January 2021

New Choices, Big Decisions

5 years on

The Evolution of Consumer Decision Making and Behaviours Under Pension Freedom and Choice

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the people's pension

STATE STREET GLOBAL ADVISORS

Ignition House would like to dedicate this report to Sir John Hills, Professor of Social Policy at LSE and the Chair of CASE (the Centre for the Analysis of Social Exclusion). John made many tremendous contributions to social science and his work has had a major impact on social policy, and on those who work to achieve better outcomes for the least well-off in society. Amongst his many achievements, John's contribution to the Pensions Commission and the success of auto-enrolment in bringing millions into pension saving for the first time will be one of his lasting legacies.

Janette Weir
Ignition House

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Foreword

STATE STREET GLOBAL ADVISORS

Alistair Byrne

Head of Retirement Strategy
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It is incredible that more than five years have passed since the advent of the pension freedoms and our initial New Choices Big Decisions research on how scheme members were navigating the options. A lot has changed since then - Brexit, Covid-19, zero interest rates, the rise of responsible investing... In commissioning this research we were interested to explore how the initial cohort of scheme members we interviewed in 2015 had fared since their initial decisions, how the retirement income landscape has changed, and whether the experience of members approaching retirement today is different.

The previous respondents were very focused on accessing their tax free cash and less on a long-term retirement income. This time we focus more on that crucial income decision. It is clear that not so much has changed. Decisions remain challenging, people struggle to see beyond the near term future, and cannot always access the type of advice and support they would like. As an industry we need to continue simplifying and clarifying our offerings, providing guidance and support, and easy paths to follow, whether we call them 'defaults' or not.

As ever, we are grateful to Ignition House for leading this research and to The People's Pension for their collaboration. We hope you find the report useful and insightful and we look forward to discussing it with you.

the people's pension

Philip Brown

Director of Policy and External Affairs
B&CE

This report marks the third wave of this study into the minds and habits of the group of pioneers over 55 years old who have had to navigate the pension freedoms. It makes for fascinating reading because those taking part are now approaching or beginning retirement.

The unique insight that Ignition House's work provides, highlights that the majority are sleepwalking into retirement, with their life choices being driven by present circumstances rather than carefully considered financial planning about the long term.

Our view is that a pension should aim to provide an income throughout retirement and should not be treated as just another savings product. As automatic enrolment workplace pensions mature and people reliant solely on DC pensions start to retire in large numbers, policy makers and providers need to be ready to ensure that DC pensions are the bedrock of a decent retirement. Of course, people should be free to opt out of this and take their money in any way they choose, but the starting assumption should be that a pension means an income for life. This research shows that many people are not equipped to master the retirement choices with which they are faced and are not equipped to manage the risks posed by retiring with DC.

The challenge for policy makers is to ensure DC retirees are safeguarded but that their freedom to use their retirement savings in a manner of their choosing is preserved. Starting to shift the objective towards taking an income but stopping short of making it compulsory strikes that balance to the benefit of most savers.

1 Summary and implications

Background

Pension freedoms, introduced in April 2015, have radically changed how people can access their Defined Contribution (DC) pension pots after the age of 55, and much can be learned from the first cohort of decision-makers who are forging new paths through the complexities and challenges of this new landscape. Our early studies clearly showed that pension freedoms have switched the mental accounting of DC pensions from a future retirement income choice to a consumption choice. We identified the decoupling of the decision to take tax-free cash - often seen as a 'no brainer' by members - from deciding what to do with the remaining 75%. This second decision is, understandably, widely recognised to be much more difficult.

There is much concern in the industry about designing 'sustainable withdrawal rates' and ensuring members have an income for life. But in reality, members seem to be choosing a very different path. While the FCA retirement market data paints a clear picture of what people are withdrawing, there is very little which provides robust insights into why they are behaving in this way or indeed, whether these withdrawal rates are rational given their household circumstances. Our new research fills this important void in our understanding by focusing on the decision-making processes of those in drawdown who are close to, or actually in, full retirement.

