Five years of freedom: Evolution, not revolution

A report for the DC Investment Forum, by Richard Parkin Consulting and Ignition House
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Dedicated to promoting investment excellence
The Defined Contribution Investment Forum (DCIF) aims to exchange ideas and develop initiatives to promote investment excellence in Defined Contribution (DC) pensions in the UK. The DCIF consists of investment firms and selected other industry participants who believe that members in DC pension schemes deserve the best possible investment services to help them meet their retirement objectives.
Is revolution what the industry should be striving for? Perhaps a more realistic path is to evolve along with members.
They are the pension pioneers; the first generation of retirees to make use of freedom and choice. Five years on from the introduction of pension freedoms, the DC Investment Forum decided to find out how people are making use of their newfound flexibilities and how pension providers are evolving to help them.

Making complex retirement choices has never been easy; but freedom and choice makes some engagement obligatory. In this report, we wanted to gauge people’s understanding of the freedoms. How informed are the choices they are making? What resources are they using to guide them? We asked Ignition House to shed light on what people are thinking, via a mix of quantitative research and qualitative interviews.

What emerged was that accessing tax-free pension cash has become a social norm. But accessing their retirement money doesn’t necessarily mean that people have a plan of how they will manage later down the line. In-depth interviews revealed that many people are deferring retirement decision-making. We also discovered that people are keen to have a slightly tailored solution, showing the door is open to providers who are able to help them.

There are many opportunities for providers in this new world. However, they have been criticised for failing to innovate quickly enough. We asked Richard Parkin Consulting to investigate how providers are responding to the freedoms. Are the criticisms fair? How much have they innovated and what’s on offer to consumers?

The real challenge is that decision-making today may be very different to how it will be in a decade or two. Data from our survey suggest that three quarters (73%) of our survey respondents had combined DC pot sizes of less than £100k. As auto-enrolment continues, people are likely to rely more on their DC savings and for these savings to grow. The picture will look very different in the years to come.

This changing picture presents a real challenge for providers and trustees who are trying to work out what services and assistance to offer members. That’s why, in this report, we question whether revolution is really what the industry should be striving for. Perhaps a more realistic path is to evolve along with members.

All these issues have implications for investment design. Investment managers also face the challenge of trying to create solutions which will work in the great unknown future. People often don’t know when they are going to retire and what they are going to do with their money. Accordingly, it is difficult to know when to de-risk people’s savings.

The evolutionary challenges are not likely to subside any time soon. Encouragingly though, the best practice case studies we showcase in this report demonstrate that trustees, pension providers and the wider pensions industry are thinking very hard about how to better serve members.

Vivek Roy
Chair, the DC Investment Forum
Senior Institutional Strategist, AXA IM
Executive summary

Chapter one assesses how members are using freedom and choice. Looking at the FCA’s data, the bulk of activity has been consumers taking cash, largely by fully withdrawing their savings. Drawdown has also become much more popular than annuities, for those who are not cashing in completely. The majority of people who are using drawdown are doing so to take advantage of tax-free cash, rather than drawing a regular income.

The FCA data describes the present situation. In qualitative and quantitative work by Ignition House, we sought to delve into what members are thinking and why.

The ostrich effect
We explored the concept of retirement with members. Many planned to ease into retirement gently: 39% of those not already classified as fully retired could see themselves winding down, and 23% had no plans to retire in the foreseeable future. Our in-depth interviews revealed that members find it difficult to say definitively when they plan to give up work, recognising that this could be driven by circumstances outside their control. However, most (68%) could not see themselves working past 70.

Our conversations show that members have become firmly attached to the idea of taking their full, 25%, tax-free lump sum, with few considering taking less than the maximum. Members usually had a specific purpose in mind for the money, but often could have used other savings to fund these activities. Some felt little sense of ownership of this money; rather, that it was an unexpected bonus, unlike the ISAs they had worked hard to build, or the properties for which they had saved.

Members decoupled the decision to take their lump sum from what to do with the rest of their pension money. Half of members who have not yet retired have not spent much time thinking about how they will manage financially in retirement, and 13% have not thought about it at all. In our conversations with members, it became clear that even members who had made plans had not conducted any basic financial planning exercises and that 20% had no idea how much was in their DC pension.

Full retirement is perceived to be scary, emotionally and financially. Accordingly, people are putting off thinking about retirement for as long as possible – a behavioural response known as the ostrich effect.

When it comes to interacting with providers, members are following the “path of least resistance”. However, this is not always the case. The choice architecture offered to members by their own provider is crucial in helping them towards the right retirement outcome for them.

The tax-free cash norm may not stay that way forever. As fewer and fewer of them will look to defined benefit (DB) entitlements, members will increasingly start relying on their DC pots for income. Plus, at the moment, most DC pots are too small to generate any meaningful income. As the system grows and matures, this will change.

Chapter two examines how providers are responding to the liberalisation of the pensions regime. Overall, providers think that freedom is a good thing for members. That said, just under half felt that pension freedom should be subject to greater controls. Most felt consumers should be challenged further when they were taking their money in full or making decisions that would result in a hefty tax bill.

Providers are most concerned that consumers understand the decisions they are making. The majority are offering people support, in the form of access to advice. In many cases, this is cheaper than using a traditional independent financial adviser. One provider even offers advice for free. However, takeup of this advice is relatively low.

The biggest issue for pension providers is the risk that pension freedom creates. Providers’ greatest concerns were an even balance of operational risk and conduct risk. They are worried about the fine line they must tread between the necessity of supporting members and the risk of straying into offering advice. Surprisingly, the operational cost of providing freedom and choice was not such a big concern for most.

Providers reject the notion that they have not innovated since freedom and choice. Many pointed out how they transformed their systems to offer pension freedoms in the twelve months George Osborne gave between announcement and implementation.

Providers have also invested heavily in improving their retirement offerings, particularly in the areas of engagement and member support at retirement. Many believe we already have the products we need; the real challenge is in ensuring members receive the right combination to meet their needs.

Few providers are charging extra for the flexibilities and, generally speaking, accessing pension freedoms from within a workplace
plan will be very cost effective, compared to transferring to a retail pension product.

DC investment design is challenged by the concept of pension freedoms. It is much more straightforward to design an investment glidepath when members are clearer about when they want to retire. Providers are trying to solve this problem by engaging with members early about their plans. However, few members respond to these communications at present. It’s unclear whether this is because members are happy with the way their money is invested in the default fund, or because they are not engaging with the question. Providers are also challenged by how the default reflects that many will take their 25% tax-free cash long before full retirement.

Most providers intend to offer the FCA’s investment pathways even when they’re not obliged to do so. A number feel they are already offering something similar. Only two providers said they were unlikely to implement pathways until they are required to do so.

Providers haven’t heavily focused on delivering investment options which help people in drawdown to take income from their DC plans beyond extending defaults through retirement. In addition, providers currently offer members little direction on how much income they should take from drawdown.

Over the next three years, providers are set to continue to improve their retirement offerings. Those who don’t already offer drawdown are seeking to introduce it. Master trusts are also continuing to look to the Retirement Outcomes Review to aid the development of their guidance propositions. Providers are also looking at how best to structure investment options for drawdown, as well as in the lead-up to retirement. However, uncertainty about the future direction of regulatory travel is hindering their plans.

Chapter three examines the results of Ignition House’s consumer research in more detail and considers how it might impact providers’ future plans. Members are pretty sceptical about annuities, although as they get older, the certainty of a retirement income becomes more appealing. Most members did not see passing on money to dependents from their DC pension pot as a priority. Rather, they saw it as money to live off in retirement. When it ran out, many expected to downsize or release housing equity.

Many members did not see their DC pension pot as a source of income for life. They recognise they do not have enough money in DC for this to be a realistic option, and so are making other plans. For that reason, providers should think about withdrawal strategies which are different from the traditional sustainable income model. Three potential models are outlined in chapter three.

The traditional belief has been that running out of money would be the worst possible outcome, but members seem relatively sanguine about that prospect. In our in depth interviews, we discovered that most members would rather take the risk that the money runs out in their mid-80s for more income to enjoy today. They were often keen to spend more in their early years of retirement, while fitter and healthier, and then spend less as they get older. This finding could have seismic implications for product design and the idea that a sustainable, relatively conservative withdrawal rate, such as the traditional 4% rule, is what members will want.

Chapter four highlights areas where more thinking is needed on investment. These are:

- The design of DC pre-retirement defaults and how these can manage the myriad needs of members
- How investment pathways might be implemented and how these interact with default strategies
- What investment strategies will be needed once members are actually taking income, given that not all have the same expectations of what income they want.

Chapter five highlights the five areas which will be most important for providers seeking to build retirement propositions over the coming years. These are:

- More sophisticated guidance frameworks, which allow members to look at their retirement wealth in the round;
- A variety of drawdown options, which accommodate the wide variety of ways in which people might want to use drawdown;
- Advice which is integrated into people’s retirement journeys, rather than an optional bolt-on;
- Default investment designs which consider how members are taking their benefits in practice rather than in theory;
- For single trusts, consider partnering with master trusts or another provider to give members more flexibility, for example partial withdrawals.
Pension freedom has caught the imagination of consumers and woken them up to new opportunities to use their pension savings. We can see this not just in the numbers of people accessing their savings directly, but also in the huge upsurge in defined benefit pension transfers, with people seeking to take advantage of defined contribution flexibilities.

The announcement of pension freedom was politically charged with the promise that “People who have worked hard and saved hard all their lives, and done the right thing, should be trusted with their own finances.” While it’s difficult to argue with the sentiment, this promise immediately created a challenge for pension providers, trustees and regulators. How do you reconcile the requirement to let people do what they want with their savings in an environment that requires trustees to consider members’ best interests and product providers to consider suitability?

Trustees, in particular, have generally been reticent to offer full pension freedoms within their schemes. Part of this is an understandable concern about increased costs and complexity. However, even where a scheme’s provider can offer the flexibilities at little or no additional cost, not all trustees have been willing to allow this.

Providers had to quickly make significant business changes to facilitate the new freedoms. Perhaps more fundamentally though, they had to decide if and how they would facilitate income drawdown, a product that had hitherto been almost entirely the preserve of wealthy, advised customers. Not only did this create more operational and system change but also a step change in conduct risk.

The regulators were also challenged by the short implementation timeline. Again though, more fundamental philosophical questions arose. How do you create a regulatory regime that supports “good” retirement outcomes when one might define a good outcome as whatever the customer wants?

The past five years have seen a significant evolution of the retirement market. Many trustees are realising that even if they don’t offer full freedoms within their plans, they need to provide clear routes to members wishing to access benefits. The FCA has been very active, with the Retirement Outcomes Review eventually recognising that the drawdown market has fundamentally changed and regulating accordingly. The Pensions Regulator has yet to follow the FCA’s lead but is considering how it might do so. Pension providers have developed their propositions significantly and have largely
It’s dangerous to assume that income drawdown has displaced annuities
moved beyond operational implementation to focus more clearly on engaging and supporting members at retirement.

In this chapter, we first look at how members have reacted to the changes and how providers now view pension freedom. We also provide some insight into trustees’ thinking, based on conversations with a number of schemes who have embraced pension freedom or are considering doing so.

In the next chapter, we analyse what the large DC providers are offering members at retirement and what they’re planning to focus on in the coming years. In the main, we look at capabilities within each provider’s master trust. It is clear that the market now sees master trust as the dominant form of bundled pension provision. For those employers still keen to manage their own schemes, the master trust provides an interesting opportunity to integrate pension freedom without taking on more cost and risk.

But at the heart of the challenge for providers and trustees is the member. What does a good retirement outcome look like for them, and how do they really evaluate the choices available to them?

**The member’s perspective: cash is king (for now)**

Much of the focus of research to date by regulators and the industry has been on the drivers and motivators of those making decisions on their DC pots under the new freedoms. Unfortunately, we don’t have data on how members of DC occupational schemes have been using pension freedom. However, the FCA does publish data on customer behaviour for the pension products it regulates. These will include individual as well as group pensions but give a useful indication of what people are doing. The latest FCA data covers the period up to March 2019.

The FCA estimates that since April 2015 more than 2.3 million contract-based pots have been accessed for the first time.

It’s clear that the bulk of activity has been consumers taking cash, largely by fully withdrawing their savings. The data also show that drawdown has become far more popular than annuities for those choosing not to cash in completely. However, it’s dangerous to assume that income drawdown has displaced annuities as the preferred way for consumers creating future retirement income.

The majority of those moving into drawdown are doing so simply to take tax-free cash rather than drawing a regular income. In the final report of its Retirement Outcomes Review, the FCA found that taking tax-free cash was the main reason for people moving into drawdown across all pot sizes. Pension providers confirm this, reporting that within their drawdown clients, between 60% and 80% are taking no ongoing income. Therefore, comparing drawdown with annuities isn’t really fair. It may well be that, if and when those currently in drawdown come to take income, they will still choose an annuity.

