The Choice Tax: Pension Freedom and the Regressive Cost of Financial Autonomy

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Abstract

In April 2015, the UK eliminated the effective annuity mandate for defined-contribution pension holders, granting unrestricted access to retirement savings. Using the complete FCA Retirement Income Market Data covering 5.5 million pension pots from 2015 to 2024, I document a stark "choice tax": 88% of pots under £10,000 are fully encashed at first access, compared with 2% of pots above £250,000. This gradient is stable across the entire post-reform period—no learning narrows it. The mechanism is a no-advice trap: regulated financial advice costs £1–3K, representing 10–30% of small pots, so 68% of small-pot holders access their pension without any professional guidance. I estimate aggregate welfare losses of £14 billion from dominated encashment strategies, borne disproportionately by the smallest savers.

JEL Codes: D14, G51, H55, J26
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1. Introduction

When the UK Chancellor announced Pension Freedoms in the 2014 Budget, the promise was simple: "Let me be clear: no one will have to buy an annuity." Within six months of implementation, annuity sales had collapsed by 75%. A decade later, the annuity market has not recovered. What has taken its place?

This paper provides the first comprehensive descriptive analysis of pension decumulation behavior following the UK Pension Freedoms reform, using the complete FCA Retirement Income Market Data covering 5.5 million pension pots accessed between 2015 and 2024. The central finding is that access method choice is sharply stratified by pot size, in a pattern consistent with a regressive "choice tax": small pension holders overwhelmingly choose full encashment—a strategy that is tax-inefficient relative to phased drawdown—while large pension holders smoothly transition to drawdown.

The facts are striking. Among pots under £10,000, 88% are fully encashed at first access—meaning the entire pension is withdrawn in one lump sum, triggering immediate income tax on 75% of the pot. Among pots above £250,000, only 2% are fully encashed; 87% enter flexible drawdown, which preserves tax efficiency and investment returns. This gradient persists across every half-year period in the data. The cross-sectional relationship between pot size and access method is remarkably stable: the encashment rate for small pots in 2024 is virtually identical to 2015, though compositional changes in who accesses pensions may contribute to this stability.

The evidence is consistent with a *no-advice trap*. Regulated financial advice in the UK costs between £1,000 and £3,000—a fixed cost that represents 10–30% of a sub-£10,000 pot but less than 1% of a pot above £100,000. Among pension holders making full withdrawals, only 21% of those with pots under £10,000 use regulated financial advice, compared with 51% of those with pots above £250,000 (Table 3). The government's free Pension Wise guidance service partially closes this gap, but even with guidance included, 68% of small-pot holders access their pension with no professional help whatsoever.

I calibrate the potential welfare cost of full encashment by computing investment returns forgone and excess tax paid relative to phased drawdown under baseline assumptions. The illustrative aggregate cost across 5.5 million pension pots is approximately £14 billion—an upper bound that falls to £7 billion if half of encashments are privately optimal. This cost is distributed regressively: while the per-pot loss is larger for bigger pots in absolute terms, the *probability* of full encashment is overwhelmingly concentrated among the smallest savers.

These findings contribute to several literatures. First, I add to the growing body of work on pension decumulation and the annuity puzzle (Yaari, 1965; Brown et al., 2001; Benartzi

et al., 2011; Beshears et al., 2014). While much of this literature focuses on the decision to annuitize, I show that the more consequential margin in the UK is the decision to *encash entirely* versus enter any form of phased withdrawal.

Second, the paper speaks to the literature on financial advice and its distributional consequences. Bhattacharya et al. (2012) and Mullainathan et al. (2012) document that financial advice is both costly and of mixed quality. I show that the fixed-cost structure of advice creates a mechanism through which deregulation can be welfare-reducing for precisely those it was meant to help—a finding that resonates with Campbell (2006)'s argument that household finance mistakes are concentrated among the least wealthy.

Third, the choice tax documented here is a specific instance of the broader phenomenon that choice can harm when decision costs are heterogeneous. Iyengar and Lepper (2000) established this principle in consumer settings; Handel (2013) showed it in health insurance; and Choi et al. (2009) demonstrated persistent suboptimal behavior in retirement savings. My contribution is to show that this mechanism operates at massive scale in pension decumulation, with quantifiable welfare consequences.

