with PW, they will be talked through the options of how they can take their pension but receive limited information on the interaction of state benefits and private pensions. See, for example, the generic information currently available on the PW website. Those wanting more information on means-tested benefits are encouraged to use one of the online calculators (found via the link above). These are comprehensive but consequently require a lot of information, involving perhaps 40-50 questions, so there are inevitably drop outs from the process. They are also not designed to answer ‘what if’ questions such as how taking a pension in one way or another will affect benefit.

While the providers we have spoken to are aware of issues around means-tested benefits and private pensions, we have yet to find an in-house guidance process that provides any more help with the interaction than the limited amount available via Pension Wise.

There may also be a difference between the stylised examples shown in the previous section and what actually happens in real life once the money has been taken out. For example, we assumed in the previous section that the DWP and/or local authority is immediately made aware of the pension withdrawal. In practice, the onus is on the individual to report this, and it seems possible to us that there is potential for significant under-reporting. One scenario, especially for local authority administered benefits, is that councils catch up in a rather 'lumpy' way, perhaps through periodic reviews, requests for latest bank statements etc. In this case the impact of a particular course of action with a pension could be delayed but then potentially trigger a decision that benefit has been overpaid and has to be clawed back as a lump sum.

Historically, pension provision has been focused on generating a sustainable income in retirement. But for a saver who is on means-tested benefits – and perhaps expects to be so in retirement – turning a pension pot into a regular income could wipe out some or all of their benefit and may not be financially advisable. Perhaps they would do better to use small lump sums to clear debt, which could improve their regular disposable income in a way which does not adversely affect their entitlement to benefit. But where they have large debts a better strategy might be to seek to get those debts written off (for example, via a Debt Relief Order) rather than use up their retirement savings for this purpose.

What all of this means is that, for those either currently on Universal Credit (or a legacy benefit) or potentially entitled to Pension Credit post state pension age, there is no real source of guidance round the consequences of different actions and very little data or evidence about what is actually happening on the ground.

07 Conclusions and recommendations

The interaction between the various options about using pension freedoms to access a pension pot and the knock-on implications for different means-tested benefits is highly complex. If individuals get this wrong, this can have serious consequences for their finances. Given the rollout of automatic enrolment it also seems likely that growing numbers of people, especially of working age, could find themselves having to wrestle with these issues.

We are concerned that savers will currently find it hard even to get basic information from their pension provider or from Pension Wise about how their different choices might affect their benefit, still less get guidance or advice on what the *best* outcome would be.

It seems to us that very few people in the pensions industry or even the world of financial advice and guidance would have enough knowledge of pensions rules, benefits rules and debt processes to recommend the best course of action to an individual, especially where the sums involved are modest and the saver probably could not afford to pay for advice. As indicated in the Box, providers in particular may need to think whether there are Compliance issues which need to be addressed here, and/or whether vulnerable customer policies should be brought to bear.

Vulnerable customers and compliance

In principle, pension freedoms give an individual freedom to make their own choices about how best to access their pensions. The government provides free guidance through Pension Wise, and efforts are currently underway to improve take up of that guidance, but ultimately responsibility rests with the individual.

However, this does not mean that pension providers can wash their hands of the need to look after their customers. Even setting aside the topic of this paper, conversations with savers are surrounded by extensive 'compliance' procedures such as ensuring that providers do not inadvertently cross into financial advice by steering a customer to a particular course of action. Providers are also expected by the FCA to have procedures in place to provide additional support to vulnerable customers.

It seems to us that the issue of the implications for means-tested benefits of customers taking pensions in different ways could well raise Compliance issues and vulnerable customer issues which providers may need to address with some urgency.

For example, suppose an individual takes their pension in full and the provider asks no questions about whether they are on benefit. The individual puts the money in their bank and subsequently has their UC stopped, potentially losing thousands of pounds in the process.

Is there a risk that they will challenge the provider – who does this for a living – why they did not do more to alert the customer – who may have no idea about the issues at stake – to the risk they were taking? And would it not be better for providers to address this issue now, in a preventative way, rather than potentially have to go back through past cases to see if they had failed to protect customers?

And could there be a particular category of vulnerability around those who are severely indebted? Taking a small amount of pension to clear a small amount of debt may be an optimal strategy. But using life savings to chip away at debts which could have been wiped in any case might be a terrible strategy. Given the multiple vulnerabilities often associated with seriously indebted individuals, how are providers addressing this issue, if at all?

There is a need for the industry, regulators and government to agree a position on the right approach to private pensions and means-tested benefits.

In the short term those providing guidance need better tools to help them discuss the interaction with retirees. In the longer term, once an industry position emerges, this should be used to further strengthen any guidance provided. In addition, there may well be a need to integrate debt counselling around pension withdrawals (see data need below).

There are various points in the process where support could be provided including:

- Before people make decisions (warm-up packs, mid-life MOTs etc);
- When people contact the scheme/provider
- Pension Wise
- Other Money and Pensions Service resources (apart from Pension Wise)

In all of this there is a need for significantly more data around the correlation between small pension pots, Universal Credit claims and later eligibility to Pension Credit. More specific data points that would help include:

- Proportion of those withdrawing that are on means-tested benefits?
- What do people who withdraw at 55 do with their money?
- How efficient is their course of action in terms of tax paid or benefits lost?
- If they are repaying debt was that typically the right thing to do?
- How/when do DWP / local authorities become aware of the choices pension savers have made? Is there a 'ticking time bomb' of overpayment cases where the authorities will seek to claw back inadvertent overpayments?

When pension freedoms were first introduced, the knock-on effects for those on means-tested benefits received relatively little attention. We believe our research has shown that this issue can be neglected no longer. Pension providers and schemes, regulators, guidance providers and government need to tackle this issue in a systematic way to make sure that those with modest means and modest pensions make the choices which produce the best outcomes for them.

08 About the authors

Matt Gosden is a former senior executive at Zurich insurance, and a former consulting Partner at Oliver Wyman. He currently leads Engage Smarter, which is a startup focused on delivering technology to companies that want to help their own customers make smarter financial decisions.

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Steve Webb is a partner at LCP. He worked as a micro-economist at the Institute for Fiscal Studies before taking up a post as Professor of Social Policy at Bath University. In 1997 he was elected to Parliament and from 2010-15 was the UK Pensions Minister in the Coalition government. Since then he has worked as Director of Policy at mutual insurer Royal London before joining LCP in 2020.

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