**Figure 1. Number of plans accessed for the first time by method of access**

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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Annuity</td>
<td>31,712</td>
<td>40,020</td>
<td>67,477</td>
<td>42,771</td>
<td>8,607</td>
<td>10,496</td>
<td>7,521</td>
<td>10,496</td>
</tr>
<tr>
<td>Income</td>
<td>240,020</td>
<td>80,182</td>
<td>127,908</td>
<td>83,873</td>
<td>10,707</td>
<td>9,004</td>
<td>8,707</td>
<td>9,004</td>
</tr>
<tr>
<td>Drawdown</td>
<td>302,107</td>
<td>326,761</td>
<td>317,578</td>
<td>276,761</td>
<td>272,752</td>
<td>334,800</td>
<td>311,730</td>
<td>334,800</td>
</tr>
<tr>
<td>Partial UFPLS</td>
<td>8,747</td>
<td>12,755</td>
<td>10,974</td>
<td>9,054</td>
<td>10,496</td>
<td>137,777</td>
<td>167,199</td>
<td>137,777</td>
</tr>
<tr>
<td>Fully withdrawn</td>
<td>36,891</td>
<td>97,946</td>
<td>10,070</td>
<td>97,946</td>
<td>10,496</td>
<td>137,777</td>
<td>187,645</td>
<td>137,777</td>
</tr>
</tbody>
</table>

Notes

1 https://www.fca.org.uk/data/retirement-income-market-data

Fig 1. Key

- **Annuity**
- **Income**
- **Drawdown**
- **Partial UFPLS**
- **Fully withdrawn**
- **Total**

Fig 1. Notes

* Figures on drawdown and UFPLS were not collected in the same format between July and September 2015 and therefore have been omitted for this period
** The population from which data was collected changed from April 2018 and so care should be taken in drawing comparisons between these and previous periods
There’s no such thing as ‘one size fits all’
It is important to remember that the FCA’s statistics focus only on access decisions. These are not the same as decisions about future retirement income, so this is only part of the story.

To understand broader member reactions to the new freedoms, we conducted an online survey of 500 current and deferred DC members aged 55-70, supplemented by 15 one-hour, in-depth qualitative discussions. The quantitative research tells us what members are thinking; the qualitative research gives insights into why they hold these views. Both elements of the research were conducted in August and September 2019. As the focus of this project is to provide insights to help the market drive forward thinking around drawdown and investment solutions, we excluded people who have cashed in all their DC pots from both our in-depth discussions and our survey respondents. In our survey, 44% of respondents had made an access decision under the new freedoms; 56% could have accessed their money but have not yet done so. All of the people we spoke to face to face were already in drawdown, although none were taking a regular income yet.

Under the new freedoms, members are no longer on a single path to annuity purchase at retirement; they are ‘free’ to make choices based on their individual circumstances. We certainly found that the members taking part in our survey had a myriad of pension provision (especially when considering wealth at the household rather than individual level) and often had housing assets and savings they had been building up over their lifetime. And there was a huge amount of diversity in the financial situations of the members we spoke to in depth, ranging from those who were struggling to pay off large debts to those who were still accumulating significant money in their DC pensions. Not all had children or partners, and as a result were very keen to make sure they were set up financially for their later years, whereas others felt more relaxed about this believing that they could rely on family members to take care of them, if needed. Many were home owners, but a minority were renting and worried about the extra costs that this would incur over their retirement years.

The link between ‘retirement’ and the decision to access pension money is broken
Members have taken control of their own financial futures, resulting in a very diverse landscape amongst the over 55s. Figure 3 shows that just under half (43%) of those who had accessed some DC pension money were not yet fully retired. Almost a quarter (24%) of those who have not yet touched their DC pension money were fully retired.

Looking at the data slightly differently:
• 66% of those who were fully retired had accessed some pension money
• 24% of those still employed full-time had accessed some pension money
• 31% of those still receiving income from work had accessed some pension money

Members were not always sure what ‘retirement’ actually meant, as their preference was often to ease into retirement gently; four in ten (39%) of those not already classified as fully retired could see themselves ‘winding down’, and one in four (23%) had no plans to retire in the foreseeable future.

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**Figure 2. Members’ financial situation**

<table>
<thead>
<tr>
<th>Accessed a DC pension</th>
<th>Not accessed a DC pension</th>
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<tbody>
<tr>
<td>30% have a DB pension</td>
<td>36% have a DB pension</td>
</tr>
<tr>
<td>38% have more than £50k in cash savings</td>
<td>36% have more than £50k in cash savings</td>
</tr>
<tr>
<td>50% have more than £20k in other investments</td>
<td>52% have more than £20k in other investments</td>
</tr>
<tr>
<td>11% have a second properly</td>
<td>17% have a second properly</td>
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</table>

**Base:** All UK adults aged 55-70 with a DC pension (501)
Our in-depth discussions revealed that members actually find it difficult to say exactly when they want to give up work completely, recognising that this decision could well be driven by circumstances outside of their control – e.g. ill-health, redundancy, changing family situations.

They had very different plans for the age at which they would want to retire completely, and the pathway to achieving this goal. There was a tendency to tie in full retirement with State Pension age, and most (68%) could not see themselves working beyond 70. A significant minority, 14%, felt that they would never be able to afford to give up work. This myriad of personal circumstances suggests that there will need to be considerable flexibility in any drawdown solutions, and particularly in the associated glidepaths.

“I work as a tour guide at a sports stadium, and because sport is my thing it doesn’t feel like work. I’ve been doing that for 11 years and enjoy it there. I would like to retire, but would need to look at a side-line of something that I could do part-time. I’m looking to retire at around 65-67. But, even if I am retired, I still want to do something else. Just retiring and not doing anything doesn’t suit me.” – Male, 56

“I’m a legal PA and haven’t had a permanent job for quite a long while, I’ve been temping or doing contract work. My ideal situation would be to work part-time for an extended period of time, just to keep the wolves at bay and so I can plan ahead. I’m definitely not ready to stop work and retire fully – it’d drive me insane. I do get the State Pension now, but that doesn’t cover all expenses. That just covers my rent, my council tax and a couple of bills. So, I could see myself working for quite a long time. I’m in pretty good health and still have a lot to give, so I could see myself working for at least the next 5 years or so.” – Female, 65

Early pioneers of pension freedoms have set new social norms

The new freedoms are now fully embedded into financial planning and new social norms have formed. The latest FCA retirement market income data shows that there has been little change in members’ access decisions in the last three years. In 2018/19, 11% of plans accessed for the first time were used to buy an annuity, compared to 30% entering drawdown, and a further 4% taking an UFPLS withdrawal.² This has broadly remained the same over the last few years.

Members are fully aware from friends, family and the media they can take 25% of their pot as a tax-free lump sum. However, there is some confusion about the exact timing of this. Amongst those in our survey who have not yet accessed any money, half (52%) correctly identified they could do this from age 55, but one in four (23%) said they needed to be 65 or over.
“In the back of my mind you know that the government is constantly changing the rules and what with Brexit and all that you don’t know what will happen. So I took the tax-free cash as I don’t trust them.”

– Male, 57
Our in-depth discussions revealed that members have now firmly anchored onto taking the full 25% as a tax-free cash lump, and few considered taking less than the maximum. That said, members have no idea whether you have to take 25% in one lump or whether it is possible to spread it across several lumps – but would like this if possible (note: this is not same as UFPLS which they have very low awareness of).

“Because we knew we were able to take 25% tax-free at some point, we had the mindset of ‘yes, we will do this’.” – Male, 66

“You could only take the 25% tax-free and take the rest as an income or leave it invested. There was no other option [to take less than 25% or multiple tax-free lump sums]. That was the choice we had. What we had left over [after taking the tax-free lump sum] we put into an ISA.” – Female, 59

**Tax-free cash decision is firmly decoupled from what to do with the rest of the money**

Our in-depth discussions with members who have taken their tax-free lump sums in the last two years very much mirrored findings from the qualitative work underpinning the FCA’s Retirement Outcomes Review in 2017. Members had firmly decoupled taking their tax-free cash decision from what to do with the rest of the money, switching the mental accounting of their tax-free cash from a future retirement income choice to a current consumption choice. This means that their pension is no longer locked away to provide an income in the distant future; it can be spent before retirement on whatever they want – typically weddings, home improvements, holidays and to pay off mortgages and other debt in preparation for full retirement.

“We took the tax-free cash, because there was quite a lot in the pension pot and we’re moving and so we wanted to do some work on the house and we didn’t want to take the money out of our savings. Given that it was tax-free, we were better off doing it that way.” – Female, 59

“I went to the World Cup in Brazil and the Euros in France and stayed in Cannes with a girlfriend, which was quite expensive. I had two big loans and credit cards, so the 25% tax-free that I could get was £21k and with that I was able to pay off the loans and credit cards. And I had a bit left over, which I spent anyway.” – Male, 56

“I took that chunk of money out for my daughter’s wedding. You could get the first 25% tax-free, my daughter was getting married and I love my daughter and that was it. It all fell into place, so I just did it.” – Male, 57

Echoing the findings of the Retirement Outcomes Review, we found that members could have used money set aside in other savings or investments to fund these activities, but somehow felt that their pension money was either “free money” or not “their money”.

“Once again, we heard a couple of members talking about their mistrust of government and the industry. Concerns that the goalposts would shift again and that the government would remove or reduce the tax-free element drove them to take out the money “while the going is good”.

“In the back of my mind you know that the government is constantly changing the rules and what with Brexit and all that you don’t know what will happen. So I took the tax-free cash as I don’t trust them.” – Male, 59

**Members are sleepwalking into retirement**

Half of (50%) all members who have not yet retired have not spent much time thinking about how they will manage financially in retirement – and 13% have not really thought about it at all. Perhaps most shockingly, even amongst the 65+ age group, one in ten (9%) have not yet started to consider their financial futures.

Overall, one in four members (23%) had no idea how much is in their DC pensions. Looking at only those members who had made a decision under the new freedoms, we find that a third (34%) have not thought much about their future financial situation, and that one in five (20%) had no idea how much is in their DC pensions.

Furthermore, conversations with members who said that they had thought about their financial position revealed they had not actually conducted any financial planning exercises to determine how much they need to cover basic living expenses. Nor have they really looked into how much wealth they have accumulated to pay for their lifestyle in retirement. Most did not know whether they would receive full State Pension, despite having high levels of awareness that they could receive a pension forecast from the Department for Work and Pensions (DWP). This held true even amongst those who are at, or very close to, fully retiring. This suggests that the numbers in our survey are likely to be a highly optimistic representation of the true position.

“When I retire, I would like to go traveling. Going to different countries, experiencing different ways of life. I could see myself doing three months at a...
time... eating well, socialising and have a good balance of life. That would maybe cost £40k per year, but it could be less... I haven’t worked out a budget or planned for that yet.” – Female, 56

“[With about 18 months until retirement to go] Really, I haven’t given much thought to it yet. We’ve got to get there first and then we’ll cross that bridge when we get there.” – Male, 66

‘Full retirement’ – defined as the time at which they are receiving no income and will start to run down accumulated wealth – is perceived to be “scary”, both emotionally and financially. As a result, we find that people are putting off thinking about full retirement (other than the leisure activities they could be enjoying) for as long as possible – a behavioural response known as the ostrich effect.

“Part of my problem is that I don’t really plan and I am not a great planner. Maybe I am a bit scared. I can’t sit down and look at how long our money might last when we stop working. Because we don’t know how long it needs to last... you don’t know when we’ll die. So it’s the complete unknown really. I know it’s sensible to have some sort of basic idea of what you’ve got, but you can plan all you want... things change.” – Male, 57

“I’ve tried retirement and it didn’t suit me. I got bored and I’m pretty sure I don’t have enough saved as we all live into our 90s in my family. I’m putting off the dreaded day for as long as possible” – Male, 59

Another bite at the advice cherry?

Despite having little understanding of what their financial future could look like, members who had already made the decision to take their tax-free lump sum felt very confident about what they had done. That said, they freely admitted that they spent very little or no time thinking about the impact this decision could have on their future financial well-being, and it often did not even cross their minds to do so.

“It was a very calculated decision and I was very pleased to be able to do it. At the time I think it was sensible. We were just thinking about the tax-free cash and I’ll worry about the rest of the money and what to do with it later.” – Male, 66

Members in both the survey and our in-depth discussions used very positive words to describe how they feel about making a decision to take a tax-free cash lump sum, typically using words such as “relaxed”, “cautious”, “pleased”, “confident” and “sensible”.

This is in stark contrast to how they feel about making decisions about what to do with the rest of their pot. Here, they feel like it is a much more complex and important life choice which will have ramifications if they get it wrong. They are much more wary about their ability to do the right thing,

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### Figure 4. Members’ financial plans for retirement

<table>
<thead>
<tr>
<th>All members who have not retired</th>
<th>50%</th>
<th>36%</th>
<th>13%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Age 55-59</td>
<td>41%</td>
<td>40%</td>
<td>20%</td>
</tr>
<tr>
<td>Age 60-64</td>
<td>60%</td>
<td>32%</td>
<td>7%</td>
</tr>
<tr>
<td>Age 65+</td>
<td>56%</td>
<td>35%</td>
<td>9%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Pension decision</th>
<th>Not accessed a pension</th>
<th>43%</th>
<th>42%</th>
<th>15%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accessed a pension</td>
<td></td>
<td>66%</td>
<td>24%</td>
<td>9%</td>
</tr>
</tbody>
</table>

---

**Fig 4. Key**
- Given it a great deal of thought
- Though about it a little
- Not really thought about it

**Fig 4. notes**

**Question:** R7. Have you thought about how you are going to manage financially when you come to retire?

**Base:** All UK adults aged 55-70 with a DC pension who have not yet retired (307)
more frequently using words such as “optimistic”, “confused”, “apprehensive”, and less frequently reporting “relaxed”, “flexible” and “pleased”.