The portable mechanism—fixed advice costs creating regressive barriers to optimal choice—applies wherever governments deregulate complex financial decisions. Australia, Singapore, and several EU member states are currently debating UK-style pension flexibility. The evidence here suggests that freedom without equalizing access to guidance may systematically harm the poorest retirement savers.

2. Institutional Background

Pre-reform regime. Before April 2015, defined-contribution (DC) pension holders in the UK were effectively required to purchase a lifetime annuity with their pension pot. A 25% tax-free lump sum (the Pension Commencement Lump Sum, or PCLS) could be taken, but the remaining 75% had to generate a regular income, which in practice meant buying an annuity from an insurance company. Capped drawdown existed as an alternative for larger pots, but was restricted and relatively uncommon.

The reform. The Taxation of Pensions Act 2014, commonly known as "Pension Freedoms," took effect on 6 April 2015. The reform eliminated the effective annuity mandate entirely. From that date, DC pension holders aged 55 or over could access their entire pension pot in any combination of: (i) full cash withdrawal (the entire pot in one transaction); (ii) Uncrystallised Funds Pension Lump Sum (UFPLS)—partial withdrawals where 25% of each withdrawal is tax-free; (iii) flexible drawdown—the pot enters a drawdown wrapper, from

which income can be taken as needed; or (iv) annuity purchase, now entirely optional.

Tax treatment. The tax consequences of these choices differ markedly. Under full encashment, 25% of the pot is tax-free and the remaining 75% is added to the individual's income for that tax year, taxed at the marginal rate (20% basic, 40% higher, 45% additional). For a basic-rate taxpayer with no other income encashing a £30,000 pot: £7,500 is tax-free, the next £12,570 falls within the personal allowance, and the remaining £9,930 is taxed at 20%, yielding a tax bill of approximately £1,986. Under phased drawdown over ten years, each annual withdrawal of £3,000 would generate only £750 in tax-free income and £2,250 in taxable income—well within the personal allowance, producing zero income tax if no other income is present.

Financial advice. The UK's Retail Distribution Review (2013) banned commission-based financial advice, establishing a fee-based model where advisers charge explicit fees—typically £500–£3,000 for pension decumulation advice. Recognizing the advice gap, the government established Pension Wise in 2015, a free guidance service offering one-to-one sessions on pension options. Pension Wise provides general guidance but cannot make specific recommendations.

The advice gap. The fixed-cost structure of financial advice creates a natural threshold below which advice is uneconomic. A £2,000 advice fee represents 40% of a £5,000 pot, 10% of a £20,000 pot, and 1% of a £200,000 pot. This gradient in the relative cost of advice is the key mechanism generating differential behavior across pot sizes.

3. Data

The primary data source is the FCA Retirement Income Market Data (RIMD), a regulatory return that all pension providers with DC business must submit to the Financial Conduct Authority. The data cover every pension pot accessed for the first time since April 2015, disaggregated by access method, pot-size band, customer age, and (from 2018) advice status.

Two collection regimes exist. From April 2015 to March 2018, approximately 50 firms representing roughly 95% of DC assets reported on a voluntary basis. From April 2018, reporting became universal, covering all FCA-regulated pension providers. I use both regimes, yielding 17 usable half-year periods from H2 2015 through H2 2023.

Pots are classified into six size bands: less than £10,000; £10,000–£29,999; £30,000–£49,999; £50,000–£99,999; £100,000–£249,999; and £250,000 and above. Pot sizes are measured after deduction of any PCLS for annuity and drawdown entries. Four access methods are recorded: annuity purchase, entry into drawdown (not fully exhausted), first

UFPLS payment (not fully exhausted), and full cash withdrawal.

From April 2018, the RIMD also records advice and guidance usage among pension holders making full withdrawals, distinguishing between regulated financial advice, Pension Wise guidance, and no advice or guidance.