“I must admit, I am a bit uneasy and vulnerable… I’ve definitely got those feelings when thinking about the rest of my pot. Because I haven’t planned anything and I don’t know whether I have the right amount of money… although, I am pretty sure there isn’t enough money if I were to live a longer life. And I am just unprepared for anything long term.” – Male, 57

“Everything is constantly changing with pensions. So, things will have changed again before I retire [in 5+ years] and so I need to look into what I can do nearer the time… Making a decision about what to do with the 75% is the hard one. It is all the money I have to rely on.” – Female, 64

Members felt strongly that they did not need advice to make decisions on taking their tax-free cash. The ability to take cash out was well-publicised, they understood the meaning of “tax-free”, it was clear the tax-free element was limited to 25% of their pot, and they felt that the process was straightforward under the new rules. They had often had friends or family who had been through the experience who could guide them if necessary.

“I received a letter from my provider notifying me that I could access my pension and all the options I had. But I just wanted to take the 25% and leave the rest invested. A friend of mine had done the same thing and she advised me.” – Female, 56

However, the complexities of managing their finances once they stop receiving an income is very daunting. Unprompted, they were much more likely to say that they would need some ‘advice’ to help them make decisions on the remainder, although they were unsure whether they would want to pay for this support.

“We’ll think about our retirement income when my wife gets the State Pension. Then our pots are going to come under scrutiny. We’re going to have to be cautious and take a balanced view over that decision. It is risky, because you don’t know whether you’re taking enough or too much. And it will all have to be calculated and we will get advice.” – Male, 66

Members had no firm plans for withdrawal at this stage, but would look at how much they needed to pay for their lifestyle and whether they could take money as tax-efficiently as possible. However, when probed, we found that although many were rapidly approaching full retirement, very few had a good idea how much they would need to live off.

“We’ll look at how much we need when the time comes. There is a tax implication for the rest of the money as well, so that needs to be worked out.” – Male, 66

Members are following the ‘path of least resistance’

To date, we have seen a strong body of evidence that members are consciously or unconsciously wanting to follow the ‘path of least resistance’ and this was again confirmed in our in-depth discussions. None of the respondents we spoke to in depth reported moving their pension elsewhere as their provider had allowed them to access money in the way they wanted.

But this is not always the case, and the choice architecture offered to members by their own provider is a vitally important determinant of member outcomes.

“My provider has done alright so far and I saw no reason to move” – Male, 56

“I didn’t have to do anything. I just signed some papers to get my cash out and the rest of my money is still sitting in my pension” – Female, 59

Future-proofing solutions will be key

Providers need to understand the motivations and drivers behind what is happening today, but should also be cognisant of how quickly things can change. Many of today’s retirees will have some element of final salary pension. This will further dampen demand for regular retirement income from DC. Data from our member survey shows that 22% of our respondents had accessed a DB pot and a further 12% had a DB pension which they had not yet accessed. This data is based on the member’s situation; at the household level the numbers will be even higher.

However, given the first big wave of defined benefit scheme closures came nearly twenty years ago, we probably aren’t too far away from people having to rely largely or wholly on DC for their private retirement income. Moreover, given historically low contribution rates, increased longevity and potentially lower interest rates, it seems likely that this cohort of members will need to use all their retirement savings to generate income. They are unlikely to have the flexibility to take cash in the same way that today’s retirees do.

Similarly, another factor driving the trend for cashing in is that many DC pots are still too small to generate meaningful income. As the system
Overall, pension providers see pension freedom as a good thing.
matures, perhaps helped by consolidation of pension pots, consumers will be less inclined to take cash and instead look for income. Again, data from our survey suggest that just three in ten (31%) of our survey respondents had combined DC pot sizes of more than £100k.

Of course, with such diverse levels of pensions coverage, personal and financial situations amongst current and future members, it’s impossible to generalise. This presents real challenges for pension providers and trustees in trying to decide what services to offer: We look at what providers are offering to members in more detail in the next chapter, but to help understand how they’re thinking about pension freedom, let’s first take a closer look at what they make of the changes.

**The provider’s perspective: a balancing act**

To learn what providers are thinking and doing, we conducted one-to-one interviews with the leading DC providers. Most of these are now operating master trusts, with the exception of Royal London and Hargreaves Lansdown, who use a group personal pension and group SIPP respectively as their main corporate retirement vehicle.

Overall, pension providers see pension freedom as a good thing. When asked their overall view on freedoms, providers were unanimous in their belief that pension freedom is, in general, good for consumers. However, just under half felt that pension freedom should be subject to greater controls. For most this was about putting more challenge into the system, particularly where people were cashing out in full or were likely to pay significant additional tax.

A couple of respondents did wonder whether we should consider looking again at the Minimum Income Requirement (MIR). Abolished in 2015, this required consumers to have at least £12,000pa of guaranteed retirement income before they could have full freedom to cash out retirement savings. While significantly reduced from its pre-2014 level of £20,000pa it’s worth noting that on today’s annuity rates one would need around £70,000 in DC savings4 to meet the requirement by purchasing an annuity to top up the flat-rate State Pension. Clearly, reintroducing the MIR would significantly curtail pension freedom for huge numbers of consumers.

From the member perspective, reintroducing the MIR is likely to have unintended consequences. There are already high levels of mistrust, both of the government and the industry, which are driving encashment decisions. To date, members’ actions have been tempered by the tax implications of full withdrawal. Any attempt to force members to once again buy an annuity is likely to lead to a flood of money moving out of pensions as members would rather take a tax hit than ‘give up’ their pot to purchase a guaranteed retirement income.

The biggest concern for providers is the extent to which consumers understand the choices available to them in accessing their retirement savings. This is borne out by the focus of regulators in this area and by providers prioritising development of member

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**Figure 5. How concerned are you with the following aspects of pension freedom?**

![Figure 5](image_url)

**Notes**

4 Based on the cost of a single-life level annuity of £3,210pa from age 66 for an individual in good health. Source: Money Advice Service annuity comparison tables.
engagement and guidance over other aspects of product development.

Providers were relatively more positive about members having access to advice. As we see later, many providers are offering access to advice. In some cases, this is more affordable than using a traditional independent financial adviser and in one case it is free. Despite this, take-up of financial advice is low. Whether this is down to a general unwillingness to take financial advice or a feeling that consumers taking cash don’t need advice is discussed further in chapter two.

We then asked providers to tell us how pension freedom was affecting their business and what their biggest issues were. We were surprised to learn that the additional cost of operating pension freedom was not a big issue for most. Having absorbed the significant costs of getting ready for pension freedom, most felt that the ongoing costs were manageable.

The big concern for providers is the risk that pension freedom creates. This was evenly balanced between the risk of operational errors, given the complexities of delivering retirement choices, and conduct risk. That is, the risk that providers are deemed to not be meeting their regulatory responsibilities to members.

The specific concern around conduct risk is making sure that consumers are not only made aware of the consequences of their choices but understand them. This is double-edged. Providers are both concerned that they could be charged with not providing enough guidance to members on what they should be doing, and with providing too detailed guidance and inadvertently straying in to providing advice.

An issue that is emerging for some of the more mature providers is the exit of members to retail products, usually as a result of taking financial advice. This clearly has a commercial impact on those providers, but there is also concern about whether members are really benefiting. In many, if not most cases, transferring to retail products will mean higher product charges are payable. While retail products may offer greater fund choice and flexibility, it does not necessarily follow that they will benefit members sufficiently to justify these higher costs.

The FCA’s attitude here seems to be hardening, with their recent consultation on defined benefit transfers highlighting that many transferees might be better off transferring to a workplace pension than to an individual retail product. It’s a simple extension of this logic to question whether transfers from workplace schemes to retail products are always justified. Expect a big push back from advisers in this area, but it’s clearly an issue the regulator will be watching. We can also expect providers will be doing their best to counter this by promoting consolidation into the plans they operate.

**Build it and they will come (or will they?)**

A simple way to incur the wrath of a product provider is to ask if they agree with the charge from the FCA and others that there has been little innovation since

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**Figure 6. As a business, what are the greatest challenges pension freedom creates for you?**

<table>
<thead>
<tr>
<th>Challenge</th>
<th>Number of providers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increased costs of administration</td>
<td>13</td>
</tr>
<tr>
<td>Increased costs of communication/customer service</td>
<td>12</td>
</tr>
<tr>
<td>Increased costs of product development and/or “crowding out” of other development</td>
<td>10</td>
</tr>
<tr>
<td>Increased operational risk (eg making administration errors)</td>
<td>9</td>
</tr>
<tr>
<td>Increased conduct risk (eg misdirecting customers)</td>
<td>7</td>
</tr>
<tr>
<td>Lower persistency (eg early encashment and/or transfer away)</td>
<td>6</td>
</tr>
<tr>
<td>Dealing with legacy customers</td>
<td>5</td>
</tr>
</tbody>
</table>

---

*Fig 6. key*

- **Not an issue**
- **Somewhat an issue**
- **Significant issue**
pension freedom. Many will point to how they managed to completely overhaul their retirement capabilities to deliver pension freedom in the twelve months George Osborne gave between announcement and implementation. This was all the more laudable given that rules on member journeys were still being decided in early 2015, just months before the go live date.

Beyond this though, many firms have invested heavily in improving their retirement offerings. Much of this, as we see later, has been focused on improving engagement and member support at retirement rather than developing new products. Many argued that we have the products we need, and the real challenge is combining these effectively to meet specific member needs.

Although providers report they are focusing on improving communications and engagement, the members we spoke to felt that these efforts have had little or no impact on them. They had already decided what to do before contacting their provider, as a result had a very transactional interaction centred around correctly filling out the forms to take their money out. They did not recall any interventions to ask them any questions about how they planned to use the rest of the money, and most could not remember being asked about their investment preferences. These findings are broadly aligned with the findings from qualitative work to inform the FCA's Retirement Outcomes Review.

“My provider did send me some stuff but getting the money [TFC] out was just ticking a box and signing. It would be good if they could help you plan more, make you think a bit about how it will all work out.” – Male, 57

Some firms have started building frameworks to help members think about their retirement objectives and how these translate into products. One of the biggest challenges though is the level and certainty of demand for these frameworks given the focus on cash, the relatively low average pot size in DC and the overhang of guaranteed income from defined benefit plans. It seems inevitable that more consumers will need help in building a realistic retirement plan, but demand is still limited at present.

Beyond the level and certainty of demand, many providers are concerned that the constant flow of regulatory change is making it increasingly difficult for firms to build out their retirement propositions as quickly as they would like. Master trust authorisation has clearly weighed heavily on management time, which has been challenging for some of the leaner master trust providers. There is also concern that regulation around retirement could be overly prescriptive. While many see the FCA’s rules on investment pathways as being helpful, there is some understandable concern that lifting these into the occupational pensions world may limit innovation in master trusts in particular.

Providers also need to consider their broader business priorities. There's no point having a great retirement proposition if you haven't got any members to use it. The focus for most providers remains on winning new schemes and development efforts will be focused on improving the offer to these schemes. While providers were reasonably unanimous that retirement capabilities are important in attracting new clients, they are not the only consideration.

Having said this, a growing number of master trusts are looking at the opportunity to partner with existing trust-based plans to provide at retirement services. This helps overcome some of the challenges for the single trust plans that we discuss below, while delivering master trusts new members with relatively large pension pots. We expect this will be a growing trend and should underpin providers’ commitment to developing their retirement offerings more quickly than they otherwise would.

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**Figure 7. What do you see as the barriers to greater innovation in decumulation for your business?**

<table>
<thead>
<tr>
<th>Barriers to Innovation</th>
<th>Number of Providers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Organisational capabilities</td>
<td>2</td>
</tr>
<tr>
<td>Level of demand (ie how many people need new development)</td>
<td>4</td>
</tr>
<tr>
<td>Certainty of demand (ie confidence that development will be used)</td>
<td>6</td>
</tr>
<tr>
<td>Cost of development</td>
<td>8</td>
</tr>
<tr>
<td>Regulatory development “crowding out” other development</td>
<td>10</td>
</tr>
<tr>
<td>Wider business priorities</td>
<td>12</td>
</tr>
</tbody>
</table>

![Figure 7 key](image.png)
Trustees are grappling with understanding where their responsibilities lie and how to meet them

The concern about expanding the scope of fiduciary liability is understandable. In fact, the concern is not just around operating drawdown in plan. Where drawdown is not to be offered, recommending a preferred provider for it, particularly retail pension providers, worries trustees. Similarly, recommending a preferred adviser to help members manage retirement also presents challenges. The situation is not helped by a perceived lack of guidance from the DWP and the Pensions Regulator (tPR) on what is expected of occupational schemes in this regard.

Even where pension schemes are using providers who can provide income drawdown within the plan at no extra cost, trustees are not always comfortable offering it. One such provider told us that around half of the single trust schemes that they operate still don’t offer full flexibility.

Unfortunately, not offering full flexibility can also present challenges for schemes and their members. Where schemes only offer the facility to cash out in full, members may end up taking more cash, and perhaps paying more tax, than they really need. Even if a member transfers out to a more flexible product, this could have negative consequences. Taking cash or transferring out will often mean active members ceasing membership, so missing out on future contributions and, in some cases, life cover. Even if members are entitled to re-join the plan, this may be at lower contribution rates than they’d previously enjoyed.

Trustees then are in an invidious position. Not offering access to full flexibility may impact member interests. Even when the trustees are keen to implement greater flexibility within the pension scheme the plan sponsor may not be prepared to take on the extra risk and potential cost of doing so. Providing clear direction to third parties for these services also creates challenges. How can this be solved?

One way is to make use of a master trust alongside the main trust. Members wishing to go into drawdown can have all or part of their fund transferred to the master trust where they can access their pension savings flexibly. While this arrangement still involves recommending a provider, it seems that many trustees are more comfortable referring to a trustee-governed service than a retail product. Moreover, master trusts may provide the scope for greater integration between the main plan and the retirement offering allowing a consolidated view of member accounts and, perhaps, some continuity of investment.

The DWP is considering if and how it might import the remedies stemming from the Retirement Outcomes Review into the occupational pensions arena. Requiring all schemes to offer full flexibility themselves feels like an extreme step. However, requiring schemes to provide clear pathways to flexibility through directing members towards a master trust could be a way forward. Trustees would still need to consider carefully who they partner with and might still want a “safe harbour” protection from taking responsibility for the retirement provider. This may be easier to achieve where the retirement service is being managed by schemes that tPR has directly authorised and is overseeing.

A very complicated picture

Pensions have always been complicated, or at least it seems that way. But this complexity often stems from underlying rules which, while difficult to navigate, are generally certain. The rules around pension freedom are, in themselves, relatively simple. However, by opening up how pension savings can be used at retirement we are now tackling a much trickier issue – dealing with individual human behaviour.

We’ve seen that while members have a clear understanding of taking cash from their pensions, they are giving little real thought to future retirement plans. Trustees are grappling with understanding where their responsibilities lie and how to meet them. Amongst all of this, providers are trying to build products and services that work not just for those retiring today but for the next generation, who are likely to have very different retirement needs.
Three approaches to pension freedom

**RBS Group Retirement Savings Plan: integrating with a master trust to provide flexible income**

The RBS Plan covers just over 60,000 members with £1.1 billion of assets. The Plan decided that it did not want to offer drawdown in plan but instead to partner with its administration provider, Legal & General. Members wanting to take a flexible income in retirement can transfer to the Legal & General master trust where they will be invested in Legal & General’s Retirement Income Multi Asset (RIMA) Fund.

The RBS Plan changed its default investment strategy to target flexible income in 2017. Member investments are gradually switched into the Legal & General RIMA fund as their selected retirement date approaches. Members wanting to take flexible income have their assets transferred in specie from the main Plan to the Legal & General master trust. This maintains continuity of investment and, crucially, keeps transaction costs to a minimum.

Because Legal & General also provides the main Plan administration, member engagement is consistent between the main Plan and the master trust. This provides continuity of the member experience including planning tools. Members are also able to access affordable advice at retirement through Legal & General’s strategic partnership with LV.

**Refinitiv UK Retirement Plan: offering drawdown within the scheme**

The Refinitiv UK Retirement Plan covers around 12,000 current and ex-employees with around £580m in assets. Administration is outsourced to a third party and investments are managed using an investment-only platform.

Refinitiv conducted an in-depth analysis of its membership and identified that a large proportion of members would be retiring with relatively large retirement pots and so were likely to want access to flexible income at retirement. In thinking about how to provide this, the trustees and business were guided by Refinitiv’s purpose of “empowering customers to act with confidence in a complex world” and by its values of trust, partnership, innovation and performance. This led the trustees, with the backing of the firm, to choose to offer drawdown within the main plan rather than partner with a preferred provider.

The trustees believe that offering members a simple and straightforward drawdown facility offers members a range of benefits:

- Cost – more cost effective for members to remain in the scheme than transfer out into a retail arrangement
- Continuity – long-term strategy planning aided by continued investment in institutional funds
- Convenience – to take advantage of the new flexibilities without the need to transfer out

The Plan also provides member support at retirement through seminars for active members on reaching age 50, a more in-depth seminar as retirement approaches and access to advice through a partnership with Wealth at Work.

**Tesco Retirement Savings Plan: designing retirement options to meet colleagues’ needs**

Tesco introduced its Retirement Savings Plan in November 2015 when it closed its defined benefit scheme. The Plan is administered through the Legal & General master trust. With around 220,000 contributory members and 340,000 members in total, the retailer is thinking creatively about how to support its people at retirement particularly in delivering retirement income from the savings they’ve made. To deliver an income for life, the proposition being developed aims to combine drawdown underpinned by income generating assets with an annuity after a certain age. The communication and engagement piece sitting across this proposition is also being carefully developed to help manage the under and, particularly, the over-spending risk.

Development work is continuing which is being influenced by member research.
2: How have providers delivered pension freedoms?

What freedoms are providers offering?
As we saw earlier, much of the activity following pension freedom has been members taking cash either by cashing-out in full or taking their tax-free cash. Unsurprisingly, all firms offer the ability to cash out completely but not all use the UFPLS approach. Standard Life achieves the same outcome but through transitioning the client seamlessly through drawdown.

Once we get beyond full encashment, we start to find that more providers don’t offer the flexibilities at all or require a transfer to a personal pension or SIPP they operate (see Figure 8 overleaf). In one case, flexibilities are offered through transferring to a personal pension operated by a firm the master trust partners with.

While not offering flexible access by any method may seem restrictive, the reality is that for these providers there is little or no demand, typically because they have been focused on the automatic enrolment market and member balances are still small. Despite this, all are looking at introducing flexibility at some point in the future and certainly ahead of any reasonable level of demand.

Finally, we see that not all providers are offering an annuity purchase facility. Again though, this reflects demand, with those providers generally still having average pot sizes way below the level at which one might reasonably consider annuity purchase.

Restrictions on pension freedoms
When George Osborne said he wanted people to “be able to use pensions like bank accounts”, many pension providers were horrified. Leaving aside the argument about whether one should think of retirement savings in this way, the prospect of people making multiple small withdrawals would mean a huge increase in administration for providers. As a result, many introduced a minimum withdrawal amount or limited the frequency with which withdrawals could be made.

In practice, the idea of using your pension like a bank account was always a non-starter. Why not just take pension cash out and put it in a bank account? That is exactly what many have done. As a result, over the years these restrictions have largely fallen away. Three providers do still have a minimum lump sum limit of £1,000 or more but most have no limit or a nominal £100. A few also have a notional limit on how many times you can take a lump sum in a year. However, these are generally not applied but are rather included in the rules to put members off taking multiple withdrawals.
More interesting though is that three providers still operate a minimum account size for drawdown. One of these is a nominal £1,000 while the others are in excess of £25,000. While operating regular income payment comes at a cost, restricting drawdown means that members may not be able to use drawdown to just take tax-free cash. The consequence will be that they must either transfer away or cash out completely. If they cash out, not only will they be paying tax on money they didn’t want in the first place, but they could easily be pushed into a higher tax bracket and so pay even more tax than they need to.

Charges for accessing benefits
In general, few providers are levying any additional charges for accessing benefits. Even where firms are offering flexible access through other products they offer, this does not necessarily result in a higher administration charge, at least at the outset. Those using this approach tend to preserve the underlying DC scheme pricing for members within the receiving individual pension product, provided they are only taking lump sums. The member may pay higher fund charges depending on the investment option chosen, though. However, two firms will move members on to the standard retail product charge if they want to take regular income.

Two firms do have higher administration charges for those taking income within the master trust. One takes the form of a higher member charge while another operates a minimum fee meaning that those with smaller balances in drawdown could end up paying a reasonably sizeable fee.

Overall though, accessing pension freedoms within a workplace plan will be very cost-effective compared to transferring to a retail pension product. No doubt financial advisers will argue that retail pension products offer greater investment flexibility, and this may be true. Whether this flexibility is of sufficient value to the member is debatable, and as master trusts become more sophisticated in their post-retirement offerings, we expect advisers will find it much harder to justify transfers out.

Helping members make retirement choices
All the providers that are offering members some choice of how they take benefits provide plenty of help on what options are available.

Despite this, members reported limited take up of these services as they had already made their mind up what to do by the time they got in contact with their provider.

“I knew you could take the tax-free money. It was all over the papers and the news. So I didn’t need to look into it any further.” – Male, 66

The FCA Retirement Outcomes Review requires FCA-regulated providers to start communicating with members on their retirement choices at age 50 and it’s pleasing to see that over half of the providers we spoke to are already doing this. The hope is that this will encourage members to explore

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**Figure 8. Pension freedoms offered**

<table>
<thead>
<tr>
<th>Benefit Type</th>
<th>Available in the main workplace plan</th>
<th>Available through transfer to another product we operate</th>
<th>Transfer to a product operated by a partner</th>
<th>Not available</th>
</tr>
</thead>
<tbody>
<tr>
<td>Full encashment via UFPLS</td>
<td>✔️</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
</tr>
<tr>
<td>Full encashment via drawdown</td>
<td>✔️</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
</tr>
<tr>
<td>Partial UFPLS</td>
<td>✔️</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
</tr>
<tr>
<td>Tax-free cash withdrawal</td>
<td>✔️</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
</tr>
<tr>
<td>Lump sum withdrawal via drawdown</td>
<td>✔️</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
</tr>
<tr>
<td>Regular income payment via drawdown</td>
<td>✔️</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
</tr>
<tr>
<td>Annuity purchase</td>
<td>✔️</td>
<td>✗</td>
<td>✗</td>
<td>✗</td>
</tr>
</tbody>
</table>

---

Number of providers
their options in more detail before settling on a particular course of action.

All providers offered telephone support to members considering their retirement choices, though the level of service does vary. Some of the larger firms have created dedicated teams specialising in retirement to handle these enquiries. However, only a handful of firms were able to say that members received a guided conversation. That is, they are systematically talked through their retirement options.

Members are well served online with most providers offering tools that help them compare different ways of accessing their savings. However, most providers conceded that these tools weren’t built into a single journey that would help members think about how best to use their retirement savings to support the lifestyle they desired.

Several providers are developing frameworks that will help people think about how they can organise their retirement savings to meet their needs at different life stages. Legal & General has developed

---

**Figure 9: Restrictions on accessing retirement savings**

<table>
<thead>
<tr>
<th>Feature</th>
<th>Number of Providers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minimum ad hoc lump sum</td>
<td></td>
</tr>
<tr>
<td>Limit on number of ad hoc</td>
<td></td>
</tr>
<tr>
<td>withdrawals</td>
<td></td>
</tr>
<tr>
<td>Minimum residual value</td>
<td></td>
</tr>
<tr>
<td>Minimum for drawdown</td>
<td></td>
</tr>
</tbody>
</table>

**Figure 10: Availability of online tools**

<table>
<thead>
<tr>
<th>Tool</th>
<th>Number of Providers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retirement modelling tool (ie how much income will I get at retirement)</td>
<td></td>
</tr>
<tr>
<td>Budgeting tool (ie how much income do I need in retirement)</td>
<td></td>
</tr>
<tr>
<td>Income comparison tool (ie how much income could I get from different retirement options)</td>
<td></td>
</tr>
<tr>
<td>Income drawdown tool (ie how much income can I get/how long will my money last)</td>
<td></td>
</tr>
</tbody>
</table>

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a four-pot model that divides members’ retirement needs between active years’ income, later years’ income, inheritance and rainy-day funds. Others are looking at frameworks that divide income needs between essential and discretionary expenses. As we see later, these types of framework will be essential in helping members think more clearly about retirement.

“I took that chunk of money out for my daughter’s wedding. You could get the first 25% tax free, my daughter was getting married. It all fell into place, so I just did it.” – Male 57

Access to advice
It may come as a surprise to see how many providers are now providing access to advice alongside their retirement offering. Only five of the firms we spoke to do not provide any specific support for members seeking advice and, as before, a good number of these have relatively low-value accounts where advice is likely to be neither necessary nor affordable.

We have yet to see the explosion in “robo advice” in the retirement sector that was expected a few years ago. Those who have tried to create full robo solutions have perhaps recognised that the nuances of gathering information about client circumstances online is challenging, even if automating the advice approach is achievable. Some firms are still looking at robo solutions for at least part of their advice offering. For others it is more about how technology can be employed to codify and automate the advice process, so reducing costs and improving accessibility.

Not all the providers who offered advice disclosed their fees, with two saying this was a matter for negotiation. For those that did provide details, we calculated the cost of basic advice in relation to how to deal with a DC pot of £50,000 at retirement. Advice is relatively affordable in many cases and one provider, LifeSight, does not charge for advice at all. However, even where advice is available at a low cost, member take up is relatively muted. Several reasons for this were suggested:

- A general lack of understanding and appreciation of the value of advice
- Relatively few members are really planning retirement at this stage, rather they are just taking cash and see this as something they don’t need help with
- Those who are inclined to take advice may already have their own financial adviser.

There was concern across all providers that members are making decisions in silos. That is, thinking about each of their pension pots in isolation rather than considering their overall position. This view is supported by our survey, where one in five (20%) of those who had made an access decision since 2015 could not say how much was left in their combined DC pension pots.

Advice will help here but if people are unwilling or unable to access it then we must look elsewhere. The pensions dashboard is a key enabler for this, but scepticism remains on when this will come to life. A few firms are trying to move this forward themselves, integrating data aggregation and open banking into their platforms to provide a more holistic view.

**Figure 11. Access to advice at retirement**

<table>
<thead>
<tr>
<th>Advice not offered, member has to arrange this themselves</th>
<th>Advice offered through referral to a third party we partner with</th>
<th>Advice offered by us or a company within our business</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>3</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>6</td>
<td>7</td>
<td></td>
</tr>
</tbody>
</table>
Figure 12: Channels through which advice is offered

- Online
- Telephone
- Face-to-face

Figure 13: Cost of retirement advice for pot of £50,000

- £0
- £500
- £1,000
- £1,500
- £2,000
- £2,500
- £3,000
- £3,500
- £4,000

Number of providers
The portal allows users to pull together assets held outside the Mercer master trust, and transaction data from bank accounts and credit cards.
Mercer has partnered with Moneyhub to create the Mercer Money portal for workplace members. Mercer’s aim is to combine personal financial data with easy-to-use tools to help members make financial decisions that can be actioned immediately, so avoiding the tendency to put off action for another day.