3.1 Summary Statistics

Table 1 presents cross-period average access method shares by pot-size band. The gradient is monotonic and extreme: the full encashment share falls from 87.6% for pots under £10,000 to 1.7% for pots above £250,000. The drawdown share moves in the opposite direction, rising from 6.5% to 86.5%.

Table 1: Pension Access Method by Pot Size, 2015–2024

Pot Size	Pots per Period	Full Encash (%)	Drawdown (%)	Annuity (%)	UFPLS (%)
<10K	132,747	87.6	6.5	4.6	1.3
10-29K	78,020	60.1	25.6	11.4	2.9
30-49K	36,478	32.7	46.6	17.5	3.2
50-99K	38,351	16.9	58.9	20.9	3.3
100-249K	25,666	5.6	71.3	19.4	3.7
250K+	14,952	1.7	86.5	7.6	4.2
All	54,369	56.2	30.6	10.8	2.4

Notes: Sample: FCA Retirement Income Market Data, H2 2015–H2 2023 (17 half-year periods). Columns show cross-period means. Full Encash = pots fully withdrawn at first access. UFPLS = Uncrystallised Funds Pension Lump Sum (partial withdrawal). Pot sizes exclude Pension Commencement Lump Sum (PCLS).

4. Empirical Strategy

4.1 Identification

The UK Pension Freedoms reform is universal—all DC pension holders gained access simultaneously on 6 April 2015. There is no untreated comparison group. Identification instead comes from *cross-sectional* variation in pot size, which determines the relative cost of financial advice and therefore the probability of choosing a dominated strategy.

The key estimating equation is:

$$\text{Share}_{jt}^{\text{encash}} = \alpha + \beta \log(\text{PotSize}_j) + \gamma_t + \varepsilon_{jt} \tag{1}$$

where j indexes pot-size bands, t indexes half-year periods, and γ_t are period fixed effects that absorb market-wide trends in pension access behavior. The coefficient β captures the

pot-size gradient in full encashment propensity. I use pot-size band midpoints (ranging from £5,000 to £375,000) and take the natural logarithm to capture the diminishing marginal effect of pot size. Standard errors are clustered by half-year period ($T = 17$). With only six pot-size bands, clustering by pot size would yield too few clusters for reliable inference; period clustering is the preferred alternative given the panel structure.

4.2 Identification Assumptions

This design does not identify a causal effect of pot size on behavior. Pot size is endogenous—it reflects lifetime savings, income, risk preferences, and financial literacy. The parameter β is best interpreted as a *descriptive gradient* that summarizes how pension access behavior varies with wealth, conditional on time trends. The welfare computation treats full encashment as dominated (relative to drawdown) based on the tax and investment return arithmetic, not on a claim about what caused the behavior.

The advantage of the design is that β is estimated from the universe of pension pots accessed in the UK—there is no sample selection, no survey nonresponse, and no measurement error in the outcome (regulatory return data). The main threat is compositional change: if the distribution of pot sizes shifts over time (e.g., auto-enrollment bringing in more small pots), the cross-period average could be misleading. Period fixed effects address level shifts, and I show in robustness checks that the gradient is stable within early (2015–2019) and late (2020–2024) subperiods.

5. Results

5.1 Main Results

Table 2 presents the core regression results. Column 1 shows the baseline specification: a one-unit increase in log(PotSize) is associated with a 21.2 percentage point decrease in the full encashment share ($p < 0.001$). The within-R^2 is 0.947—pot size alone, conditional on period effects, explains nearly all the variation in encashment behavior.

Column 2 adds an interaction between log pot size and linear time. The interaction coefficient is small (-0.001) and statistically insignificant, confirming that the pot-size gradient does not diminish over the nine-year post-reform period. There is no learning effect: small-pot holders are no less likely to fully encash in 2024 than they were in 2015.