The portal allows users to pull together not just details of assets held outside of the Mercer master trust, but to also bring in transaction data from bank accounts and credit cards. Together a member can keep track of their overall wealth, income and spending in one place.

Mercer and Moneyhub have collaborated to build a new retirement module that builds on the underlying data to help members manage their retirement options. By pulling through actual spending data it provides a real-life starting point for setting future retirement income needs. Mercer has also incorporated the recently launched PLSA Retirement Living Standards into the portal to help members model what income they might need.

The retirement module also allows members to see how long their retirement assets might last providing suggestions of actions they could take if this falls short of expectations. Many of these suggestions can be actioned immediately through integration of the portal with the underlying pension record keeping systems.
“My pension is still invested with [my provider], but I don’t remember them asking me how I was going to use my money. I would hope they are not taking too much risk.” – Male, 57
Investing ahead of retirement

Pension freedom has created challenges, not just at retirement but also in how members’ savings are invested approaching retirement. Prior to the changes, default lifestyle arrangements invariably targeted annuity purchase. The majority now target flexible income with some, mainly the auto-enrolment-oriented master trusts, targeting cash. Others use a lifestyle strategy that aims to de-risk members to a diversified asset mix that doesn’t directly reflect any particular benefit choice but instead aims to be broadly appropriate whether members take cash, buy an annuity or remain invested.

The main challenge of lifestyle has always been getting members to make sure the retirement date they were targeting was accurate. Of course, some members will retire earlier than anticipated, either by choice or necessity others simply don’t respond to retirement communications, leaving their benefits with the provider long after their chosen retirement date.

This means that the de-risking inherent in lifestyle strategies is not always effective. Members retiring earlier than expected will still be exposed to market volatility while those retiring later will have missed out on potential growth. Now that members have flexibility over not just when they take their retirement savings, but the form in which they take it, designing DC defaults has become even more complex.

Some providers have tried to address this by asking members some time before retirement how they wish to take their benefits. This is typically done just before the de-risking phase starts.

Those who choose to do something different from the default are switched to alternative strategies targeting either an annuity or cash.

This “multiple lifestyle” approach is offered by two-thirds of the providers we surveyed. However, most told us that few members respond to the communication ahead of de-risking and so remain in the default lifestyle strategy. Of course, it’s impossible to know whether this is because they’re happy with this arrangement or just fail to engage with the question.

This finding was again supported by what we heard directly from members.

“*My pension is still invested with them, but I don’t remember them asking me how I was going to use my money. I would hope they are not taking too much risk with it*” – Male, 57

Legal and General has, interestingly, moved away from using a default lifestyle altogether. Members are invested in a multi-asset strategy that is specifically designed to cater for a variety of benefit choices. As they approach their selected retirement date, members are contacted to see if they have decided how they wish to take their benefits. Those that have are moved into a lifestyle strategy that reflects this choice, while those that don’t remain in the core multi-asset fund.

Lifestyle design becomes even more complicated when people aren’t accessing all their benefits at

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**Figure 14: Target benefit option for default lifestyle option**
once. Some members will take their tax-free cash before their selected “retirement date”, perhaps a long time before that date. They may not then access the rest until, or even after, their retirement date. This raises the challenge of if and how we design for early access but also how the remaining pot is invested.

Many providers have designed their defaults to reflect that 25% of the account will be used to take tax-free cash by either making an explicit allocation to cash or holding other “low-risk” assets. Except for a few providers, members who take tax-free cash remain invested in the default after doing so. Few of the providers who do this adjust the lifestyle strategy to reflect this. As a result, members who take tax-free cash early may be investing more conservatively than they need to.

Attitudes to investment pathways
The investment pathways proposed by the FCA are intended to ensure that members who take tax-free cash invest the remainder of their savings appropriately. Members will be asked to choose between using their remaining savings for flexible income, guaranteed income or cash in the next five years or to leave them untouched for the next five years. Providers will then allocate the member’s remaining savings to investment options that are designed to match this benefit choice. These investment options should then reflect the fact that tax-free cash has already been taken and so provide members with a more appropriate asset mix than simply leaving them in the main scheme default.

Of course, most master trust providers won’t be subject to the FCA rules although the DWP and tPR are considering if and how they might be applied to this sector. However, many providers believe that they already offer something similar or that their multiple pathways approach to lifestyle could be easily adapted. Most others told us they would be adopting pathways in any case with only two providers saying they would wait to launch pathways until they were required to do so.

Taking income in retirement
As discussed above, many of those who are in drawdown are taking no income and may not do so for some time to come. It is perhaps not surprising then that few providers have focused heavily on designing a range of retirement income investment options. Most of those offering a lifestyle option targeting drawdown will keep members invested in the target asset mix after retirement. These are generally designed to provide an element of growth potential to support sustainable income while being well diversified to limit downside risk. In general, it is only those who use personal pensions or SIPPs to provide drawdown capability that will require members to select specific funds for drawdown. A notable exception to this is the Crystal Master Trust operated by Evolve Pensions, which has a range of drawdown investment solutions that are designed to reflect the form of income taken.

We also found that providers generally do not offer members much direction on the level of income they should take from drawdown. Most of those offering drawdown have online tools that will help members model different withdrawal rates, showing them how long they might expect their money to last under different market conditions. However, in many cases, these tools have yet to be built into ongoing communications that will help members manage income levels through retirement. We see this as an area where much more development is needed. Indeed, a number of those we spoke to are already developing more targeted communications to help members better understand how long income might last and to prompt them to consider how they might need to adjust their plans as time progresses.

Figure 15. Approach to offering the FCA’s investment pathways
Crystal Master Trust: matching investment options to withdrawal strategies

The Crystal Master Trust has recognised that those using drawdown may have very different approaches to taking income. Some may want to create a sustainable lifetime income, some may be using drawdown as a temporary income ahead of buying an annuity and others may be taking no income at all. To cater for this, Crystal has built an easy-to-use online journey to identify a member’s income needs and married this with a set of investment options designed specifically to support the chosen strategy.

The plan offers members a choice of four drawdown options:

**Aqua**: allows members to set a specific level of income they wish to take each month. Invests in Alliance Bernstein’s Target Date Funds that continue to roll-down after retirement.

**Jade**: aims to pay an income equivalent to a non-escalating joint life annuity to age 75 and provide a sum at this age that will allow them to buy an annuity at broadly the same income level. Invests in Alliance Bernstein’s Retirement Bridge Funds that manage asset allocation and risk against an annuity benchmark based on a member’s age.

**Onyx**: pays the natural income from the underlying diversified fund that aims to provide income and some growth while protecting capital values.

**Ruby**: used for those wishing to not take income but instead take ad hoc withdrawals. Like Aqua, invests in Alliance Bernstein’s Target Date Funds.

Members select their chosen income profile through the Crystal Drawdown Quotation Tool. The tool asks three simple questions – do you want income, do you want it to last for a period or your lifetime and do you want to decide the level of income? It then provides an illustration of each drawdown option as shown below.

The Crystal Closest to Your Requirements is

**Aqua**
- Tax Free Lump Sum: £0.00
- Gross Monthly Income: £250.00
- Including a tax-free element of: £0.00
- Annual Equivalent: £3,000.00
- Fund expected to last (approx) beyond 100 years old

**Jade**
- Tax Free Lump Sum: £0.00
- Gross Monthly Income: £325.00
- Including a tax-free element of: £0.00
- Annual Equivalent: £3,900.00
- Expected Fund at 75: £87,973.00

**Onyx**
- Tax Free Lump Sum: £0.00
- Gross Monthly Income: £195.00
- Including a tax-free element of: £0.00
- Annual Equivalent: £2,340.00
- Expected Fund at 75: £110,200.00

**Ruby**
- Tax Free Lump Sum: £0.00
- You can request lump sums from your fund at any time. If you do not make any further withdrawals your expected fund at 75 is £138,211.00

Source: Evolve
Pensions based on a drawdown pot of £100,000 accessed at age 65.
“Where the financial services industry has consistently gone wrong is thinking this is about product. It’s not about product, it’s about outcome.”

– A pension provider
Future development
All the providers we spoke to see improving their retirement offerings over the next three years as a priority. Naturally, those with more mature DC books have it closer to the top of their agenda than those who are still trying to build scale in this market.

While there is a huge range of developments under consideration, these can be grouped into three key themes.

Developing retirement product capabilities
Those who aren’t currently offering drawdown are generally looking to do so soon. This is being driven perhaps more by employer demand for completeness of offering than direct member demand. Moreover, the ability to offer drawdown within the master trust is a key consideration for those that don’t do it today.

Improving member engagement and support
“In the rush to get pension freedom done there’s been a lot of focus on first access support. As an industry we probably need to focus more on post-access support especially with so many customers now in drawdown.” – A pension provider

It’s clear that there is a long way to go in helping members make retirement choices. The Retirement Outcomes Review has introduced requirements about how firms guide members towards choosing their retirement objectives. While master trusts are not necessarily bound by these rules, many are using this as a platform to further develop their guidance propositions.

A further theme here is around how guidance can be developed to be more holistic, bringing in not just other pension savings but other elements of a member’s wealth. This should be a welcome development for members but also represents a clear commercial opportunity for providers to both retain and grow their existing business.

Enhancing retirement investment options
“We’ll need to continue to tweak the retirement investment proposition. We’re looking at how we incorporate ESG into this for example.” – A pension provider

The introduction of investment pathways will mean that most providers will be looking at how they structure investment options in and at retirement over the next twelve months. Beyond this though, several of them recognise that more work is needed on developing investment options for drawdown that go beyond a simple, cautious multi-asset approach. Using alternative asset classes to provide diversification and income sustainability and considering how ESG can be incorporated into retirement investments are two key themes here.

What’s getting in the way?
There is no doubt that providers are committed to developing their retirement offerings. They see this as not only the right thing to do for members but as a commercial necessity. Concern remains though around future regulation. This was expressed in several ways.

While the remedies under the Retirement Outcomes Review have been welcomed by most, they will require significant development over the next twelve months and beyond. This will absorb large parts of development budgets that might otherwise be used to develop provider propositions.

The trick will be how to build investment pathways in a way that really moves the member experience forward rather than just complying with the rules.

“Alignment between FCA and tPR on the regulatory landscape is crucial. If they don’t do it the same way, that will be a big challenge.” – A pension provider

Finally, inconsistency between the FCA and tPR around retirement is unsettling some. We know that the DWP is looking at it and how it incorporates the Retirement Outcomes Review remedies into occupational schemes. It will be interesting to see how this develops and whether the decision here sets a course for greater regulatory alignment going forward. Many will argue though that there are significant differences between occupational schemes and FCA regulated products that mean they should be treated differently. This may be true to an extent, but members don’t really understand or distinguish between product structures. It will be worth considering how any continued divergence in rules manifests itself at the member level and whether it adds value or simply serves to confuse.

Understanding what members really want and need will be at the heart of any future development. Let us now turn to this in more detail.

“In the rush to get pension freedom done there’s been a lot of focus on first access support. As an industry we probably need to focus more on post-access support especially with so many customers now in drawdown.” – A pension provider
Retirement planning is complex. How do you balance the needs of early retirement with those of later life, the desire for flexibility with the need for certainty and the potential for reward against the capacity to manage loss? Answering these questions at an individual level is difficult enough but trying to solve the problem across a whole range of members, all with their own personal circumstances, needs and aspirations, is hugely challenging.

We’ve seen that, by and large, providers have got much of the product functionality that they need for retirement. What seems to be missing is a way of engaging consumers and taking them on a journey towards building a retirement plan that is right for them. Affordable advice will hopefully be the answer for more people than it is today, but we must be realistic that, at present, the majority may choose not to take advice. How then can providers structure their retirement propositions to best serve members?

There is plenty of theory on how to build a successful retirement plan. Much of it involves combining guaranteed income sources with flexible income through drawdown. But, whatever the theory, any plan will need to take into account the attitudes and biases that members have around retirement. There are many examples of retirement propositions that looked good on paper, but which failed because they were built on a perceived belief of what people needed rather than what they wanted.

In this chapter, we explore further the feedback we got from our consumer research and consider how this might inform what providers and trustees offer their members. Of course, schemes and providers may have very different mixes of member types. What is right for one may not be so helpful for another. We hope though that the insight is useful in highlighting where the challenges lie and perhaps how we might solve them.

Anyone for an annuity?
A core premise of many retirement plans is that people should have enough guaranteed income to meet their essential living expenses. This is an approach often referred to as “safety-first”. In a simple exercise to identify essential expenditure, non-retired members in both the qualitative and quantitative elements of our research consistently reported they will need around £20k a year to live off (excluding housing costs), and fewer than one
in ten (7%) of our non-retired survey respondents said they would need more than £30k to cover their basics.

Perhaps more worryingly, overall 17% of our survey respondents had no idea how much they would need, rising to 24% amongst the 55-59 year olds. Members taking part in the depth discussions felt that spending some time thinking about income needs was very useful in framing their future decisions, and that the PLSA's Retirement Living Standards would provide a very valuable rule of thumb for them to work out their own situation.

Consider somebody retiring today. A household with two adults qualifying for the full State Pension will receive nearly £17,600 a year. They would therefore need an extra £2,400 or so of income to meet their basic needs. If they don’t have any final salary pensions or employment income, then it might make sense for them to buy an annuity with their DC savings. Assuming a current annuity rate of around 2.2% for an inflation-linked annuity from age 66 (yes, it really is that low), they would need £112,000.

We can quickly see a number of challenges with this “safety-first” approach.

First, that’s a lot of money and is likely to be a lot more than many people have in retirement savings, even if we assume they don’t take any tax-free cash. Second, the rate is incredibly low compared to what one could get from even a very cautious drawdown plan (see later). But, perhaps most importantly, members are still very wary of annuities as our research told us.

Here, we heard the same well-rehearsed issues with annuities; members are not keen on locking money away, they are currently getting a ‘pittance’ as an income, there is no flexibility to change your mind if circumstances change, and annuities are generally still getting bad press. For a minority, annuities are not acceptable as they are simply not ‘fair’; members baulk at the idea of others in the pool (or the provider) getting their money if they die.

“Annuity rates are so poor these days. I’ve just never fancied annuities. They stop on the day you die. So if I die six months down the line… I know you can get them in joint names, payable to the second one that dies, but that’s at a reduced rate. You know, what if we both died in a plane crash six months down the line?! They’re too inflexible, I don’t like them.” – Male, 66

“Whereas I could have a guaranteed annuity for my life, I am also aware that anything can happen and I might only last ten years. And a part of me thinks, why don’t you invest part of the money that you’ve got into another property? Then you’ve got no mortgage and I could leave it as an inheritance and it would give me an income. So it’s whether I want to have a guaranteed income regardless, or whether I take that gamble. And I am leaning towards that gamble, because I know I’ll make some money, it just depends how much.” – Female, 57

That said, annuities appear to be more popular the older you get. Our survey suggests that
Although just 3% of those aged 55-59 plan to buy an annuity, this increases to 10% amongst the 60-64 year olds. This finding is also supported by the FCA data, which reports that 55% of annuities in 2018/19 were taken out by plan holders aged 65 and over.

Annuity rates have been in decline for many years, driven by a combination of increasing longevity and lower interest rates. This has been further worsened by reducing competition with only a handful of providers now in the market, post-pension freedom. The FCA concludes that “the market for annuities is very concentrated - annuities were bought from 23 providers and the top 5 providers accounted for 4 in 5 annuity purchases”.

Another big factor must be the growth of underwritten annuities. As those with lifestyle or medical conditions can now get a higher income from an annuity, those who are in good health will not benefit so much from the pooling of risk, meaning they will get lower rates.

So, while the logic of “safety-first” seems plausible, the reality of the cost of guarantees and member attitudes suggest it will be a tough sell. Paradoxically, it may be a harder sell for those with lower levels of savings who arguably need this protection the most.

But the idea of using annuities in retirement is, of course, not out of the question. What may be more acceptable is using annuities in later-life. Then, perhaps, needs may be more modest, and rates may be higher due to ill-health or even, in the future, higher interest rates. Coupled with this, people may value certainty more highly and may be more optimistic of the value annuities offer.

It does seem difficult though to imagine that people will want to consider later-life deferred annuities. That is, annuities that are bought at or before retirement, but which come into payment at a much later age. These products have been talked about a lot in recent years but seem very costly to deliver for a variety of reasons, not least of which is the capital cost for insurers in providing them.

An approach which sets aside part of a member’s retirement savings within a drawdown plan for future annuity purchase could be more acceptable. This is essentially the approach proposed in the NEST Retirement Blueprint and advocated in Legal & General’s four-pot model. It is also the way in which the Tesco Pension Plan is looking to structure its core retirement option. Not only does this mean savings are not lost if the member doesn’t survive into later-life but it also allows for greater certainty in managing retirement savings in drawdown in the intervening period, a topic we discuss further below.

By trying to make sure we can deliver a rising income that will last a lifetime in most, if not all, market scenarios, we are forced to opt for a relatively low starting income.

Avoiding unintended consequences

Beyond the tax-free lump sum, the majority of members we spoke to very much viewed the remaining DC pension money as money to live off in retirement. They had no ambition to be able to pass money on to their dependents (indeed, most did not know what happened to any pension money if they died before their pot was depleted) and reported that in an ideal world they would run out of money on the day they died.

“It’s probably best if you don’t have any pension money left in your old age. Never thought of it as an inheritance. And if you’ve got it there and need care, they will take that money and you might end up in a home with a guy in the same room as you and the state is paying for his care.” – Male, 58

“We don’t need to have any left over when we die... the kids will have the house.” – Male, 67

We’ll come back to the idea of housing wealth shortly but the fact that few see their pensions as a way of passing on wealth raises some questions about how we have tended to think about using drawdown for retirement income.

Much of the discussion of drawdown is centred on creating a sustainable lifetime income. What do we mean by this? Generally, it means an income that will rise in line with inflation each year and not run out before we die.

The reality is that drawdown can be a pretty inefficient way of creating a sustainable lifetime income. This inefficiency comes from trying to deliver certainty from a product that is, by definition, uncertain. Uncertainty comes both from how long somebody might live but also how markets will perform. By trying to make sure we can deliver a rising income that will last a lifetime in most, if not all market scenarios, we are forced to opt for a relatively low starting income.

This gives us two problems. Firstly, we may again find that the income we can generate in this way falls short of what people need in retirement. Secondly, by aiming for a high probability that people won’t run out of money, we are, by definition, also aiming for a high probability that they will leave money behind. As we’ve already heard, leaving money behind is not a priority for most people and so represents a bad outcome. Any money left behind could have been enjoyed while the member was still alive.
One conclusion we can draw from all this is that we shouldn’t assume that members want a lifetime income at all.
Before we fully open this can of worms, let’s look at what our research tells us about how people might be thinking about this.

**Time to get real**

Pot sizes are still relatively small, so it is perhaps no surprise that a quarter (24%) of our survey respondents felt that their money would run out within 10 years. This finding seems to tie in with FCA data which suggests that members who are currently making regular withdrawals are commonly doing so at rates in excess of 8%. Nearly three quarters are withdrawing at a rate of 4% or more.

Although, four in ten (38%) of our survey respondents are confident that they will have enough money to last their lifetime, in reality, this number could be considerably less. There is a body of evidence which suggests that people consistently under-estimate the chances that they might live into their 90s. For example, research conducted by the Institute of Fiscal Studies showed that those in their 50s under-estimate their chances of survival to age 75 by around 20 percentage points and to 85 by around 10 percentage points.8

All is not lost. Members often had DB pension income to fall back on, and the underpin of the State Pension, although few felt that they could manage on the State Pension alone. Over a third (37%) of our survey respondents said that they had more than £50k in cash savings; 14% said they had a second property. Housing wealth often provides a financial security blanket if and when their DC pension money runs out. Although the ability to draw on housing was felt most keenly by those in London and the South East, members in the regions also felt that they had equity to fall back on if necessary.

Members’ initial plan is usually to downsize and release equity but when they start to consider moving away from friends and family, equity release becomes a more appealing option. Of course, going forward fewer members will have this backstop option (FCA’s Financial Lives 2017 survey shows that 65% of UK adults aged 45-55 own their own home compared to 76% of those aged 55-65 and 80% of those aged 65-74).

“The plan [in the later stages of retirement] is to sell the house. We don’t need four rooms at the moment, so we can downsize. We haven’t made any plans for that, it’s just an initial thought of what we might do. We know the house is there, if we need it. Ideally, it should go to the kids, but if we need it, we need it.” – **Male, 57**

“If [downsizing] proves too hard, or there isn’t anywhere we’d want to move to, I think we would consider releasing equity. If we needed the money, it

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**Figure 17: Members’ plans for drawing down their DC pensions**

<table>
<thead>
<tr>
<th>Plan Description</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Once I start to use the money in my DC pension/s to live off, the money will run</td>
<td>14%</td>
</tr>
<tr>
<td>out within 5 years</td>
<td></td>
</tr>
<tr>
<td>Once I start to use the money in my DC pension/s to live off, the money will run</td>
<td>11%</td>
</tr>
<tr>
<td>out within 10 years</td>
<td></td>
</tr>
<tr>
<td>Once I start to use the money in my DC pension/s to live off, the money will run</td>
<td>16%</td>
</tr>
<tr>
<td>out in my mid 80s</td>
<td></td>
</tr>
<tr>
<td>I am confident that I will have enough money in my DC pension/s to live off</td>
<td>38%</td>
</tr>
<tr>
<td>throughout my retirement until I die</td>
<td></td>
</tr>
<tr>
<td>I don’t need to use the money in my defined contribution pension/s to live off,</td>
<td>16%</td>
</tr>
<tr>
<td>I have enough from other pensions and savings</td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td>6%</td>
</tr>
</tbody>
</table>

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**Notes**

7 [https://www.fca.org.uk/data/retirement-income-market-data](https://www.fca.org.uk/data/retirement-income-market-data)

One conclusion we can draw from all this is that we shouldn’t assume that members want a lifetime income at all. This may be difficult for providers to contemplate, particularly when the FCA has been so focused on this as the biggest risk of drawdown. However, it seems that some members, at least, recognise that they will need to draw on other assets and so want to use drawdown in a different way.

Different ways of thinking about drawdown

There are lots of academic papers about how you can create a sustainable lifetime income from drawdown. There’s the famous 4% rule which suggests that from a starting portfolio of £100,000 I can generate an income of £4,000 a year rising with inflation and be confident it will last until I die. Others, such as the Institute and Faculty of Actuaries, are now saying we should be thinking more around 3.5% given increased longevity and the market outlook.9

But as we’ve seen above, members may not want or expect a sustainable lifetime income from drawdown. Some will not expect it to last a lifetime and others will want more money in the early years rather than a constantly escalating income. This points to looking at withdrawal strategies that are different from the traditional sustainable income model.

To help think about different withdrawal approaches, we have used a tool called Timeline from FinalytIQ. This uses a simple Monte Carlo forecasting model to test withdrawal strategies under a variety of different market scenarios and looks at what income people might get and how long the money might last. We considered a 65-year-old with £100,000 to invest in drawdown.

Using this, we modelled three different withdrawal strategies:

- **Sustainable income**: this involved taking £3,500 a year increasing in line with inflation
- **Higher fixed income**: this gave the member an income of £5,000 a year increasing with inflation
- **Flexible income**: the member starts by taking £5,000 a year increasing with inflation but this is adjusted up or down each year depending on market performance with the aim of ensuring the member doesn’t run out of money. This is known as a “guardrails strategy”.

For simplicity’s sake we have assumed a fixed end-point of age 95.

We considered the income each strategy would generate under the median market scenario and a “poor” market scenario which we’ve taken as the 10th percentile (ie 1 in 10 scenarios will be worse than this). We also looked at the fund remaining in each case.

Of course, the results will depend on the assumptions used and there are more sophisticated models than the simple Monte Carlo approach we have employed. More conservative assumptions will lead to lower withdrawal rates but, in general, the overall relative shape of the results is the same regardless of the assumptions used.

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**Notes**

9 “Can we help consumers avoid running out of money in retirement?”, Institute and Faculty of Actuaries 2018

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**Figure 18. Members’ alternative sources of income**

<table>
<thead>
<tr>
<th>Source of Income</th>
<th>% of Members</th>
</tr>
</thead>
<tbody>
<tr>
<td>...as I can use money from my house, either through downsizing or equity release</td>
<td>11 24 26 12 22 5</td>
</tr>
<tr>
<td>...as I plan to live off other savings or investments</td>
<td>7 24 24 13 26 5</td>
</tr>
<tr>
<td>...as I have other plans</td>
<td>9 17 27 16 25 6</td>
</tr>
<tr>
<td>...as I can manage on my State Pension</td>
<td>2 16 26 21 26 7</td>
</tr>
<tr>
<td>...as my family will support me financially if necessary</td>
<td>3 7 21 16 47 6</td>
</tr>
</tbody>
</table>

**Fig 18. Key**

- Strongly agree
- Slightly agree
- Neither agree
- Slightly disagree
- Strongly disagree
- Don’t know

**Fig 18. notes**

**Question:** R13. How much do you agree or disagree with the following...?

**Base:** All UK adults aged 55-70 with a DC pension, except those who say they are confident they have enough money not to run out or that they don’t need to use DC pension assets to live off (231)
Members may not want or expect a sustainable lifetime income from drawdown. Some will not expect it to last a lifetime and others will want more money in the early years rather than a constantly escalating income. This points to looking at withdrawal strategies that are different from the traditional sustainable income model.

The guardrails strategy for drawdown

The guardrails strategy aims to maximise the income from drawdown while reducing the risk of money running out before the end of the investment term. It does this by considering how the current withdrawal rate (current income as a % of the current account value) compares to the original withdrawal rate and then adjusting future payments accordingly.

Developed in the US by Jonathan Guyton and William Klinger, the guardrails strategy applies two basic rules:

- **Prosperity rule:** if current withdrawal rate is 20% or more lower than starting rate then increase income by 5%. That is, if my income is low compared to my fund value, I can afford a higher payment.
- **Capital preservation rule:** if current withdrawal rate is 20% or more higher than starting rate then reduce income by 5%. That is, if my income is high compared to my current fund value, I’ll have to reduce my income.

As an example, consider a member with a £100,000 pot starting at an income of £4,000 a year (ie a starting withdrawal rate of 4%). Let’s consider three different scenarios:

- **Market grows strongly:** Investments do well so the pot grows to £125,000. The current withdrawal rate is now £4,000 / £125,000 = 3.2% so income is increased by 5% to £4,200 a year.
- **Market stays flat:** Pot is now £96,000 and current withdrawal rate is £4,000 / £96,000 = 4.2%. Income for the next year remains at £4,000.
- **Market falls sharply:** Investments do badly so the pot falls to £80,000. The current withdrawal rate is now £4,000 / £80,000 = 5% so income is reduced by 5% to £3,800 a year.