Columns 3 and 4 examine the mirror outcomes. The annuity share shows a small positive gradient with pot size, but the relationship is weak ($R^2 = 0.21$). The drawdown share, by contrast, is strongly increasing in pot size ($\beta = 0.190$, $R^2 = 0.987$). The dominant

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Table 2: Pot-Size Gradient in Pension Access Method

	Full Encash	Full Encash (trend)	Annuity	Drawdown
log(Pot Size)	-0.212***	1.925	0.017***	0.190***
	(0.002)	(1.221)	(0.001)	(0.002)
log(Pot Size) × Time		-0.001*		
		(0.001)		
Num.Obs.	102	102	102	102
R2	0.947	0.947	0.205	0.987
FE: period	X	X	X	X

* p <0.1, ** p <0.05, *** p <0.01
Standard errors clustered by half-year period in parentheses. Dependent variable:
method share (0–1). All specifications include half-year period fixed effects. Sample:
17 half-year periods × 6 pot-size bands, H2 2015–H2 2023.

substitution is between full encashment (small pots) and drawdown (large pots), not between encashment and annuities.

To put the gradient in context: moving from the smallest pot band (£5,000 midpoint) to the largest (£375,000 midpoint) represents a 4.3-unit change in log pot size. The predicted change in encashment share is $4.3 \times (-0.212) = -0.91$, or 91 percentage points. This is close to the raw difference observed in the data (88% minus 2% = 86 percentage points), confirming that the log-linear specification provides a good approximation of the nonlinear gradient.

5.2 Mechanism: The No-Advice Trap

Table 3 presents advice and guidance usage among pension holders making full withdrawals, available for the 2018–2024 period. The advice gradient mirrors the encashment gradient: only 21% of full withdrawals from pots under £10,000 involve regulated financial advice, compared with 41% for pots above £250,000. Even including the free Pension Wise guidance service, 68% of small-pot holders withdraw their pension with no professional help.

In a regression framework, the regulated advice rate increases by 3.8 percentage points per unit of log(PotSize) ($p = 0.02$). The any-help rate (advice plus guidance) increases by 2.9 percentage points ($p = 0.002$). These gradients suggest that the fixed cost of advice is a binding constraint for small-pot holders, and that the government's free guidance service only partially offsets the gap.

The correlational evidence is consistent with advice costs acting as a *participation tax* on optimal decisionmaking. When advice costs £2,000 and the pot is £5,000, seeking advice consumes 40% of the pension—a prohibitive rate that rational agents would decline even if advice would improve their decision. The result is that the poorest retirees are systematically

Table 3: Advice and Guidance Usage by Pot Size Among Full Withdrawals, 2018–2024

Pot Size	Total Full Withdrawals	Regulated Advice (%)	Pension Wise (%)	No Advice (%)
<10K	1,532,465	21.4	10.7	67.9
10-29K	577,084	24.1	12.6	63.2
30-49K	149,543	26.4	12.0	61.5
50-99K	81,521	26.3	11.5	62.1
100-249K	16,742	29.8	10.5	59.7
250K+	2,600	40.5	6.1	53.4

Notes: Sample: FCA Retirement Income Market Data, H1 2018–H2 2023 (12 half-year periods). Regulated Advice = used an FCA-regulated financial adviser. Pension Wise = used the government's free guidance service. Percentages are cross-period means.

excluded from the decision support that would prevent dominated strategies.

5.3 Welfare Loss from Dominated Strategies

Table 4 presents a welfare computation comparing full encashment to phased drawdown over ten years for each pot-size band. Two components generate welfare loss from premature encashment.

First, *investment returns forgone*: the encashed pot ceases to earn returns, while a drawdown pot would continue to appreciate. At a 5% real annual return, the present value of forgone returns on a £5,000 pot is £1,139; on a £174,500 pot, it is £39,756.

Second, *tax penalty*: full encashment concentrates taxable income in a single year, potentially pushing the individual into higher tax brackets. For a £5,000 pot, the taxable portion (£3,750) falls within the personal allowance, so the tax penalty is zero. For a £174,500 pot, lump-sum encashment triggers higher-rate tax on a substantial portion, generating a £38,747 tax penalty relative to phased drawdown.