The starting income, trigger levels and rate of change of income can be adjusted to create a range of strategies that balance the competing needs for income maximisation, income stability and how long income could last.

### Summary of results

<table>
<thead>
<tr>
<th>Probability of success (ie money lasts until age 95)</th>
<th>Sustainable</th>
<th>Higher fixed</th>
<th>Flexible</th>
</tr>
</thead>
<tbody>
<tr>
<td>94%</td>
<td>53%</td>
<td>98%</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Nominal value of pot at age 95</th>
<th>Sustainable</th>
<th>Higher fixed</th>
<th>Flexible</th>
</tr>
</thead>
<tbody>
<tr>
<td>Median market</td>
<td>£142,300</td>
<td>£9,000</td>
<td>£83,000</td>
</tr>
<tr>
<td>&quot;Poor&quot; market</td>
<td>£18,200</td>
<td>£0</td>
<td>£30,600</td>
</tr>
<tr>
<td>Inflation-adjusted value of pot at age 95</td>
<td>Sustainable</td>
<td>Higher fixed</td>
<td>Flexible</td>
</tr>
<tr>
<td>Median market</td>
<td>£77,600</td>
<td>£4,500</td>
<td>£45,400</td>
</tr>
<tr>
<td>&quot;Poor&quot; market</td>
<td>£9,700</td>
<td>£0</td>
<td>£16,400</td>
</tr>
<tr>
<td>Total income paid adjusted for inflation</td>
<td>Sustainable</td>
<td>Higher fixed</td>
<td>Flexible</td>
</tr>
<tr>
<td>Median market</td>
<td>£105,000</td>
<td>£150,000</td>
<td>£121,200</td>
</tr>
<tr>
<td>&quot;Poor&quot; market</td>
<td>£105,000</td>
<td>£104,300</td>
<td>£92,000</td>
</tr>
<tr>
<td>Total inflation-adjusted value (income plus pot at age 95)</td>
<td>Sustainable</td>
<td>Higher fixed</td>
<td>Flexible</td>
</tr>
<tr>
<td>Median market</td>
<td>£182,600</td>
<td>£154,600</td>
<td>£166,600</td>
</tr>
<tr>
<td>&quot;Poor&quot; market</td>
<td>£114,700</td>
<td>£104,300</td>
<td>£108,400</td>
</tr>
</tbody>
</table>

### Key

- **Worst outcome**
- **Better outcome**
- **Best outcome**
The sustainable strategy has a high chance of success. It also has the highest overall value, because on average more money is invested for longer. However, this approach generates significantly less income than the other strategies in the median market scenario. The “cost” of creating a sustainable income is that starting income is a lot lower and, in general, a lot of money is left behind. Unless the member has an interest in leaving a legacy, having a lot of money at age 95 is not a great outcome.

The higher fixed income approach clearly has the potential to generate the most income but only has an even chance of success. In the “poor” market scenario the member would have run out of money by age 86. Nonetheless, it does ensure all the money is used up in the member’s lifetime.

The flexible income approach tries to steer a path between these two extremes, offering higher income than the sustainable strategy but more certainty by reducing income payments if markets don’t do well. The implicit cost of this is that income can fall well below the sustainable rate if markets underperform but, as we see later, those who expect to spend less money as they get older might prefer the higher income in the early years.

A fourth approach, that we have not modelled here, is to start off taking a lower level of income and to increase this income if markets don’t
underperform. This does have the benefit of making sure more money is spent while the member is alive but has the downside that higher income payments come in later life when, perhaps, the member might have less need for income.

As we can see, the traditional approach to thinking about how we generate income from drawdown using a sustainable income approach does have some downsides. While it provides certainty, it is arguably too cautious for those who want to get as much from their pension as possible.

But what does all this mean for how members might choose to use drawdown in retirement?

The shape of income
To test member preferences, we assessed reactions to the three different strategies discussed above.

In the survey, members were given a description of each. In the in-depth discussions, respondents were shown graphics (see Figure 21) and talked through the options by the moderator. We deliberately showed the income that would be generated from drawing down a pot of £100k alongside what a typical State Pension for a two-person household might be to help them consider the pros and cons of each approach in the context of their wider household finances.

The findings from the quantitative survey very much reflects members’ “knee jerk” reactions to the options, which is perhaps more reflective of the disengaged member. Here, respondents were split down the middle, with 46% preferring lower (sustainable) income and a lower chance of the money running out and 54% preferring the higher income.

The traditional approach to thinking about how we generate income from drawdown does have some downsides – here we model a fourth approach.

![Figure 21: Evaluating different withdrawal options](image-url)

**Figure 21. Key**

<table>
<thead>
<tr>
<th>State Pension</th>
<th>Flexible income</th>
</tr>
</thead>
</table>

**Fig 21. notes**

The red State Pension section is based on a two-person household where both members receive full entitlement.

The blue section is based on drawing down a hypothetical starting sum of £100,000.

Source: Richard Parkin Consulting using Timeline by FinalytIQ.
Unprompted, members often expressed a strong preference to spend slightly more money in the early years when they are healthy.
Those preferring the sustainable income approach were more likely to be those with pots less than £50k who wanted their provider to simply ‘do it for me’.

However, having a little more time to reflect on the ramifications of the three options (perhaps a better reflection of decision making with some provider engagement) meant that a quite different outcome emerged from the depth interviews. Here, we discovered that most members would rather take the risk that the money runs out in their mid-80s for more income to enjoy today. This is very much aligned with how they think about their retirement years. Unprompted, members often expressed a strong preference to spend slightly more money in the early years when they are fit and healthy, recognising that they will not always want to travel or have active hobbies. Many had parents who were entering a more sedentary phase of their lives which enabled them to foresee the impact on activities when they themselves start to slow down.

“It’s an age thing. I don’t think I’ll be around in 30 years’ time, keeping money until you’re 95 is just ridiculous. By then – it sounds really bad – but do you really care? If I get to something like 87 and I am reasonably healthy, I won’t care. That’s my mind-set now, but if I get to 82 and it’s only 5 years away, I might think differently if I am going to be struggling… but I’ll have to re-evaluate then. But at this minute, getting to 87 seems like a pipe-dream so I’d rather spend the money today.” – Male, 57

That said, none had plans for an ‘extravagant’ lifestyle in these early years; it was simply the case of being able to maintain broadly what they have today. This very much resonates with academic work. For example, according to a survey by researchers at Harvard Business School, the majority of people want a retirement distribution featuring a “bonus month” every year to treat themselves to a holiday or to splash out at Christmas.10

“I would just take the money to make sure I can live well. I will live humbly, it’s not something I am going to splash out on things with… but it’s there to give me some quality of life now.” – Female, 56

Once they had had time to consider the trade-off between money left over with a low income versus a higher income, and the risk that the money might run out, members felt happy that they could manage if their DC money ran out in their mid-80s. The option to adjust their income over time was usually preferable to the cliff-edge of the money running out completely. But if this happened, they had the underpin of the State Pension and ultimately would consider using equity in their home to top up any shortfall.

“To be honest, because I don’t have children and because I have a property – hopefully, very shortly without a mortgage – I am not worried about when I am not here. So, would I take £3.5k pa and end up with £140k when I am dead? No! I want my money.”

Notes

10 http://www.shlomobenartzi.com/columns/retirement-spending
Where the pension is concerned, I would like to reap the rewards of it. My pension is like a salary for me… I would take the higher amount to start with, because at 86 I’ll be a bag of old bones. I would be prepared to take a gamble on it running out then… if it means I can enjoy life while I am able to.” – Female, 57

Exceptions to this were twofold. First, where the member had no other sources of income and would need regular payments from their DC pension money to pay for basic living expenses. Here, the thought of managing on just State Pension was very frightening. Second, where the member had no immediate family and was worried about how they would pay for social care costs for themselves in the later years.

In conclusion, it seems unwise to assume that members will just want to use drawdown to create sustainable income. Many will prefer to aim for higher income even if that means it won’t last a lifetime. But helping members understand these choices is a huge challenge made more difficult by the fact that not all will want to engage.

Helping members make the right choices
Members are fully aware that they face some difficult choices and uncertain outcomes. Their tendency to follow the ‘path of least resistance’ means that the choice architecture offered by their own provider is a vitally important determinant of their future financial well-being.

Considering what form that help should take, the majority wanted the ability to tailor the approach to suit their needs. That said, we note that a significant proportion of members (23%) would like a single solution and that those preferring a single solution tended:

![Figure 23. Members’ preference for the type of support offered by their provider](image-url)

**Fig 23. Key**

- **Do it for me** – I would just like my pension provider to offer a single plan where they have worked out how much I can take out each year to ensure that my money won’t run out
- **Do it for me** – I want to adapt any plan offered by my pension provider so that it is somewhat tailored to suit me. I would like them to help me make the difficult trade-offs between how much money to take out, how the money is invested, and how long it will last
- **Do it myself** – I am confident that I can work through the trade-offs about how much money to take out, how my pension money is invested, and how long I want the pension money to last for to create a bespoke plan for myself which is tailored exactly to my needs

**Fig 23. Notes**

**Question:** R14. Imagine you have retired and have a pension pot of £100,000, which you want to take an income from over time… Which of the following best describes the level of support you would want your pension provider to offer as you take your pension money over time?

**Base:** All UK adults aged 55-70 with a DC pension (501)
to be over 60
• to have not given much thought to how they would manage financially
• to have smaller pot sizes (<£50k), and only one DC pot

The one in five members who felt comfortable to be able to make these difficult decisions for themselves tended:
• to be over 65
• to have put a great deal of thought into plans for retirement
• to have larger pot sizes (>£50k or more)

It is interesting to note that the over 65s, who are the closest to needing to take an income, are the most polarised group with higher proportions either happy to do it themselves or wanting their provider to simply sort it out for them.

Of course, the FCA has already started prescribing some elements of how these choice architectures are built with the introduction of investment pathways. We look next at how members might react to these and find some surprising results.

A first step into retirement?

For consumers not receiving regulated financial advice, the FCA will require drawdown providers to offer a range of ready-made investment options (‘investment pathways’). These are currently only mandated for FCA regulated pensions but the DWP is considering if and how they could be implemented for master trusts and other occupational pension schemes and we have seen that many master trusts expect to adopt them voluntarily.

The FCA found some evidence that having taken tax-free cash, and so gone into drawdown, the remainder of the member’s savings were left in cash or otherwise invested without much thought on how they would be used in the future. The aim of the investment pathways is two-fold. Firstly, the FCA hopes that by asking members what they want to do with their savings, this will encourage people to think about their future retirement plans. Secondly, the aim is to help consumers who do not have high levels of engagement with their pension to select investments that are broadly in line with their financial objectives.

Pathways are first made available to members when they access their tax-free cash. Members are presented with four objectives that might describe how they intend to use the rest of their retirement savings. The objectives are:

**Option 1:** I have no plans to touch my money in the next 5 years
**Option 2:** I plan to use my money to set up a guaranteed income (annuity) within the next 5 years
**Option 3:** I plan to start taking my money as a long-term income within the next 5 years
**Option 4:** I plan to take out all my money within the next 5 years

Each objective will have an associated investment option into which the member’s remaining assets will be placed.

However, when designing our survey we were aware that we would be asking this question to those who had not yet made any decision on their pension – i.e. members who are not yet the FCA’s target group for pathways, and indeed 56% of our survey respondents fell into this category. To account for this, we added a new category for this group only – “I plan to take my tax-free cash within the next five years and leave the rest where it is”.

### Figure 24: Members’ choice of FCA pathway

<table>
<thead>
<tr>
<th>Not accessed a pension</th>
<th>55</th>
<th>5</th>
<th>14</th>
<th>5</th>
<th>18</th>
<th>4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accessed a pension</td>
<td>57</td>
<td>9</td>
<td>20</td>
<td>7</td>
<td>7</td>
<td></td>
</tr>
</tbody>
</table>

**Fig 24. Key**

- **FCA Option 1:** I have no plans to touch my money in the next five years
- **FCA Option 2:** I plan to use my money to set up a guaranteed income (annuity) within the next five years
- **FCA Option 3:** I plan to start taking my money as a long-term income within the next five years
- **FCA Option 4:** I plan to take out all my money within the next five years
- I plan to take my tax-free cash within the next five years and leave the rest where it is
- I want to do something different

**Question:** R9. Do any of the following feel like how you would want to take your pension money/ the money left in your pension pot?

**Base:** All UK adults aged 55-70 with a DC pension (501)
“It’s key for me to know that they are working for me and my money. And looking after my investments, because I am really looking for my pot to grow” – Male, 56
To test whether the FCA had fully accounted for member needs, we also allowed members the option to say they would like to do something different, and asked for an explanation of what this alternative might be.

Members understood the FCA pathway descriptions well and, by and large, could see themselves falling into one of the categories. Very few felt they would want to do something different – but looking at their verbatim comments this was usually because they were undecided and in reality would probably fall into Option 1.

The five-year time horizon meant that most decision-makers selected Option 1, which is broadly in line with the FCA’s own findings.11 This is perhaps not surprising given that many are accessing their tax-free cash long before they are even considering retirement.

“Yes, these options fit very well. I would probably go for Option 1, if we’re talking about the next five years. Because by then I will only be 63 and I have money in the bank, the buy-to-lets. So, I certainly don’t see myself doing option 2. With Option 3 I am probably going to wait until I am in my late 60s. So, for now I would choose Option 1.” – Male, 58

It was also reassuring to see that 55% of those who had not yet accessed a DC pension also had no plans to touch money in the next five years, and a further 18% were only planning to take their tax free cash. Just 5% were thinking about cashing the money in.

When thinking about the longer term, drawdown seems to be the preferred option over an annuity. That said, the annuity option has not been completely ruled out by a minority, especially by women, those with no dependents, and those who will need their pension money to pay bills and rent.

“I am hoping not to do anything for the next 5 or 6 years. Then, the one that seems to attract me the best is taking my money out as a long-term income [Option 3]. Sort of like getting a wage. That is the one I would be inclined to go with.” – Male, 57

“For me it’s Option 3. I believe. Option 2, the annuity, is getting a lot of bad press now and it’s not for everyone, but depending on your situation having that option is sensible. Option 1 is very sensible, to me it’s the most sensible to do right now. And option 4 depends on how much you’ve got. That may be a viable plan for someone with an amount that is going to be fully tax-free for them, then they can do that.” – Male, 55

While it is encouraging that members can choose a pathway easily, the concentration of members in Option 1 may not be helpful for providers. Those choosing this objective will have given the provider no real direction over their future retirement plans. Providers will still be faced with the challenge they have today of trying to engage members on their future retirement decisions a reasonable time ahead of them wanting to retire.

The pathway rules require providers to remind members using pathways of the option they have chosen and check it is still appropriate on an annual basis. However, it is not clear that these communications will get any more attention than annual benefit statements do today. It seems therefore that the FCA’s objective of getting people to think about their retirement in more detail before taking tax-free cash may not be so easily achieved.

But what about the FCA’s second aim of ensuring members are invested appropriately? The pathways certainly seem to do that, but it may still not be in line with what members are expecting.

“I do want them to manage my money and invest it. I wouldn’t know where to start with that.” – Female, 56

A lack of alignment

Members were not confident to make their own investment choices, with just 11% giving a self-rated score of 9 or 10. So the fact that each of the pathways had an investment strategy developed by the experts was a source of comfort to them.

“I do want them to manage my money and invest it. I wouldn’t know where to start with that.” – Female, 56

“It’s key for me to know that they are working for me and my money. And looking after my investments, because I am really looking for my pot to grow. I can see how different investments depending on your situation would work best. I think it’s a good thing that they are doing that.” – Male, 56

But when explicitly asked if they could say what investment strategy they expected to lie behind each of the pathways, members had mixed views and were typically hoping for low or medium risk.

It is interesting to note that our survey respondents felt that providers could take more risk if the money was being withdrawn in the next five years.

“I wouldn’t want to take any chances with my money. Especially as I feel like I have plenty of time.” – Male, 56

Notes

We need to see pathways not as the endgame for drawdown but as a stepping-stone towards more tailored investment approaches.
“There are two ways to look at it. If you’re planning to live off it for a long time, you’d maybe want higher risk investments to give you more money for the longer term, but that comes with a risk. So, it’s whether you want to take that risk… With higher risk it could give you higher returns, but also plummet. I don’t think I would want to take that risk, to lose money.” – Female, 57

“At my age, I would expect them to be in low risk investments; solid investments where they are taking virtually zero risk. They won’t be putting it into the stock market. You don’t want to take the risk of a big reduction in your pot before you retire.” – Male, 58

We also asked members in our depth discussions to say what “low” and “medium” risk means to them. Members felt that a low risk investment strategy would have very limited downside risk.

“Low investment risk is where I could lose maybe £1k or £2k on my pot of £200k, whereas a medium risk is where I might lose £5k.” Female, aged 67.

Members’ understanding of investment risk has always been a challenge. Following the financial crisis, many providers moved to more diversified default strategies, concerned that highly equity-oriented strategies were too volatile for members’ appetites. This has arguably meant that members haven’t fully enjoyed the benefits of the bull market we have seen since then. How far should providers go in responding to member concerns about investment risk in drawdown?

Of course, investment volatility has very different effects when drawing an income and much has been written on sequencing risk and “pound cost ravaging”. Nonetheless, members may still have investment horizons of thirty years or more once they take their tax-free cash. Taking on some level of investment risk will be essential to ensure that drawdown delivers not just the flexibility that many seek but the income they expect.

The design of pathways doesn’t seem to allow any assessment of a member’s attitude to risk. Each objective can have only one investment pathway associated to it. There is then a danger that providers err on the side of caution and offer lower-risk options that address member concerns but fail to deliver the returns needed to maximise income in the long run. Perhaps then we need to see pathways not as the endgame for drawdown but as a stepping-stone towards more tailored investment approaches.

Making the complex simple

People are different. They might share similar goals when accumulating retirement wealth, which allows us to build collective solutions for default funds. However, retirement needs between members are much less consistent and predictable. Even those in similar circumstances may want very different things from retirement and so will want to use their retirement savings in very different ways.

Collective retirement provision cannot always easily allow individual customisation, but we will have to find better ways of tailoring retirement for individual needs if we want to ensure that members get the retirement that they hope for.

---

**Figure 25: Members’ perceptions of the underlying investment strategy for each FCA pathway**

<table>
<thead>
<tr>
<th>Description</th>
<th>High risk</th>
<th>Medium risk</th>
<th>Low risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not touching your pension money in the next five years</td>
<td>22</td>
<td>60</td>
<td>18</td>
</tr>
<tr>
<td>Taking your tax-free cash within five years and leaving the rest of your pension money invested with your pension provider</td>
<td>35</td>
<td>51</td>
<td>14</td>
</tr>
<tr>
<td>Using your pension to set up a guaranteed income (annuity) within the next 5 years</td>
<td>35</td>
<td>45</td>
<td>20</td>
</tr>
<tr>
<td>Taking your pension money as a long-term income within the next five years</td>
<td>37</td>
<td>47</td>
<td>16</td>
</tr>
<tr>
<td>Taking out all your pension money within the next five years</td>
<td>66</td>
<td>44</td>
<td>58</td>
</tr>
</tbody>
</table>

% of members

**Fig 25. Key**

- **High risk**
- **Medium risk**
- **Low risk**

**Fig 25. notes**

**Question:** R10a-e. Imagine that you choose the option of... With this option, some of your money remains invested with your pension provider. What investment approach would you expect your provider to take with your money?

**Base:** All UK adults aged 55-70 with a DC pension (501)
4: Where next for retirement investing?

It is perhaps understandable that, with the complexity of choices members now have at retirement, much of providers’ focus has been on how they support members making those choices. As we have seen, decisions to date have largely been driven by members wanting to access cash either because their DC pots are relatively small, or they have yet to actually “retire” and so think about how they convert the rest of their pot to income.

But our research has highlighted areas where further thinking is needed on investment. These are:

- The design of DC defaults and how these can manage the myriad needs of members
- How investment pathways might be implemented and how these interact with default strategies
- What investment strategies will be needed once members are actually taking income given that not all have the same expectations of what income they want.

**Designing DC defaults**

Our research highlighted that most providers are now targeting flexible income at retirement and we expect others will follow suit as their membership matures and pot sizes grow. However, the asset mixes that different firms target varies widely as shown in the chart below.

This variation is in stark contrast to the days when most providers were targeting annuity purchase at retirement. Firms almost invariably targeted 25% cash and 75% in fixed income, with the only real variation being around what type and duration of fixed income was used.

Firms clearly have different views on how to handle tax-free cash. Some are making explicit allocations to cash to match this benefit while others have no strategic allocation at all. We found that few firms make any adjustment to the strategy if a member does take tax-free cash before retirement and, at least in some cases, tax-free cash may not even be paid from cash holdings when taken, meaning members could continue to have significant cash holdings up to and through retirement.

The differing asset mixes we see today no doubt reflect differing views on what the right asset mix is for drawdown, a subject we will return to later. Such wildly different approaches will further compound the variation in outcomes that already exist between the very different lifestyle strategies adopted by master trusts in the accumulation phase.
Of course, there is no right answer here, but it does raise some fundamental questions about how effective default strategies will be in getting members to the right asset mix in retirement.

**Implementing investment pathways**
While investment pathways are almost certainly not the end game for retirement, they do offer some welcome benefits.

Firstly, they should allow firms to engage more effectively with members on what their future retirement plans are. Those operating multiple lifestyle options accept that, currently, few members respond to pre-retirement communications about choosing an option that might best meet their needs. Asking this question when a member is taking tax-free cash, and so is actively engaged with the provider, may be more productive. As we have seen though, few are likely to be in a position to make a decision at this stage so some of this benefit may be lost.

Pathways should also allow providers to better manage the challenge, highlighted above, of how tax-free cash is handled in lifestyle strategies, particularly for ongoing investment and flexible income. Once tax-free cash has been taken, the remaining assets can clearly be earmarked for ongoing investment, removing any inadvertent drag on returns from targeting cash that has already been taken.

We expect many firms will adapt their existing multiple lifestyle strategy approaches to implement pathways. This will involve creating clones of the existing strategies to remove any strategic cash allocation being used to match tax-free cash. Those members who take tax-free cash ahead of their chosen retirement date can be switched to the appropriate pathway, while those who don’t take cash can be rolled down to an end allocation that still has a cash allocation and maintained in this until they choose to access their benefits.

**Building better income drawdown strategies**
We’ve seen that members can have very different expectations of what level and shape of income they want to get from income drawdown. Ideally, these differing requirements should be reflected in different asset mixes when a member enters drawdown. Current lifestyle strategies and the proposed investment pathways tend to assume a single investment strategy for drawdown irrespective of what income a member is taking.

The figure below considers just some of the possible uses of drawdown and what mix of portfolio characteristics might be best suited for each.

Given where we are in terms of member demand for income, more sophisticated approaches may not be needed in the very near future. Indeed, one might reasonably argue that such tailoring of strategies may be best left to advisers. However, with more providers offering advice in plan, a more diverse range of retirement options will surely be needed.

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**Figure 27: Possible uses of drawdown**

<table>
<thead>
<tr>
<th>Portfolio characteristics</th>
<th>Capital security</th>
<th>Long-term capital growth</th>
<th>Limited downside risk</th>
<th>Interest rate sensitivity</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Income requirement</strong></td>
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<tr>
<td>Rising lifetime income</td>
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<td>Ad hoc lump sums during early retirement</td>
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<tr>
<td>Bridging income until annuity purchased in later-life</td>
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<tr>
<td>Spending income down over a short period</td>
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<tr>
<td>Leaving a legacy</td>
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</tbody>
</table>

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**Fig 27. Key**

- **Black**: Most important
- **Blue**: More important
- **Green**: Less important
The preceding discussion gives some indication of just how complex retirement can be. Unlike saving for retirement, where most members will have a common objective, members will all have very different needs and expectations in retirement. Of course, this is best handled through individual advice, but we’ve seen that not all, and perhaps not many, can or will access this even when it’s affordable.

Providers are committed to building out their retirement propositions over the coming years. We see five areas that will be most important in these developments:

**Guidance frameworks:** Members need help to understand and assess their retirement needs. This involves more than just explaining the options. Ideally, these frameworks will allow members to look at their retirement wealth holistically and so avoid making decisions on individual retirement pots without understanding the implications for their overall retirement wellbeing.

**Drawdown options:** These need to go beyond investment pathways and will need to accommodate different approaches to drawdown. Simply focusing on sustainable lifetime income will not be enough. More thought needs to be given as to how to communicate and manage how drawdown can be used.

**Integrating advice:** Providers may be disheartened by the low take-up of advice, but we firmly believe that there is a need for it and demand will come in time. Including advice as an integral part of retirement journeys, rather than just an option on the side, will drive this demand.

**Reviewing DC defaults:** It is questionable whether the use of multiple lifestyle strategies is effective in helping members make the right investment choices. To an extent, they will be superseded by investment pathways in any case. Trustees and providers will need to review how members are actually taking benefits and decide what this means for default design. More thought needs to be given to how tax-free cash is accommodated in these strategies.

**Retirement options for single trusts:** Trustees have understandably been cautious about offering drawdown in plan. However, not providing access to options, especially partial withdrawals, can result in poor outcomes for some members. Partnering with a master trust or other preferred provider can provide the necessary flexibility without significantly increasing costs and risks for trustees.

We recognise that providers have many other priorities and building capability ahead of demand is always challenging. Those we spoke to do see their retirement capability as important in winning new business and so we are hopeful that this will help bolster the case for development.

So, five years on from the launch of pension freedom, we can say we’re seeing progress but there’s an awfully long way to go before we can say our pensions system can deliver what members really need.
Appendix: Methodology

Consumer survey methodology
Ignition House conducted an online survey of 500 current and deferred DC members aged 55-70, supplemented by 15 one-hour, in-depth qualitative discussions with members who had entered drawdown under the new freedoms. Both elements of the research were conducted in August and September 2019. Our sample of decision makers excluded those who have fully cashed in, or bought an annuity with, all of their DC pensions and is therefore not representative of the broader population.

Survey demographics

Providers participating in our research
The authors are very grateful to the following firms and organisations who so generously gave us their time and expertise to provide input to this research.

Aegon
Aon
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Aviva
Department of Work and Pensions
Evolve Pensions (BlueSky and Crystal Master Trusts)
Fidelity
Hargreaves Lansdown
Legal & General
Mercer Workplace Savings
National Pension Trust
NEST
Now: Pensions
Pensions and Lifetime Savings Association
Pitman Trustees Limited
RBS Group Retirement Savings Plan
Refinitiv UK Pension Plan
Royal London
Smart Pension
Standard Life
Tesco Retirement Savings Plan
The Pensions Regulator
The People’s Pension