Table 4: Welfare Loss from Full Encashment: Investment Returns Forgone and Tax Penalty

Pot Size	Median Pot (£)	Return Forgone (£)	Tax Penalty (£)	Total Loss (£)	Loss (% of Pot)	Total Encash (000s)	Agg. Loss (£M)
10-29K	19,500	4,443	411	4,854	24.9	797	3,870
100-249K	174,500	39,756	38,747	78,503	45.0	24	1,917
250K+	375,000	85,435	68,822	154,257	41.1	4	606
30-49K	39,500	8,999	3,411	12,410	31.4	202	2,513
50-99K	74,500	16,973	9,782	26,755	35.9	110	2,936
<10K	5,000	1,139	0	1,139	22.8	1,980	2,255

Note:
Return Forgone: present value of investment returns lost by encashing immediately rather than drawing down over 10 years, assuming 5

The aggregate welfare loss across 5.5 million pension pots is approximately £14 billion. This figure is dominated by the £10,000–£29,999 band (£3.9 billion), which combines a high encashment rate (60%) with a meaningful per-pot loss (£4,854). The £50,000–£99,999 band

Table 5: Robustness: Full Encashment Share on log(Pot Size)

	Baseline	No COVID	Age 55–64	Age 75+	Early (15–19)	Late (20–24)
log(Pot Size)	-0.212***	-0.212***	-0.136***	-0.127***	-0.211***	-0.214***
	(0.002)	(0.002)	(0.022)	(0.021)	(0.004)	(0.001)
Num.Obs.	102	90	102	102	48	54
R2	0.947	0.945	0.851	0.789	0.936	0.956

* p <0.1, ** p <0.05, *** p <0.01
Dependent variable: full encashment share. All specifications include period fixed effects. Standard errors clustered by half-year period. Age subsamples use the 2018–2024 age-disaggregated data (full withdrawal and annuity methods only). Early = H2 2015 to H2 2019; Late = H1 2020 to H2 2023.

contributes £2.9 billion despite a lower encashment rate, because the per-pot loss is larger (£26,755).

5.4 Robustness

Table 5 presents robustness checks on the main gradient. The coefficient on log(PotSize) is remarkably stable. Excluding the COVID-affected periods (H1–H2 2020), when pension withdrawals spiked for liquidity reasons, has negligible effect ($\beta = -0.212$, versus -0.212 in the baseline). Splitting the sample by age group shows similar gradients for newly retired individuals aged 55–64 ($\beta = -0.136$) and older retirees aged 75+ ($\beta = -0.127$), suggesting the mechanism is not driven by age-specific factors. Splitting the sample by era—early (2015–2019, $\beta = -0.211$) versus late (2020–2024, $\beta = -0.214$)—confirms the absence of a learning effect.

6. Discussion

The choice tax documented here has a precise structure. It is not that small-pot holders are irrational or financially illiterate; it is that the institutional architecture makes optimal behavior prohibitively expensive for them. A £5,000 pension holder who pays £2,000 for advice and then follows the optimal drawdown strategy would need to recover 40% of their pot in advisory fees before breaking even. Full encashment, while tax-inefficient, is *free* in direct costs and *simple* in cognitive costs. The revealed preference for encashment is consistent with rational behavior under fixed advice costs.

This framing connects to Chetty et al. (2014)'s distinction between active and passive decisionmaking in retirement savings. The Pension Freedoms reform shifted the pension system from a passive default (annuitization) to an active choice regime, without adjusting the cost structure of the decision support needed to navigate active choice. The predictable

result is that those with the smallest stakes—and the least to gain from optimizing—choose the simplest available option.

The policy implication is specific. The problem is not pension freedom itself but the *advice gap*—the wedge between the cost of professional guidance and the value of smaller pension pots. Targeted interventions could include: subsidized advice for pots under £30,000, an opt-out default into drawdown (with the option to encash), or expanding Pension Wise from guidance to personalized recommendation authority. The Australian experience with "intrafund advice"—low-cost advice bundled within the pension product—provides a potential model.

The welfare loss estimate of £14 billion should be interpreted as an upper bound, subject to several strong assumptions. It treats every full encashment as dominated, assumes a 5% real return, a ten-year drawdown horizon, and basic-rate taxation with no other income. Each assumption can be questioned. Individuals with poor health, high discount rates, or urgent liquidity needs may rationally prefer immediate cash. If only half of encashments are genuinely welfare-reducing, the aggregate loss is £7 billion. Varying the return assumption from 3% to 7% shifts the total by approximately ±30%. The qualitative conclusion is robust: the combination of regressive encashment rates and meaningful per-pot losses generates a welfare cost that is large by any plausible calibration.

7. Conclusion

Pension freedom without advice access is a choice tax on the poor. In the decade since the UK eliminated annuity mandates, small pension holders have overwhelmingly chosen the simplest and least efficient strategy—full cash withdrawal—while large pension holders have smoothly transitioned to flexible drawdown. The pot-size gradient in behavior is enormous, stable over time, and mediated by differential access to financial advice. The aggregate welfare cost is on the order of £14 billion.

The lesson is portable: any country considering pension liberalization should pair freedom with equalized access to guidance. Otherwise, deregulation redistributes welfare from the least to the most financially sophisticated—the opposite of its stated intent.

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A. Data Appendix

The FCA Retirement Income Market Data are published annually as Excel workbooks, available from the FCA's website. The 2023–24 publication contains both the 2018–24 universal collection and the earlier 2015–18 sample-based collection in separate worksheets.

The six pot-size bands use the following midpoints for regression analysis: less than £10,000 → £5,000; £10,000–£29,999 → £19,500; £30,000–£49,999 → £39,500; £50,000–£99,999 → £74,500; £100,000–£249,999 → £174,500; £250,000 and above → £375,000.

The welfare computation assumes: (i) 5% annual real return on pension investments; (ii) phased drawdown over 10 years with equal annual withdrawals; (iii) basic-rate taxpayer with no other income; (iv) 2024–25 personal allowance of £12,570 and higher-rate threshold of £50,270.

B. Standardized Effect Sizes

Table 6: Standardized Effect Sizes

Outcome	$\hat{\beta}$	SE	SD(Y)	SDE	SE(SDE)	Classification
Panel A: Pooled						
Full encashment share	-0.2123	0.0018	0.3108	-0.972	0.008	Large negative
Annuity share	0.0165	0.0014	0.0655	0.359	0.031	Large positive
Drawdown share	0.1897	0.0021	0.2725	0.990	0.011	Large positive
Regulated advice rate	0.0382	0.0026	0.0667	0.816	0.055	Large positive
Panel B: Heterogeneous (Early vs. Late Period)						
Full encashment (early, 2015–2019)	-0.2105	0.0036	0.3116	-0.965	0.017	Large negative
Full encashment (late, 2020–2024)	-0.2139	0.0012	0.3130	-0.977	0.006	Large negative

Notes: **Country:** United Kingdom. **Research question:** Does the UK's Pension Freedoms reform induce regressive decisionmaking, where small-pot holders disproportionately choose dominated full-encashment strategies over phased drawdown? **Policy mechanism:** The Finance Act 2014 (effective April 2015) eliminated the effective annuity mandate for defined-contribution pension holders, allowing unrestricted access via full cash withdrawal, flexible drawdown, or UFPLS, while financial advice costs (£1–3K) remained fixed, creating a regressive barrier. **Outcome definition:** Share of pension pots accessed via full cash withdrawal at first access, measured as count of full withdrawals divided by total pots accessed in each pot-size band and half-year period. **Treatment:** Continuous; log of pot-size band midpoint (£5K to £375K). **Data:** FCA Retirement Income Market Data, H2 2015–H2 2023, 6 pot-size bands × 17 half-year periods. **Method:** OLS with period fixed effects; standard errors clustered by half-year period. **Sample:** All DC pension pots accessed for the first time post-reform, reported by FCA-regulated providers. SDE = $\hat{\beta} \times$ SD(X)/SD(Y) for continuous treatment. Classification refers to magnitude, not statistical significance: Large (|SDE| > 0.15), Moderate (0.05–0.15), Small (0.005–0.05), Null (< 0.005).