Research objectives and methodology

This is the third wave of our longitudinal study, which began in 2015. Five years ago, many of our respondents – particularly those who simply took their tax-free cash and left the rest in zero income drawdown - were still working and thoughts of full retirement were quite far away. Over the years, we have found that not much had changed and they had no need for further withdrawals; either the initial sum was still being spent, or they were receiving an income from work which covered their needs. But five years on many of our respondents have now reached an age where they need to live off their DC pension money is becoming real - either through their own choice to stop working completely, or due to the current economic climate. Our one-hour online in-depth discussions explored in detail the plans they have for their lives and money, and how have they come to these decisions.

Key findings

Retirement will look very different for this generation compared to their parents, and they will face many more risks which they typically do not recognise

Our plucky pension pioneers are the first generation of pension savers who will navigate retirement under the new freedoms. By 2050 the number of people over 90 will have grown from 600,000 today to just over 1.4 million. Most will have retired under pension freedoms, but our research shows that the experience of 'retiring' is less clear-cut than it was for previous generations. Freedoms have for now firmly switched the balance from institutional to retail decision making and, as the PLSA have identified, our pension pioneers will need to navigate a plethora of risks, a journey which our research suggests they are ill-equipped for. Looking at member behaviour and the behavioural biases that drive our observations, we can clearly see that at best they under-estimate the impact of the risk, and at worst they are unaware such risks even exist or misunderstand the nature of the risk.

Members cannot see themselves working much beyond 70, and finances are rarely the key decision driver for full retirement, which means that members are storing up trouble for later life

It was very rare for us to find anyone who fitted the 'old school' binary model of retirement seen in previous generations, where people worked in full-time jobs until state pension age (SPA), and then never worked again. In the minority of cases where this was observed, it was far more prevalent amongst men than women. We observed that phased retirement is the norm, but with men and women following different paths to reach the same outcome.

However, it is questionable to what extent these economic activities will contribute much to their long-term sustainable retirement income. Present bias means that people only plan for the short term, a five- or ten- year time horizon is the norm, and that was certainly the case here. Our respondents recognised that there would come a time where they would no longer have the same energy and drive, and most were adamant that they could not see themselves working in any capacity much past 70.

Our respondents' decisions to fully retire had generally not been driven by a calculated decision that they have finally accumulated enough money to last the rest of their life. It is more to do with personal circumstances: e.g. reaching a specific age (SPA remains an important anchor for full retirement), their partner stopping work, or an unexpected event such as redundancy or ill-health (Covid-19 has exacerbated this trigger).

Deep-seated behavioural biases will make it very difficult to engage members with retirement planning

Members are sleepwalking into retirement with very little awareness of whether they will have enough money to last. There is no epiphany where the act of fully retiring turns previously poor financial planners into fully rational economic agents. Across the board, we found that financial planning for retirement is left very late - if it is done at all.

It was rare to find a member who had made any detailed calculations of their future basic living expenses. Almost all were taking a 'suck it and see' approach, even those who were less than six months from their expected retirement date. The focus was more trying to assemble information on all their pensions and the 'fun stuff' - envisaging what they are going to do with their time - rather than tackle the practical issue of how they will be paying for it. And even where there is "planning", it is not orientated to the plethora of risks they face.

Present bias is driving contentment with life in the early years, but risks disappointment in later years

Most of our retired respondents reported that they are having a comfortable retirement, and although it is not quite their 'dream', it is not too far off. All they want is their health, and to have enough money to pay the bills, do a bit of socialising and have a few holidays a year. Covid-19 has re-framed retirement expectations to focus on the simple pleasures of life – but the younger cohort does not expect this to be a permanent switch. So far, most of our respondents appeared to be coping financially and we did not find any evidence that they have, or intend to, dip further into their DC pensions directly due to Covid-19. Fully retired respondents, particularly those with an annuity in payment or with some DB in their household felt somewhat shielded from the economic fall-out.

Our total encashment cases say they have no regrets and are happy to have the money under their control. When probed to see whether what they had done with the money had made back the tax they had paid or kept pace with what they could have got as an investment return from their DC pension, none had made this comparison. Despite the current economic uncertainty due to Covid-19, our Secure Stans and Sues still had mixed feelings about their annuity purchase.

Covid-19 has reinforced the decision to take and spend their tax-free cash. Both our original 'gang' and our new drawdown respondents generally felt vindicated that they had made the right choice to travel and enjoy the money while they could, to spend money on home improvements given they are spending so much time in the house and to have the special memories from their family events, given that these are no longer possible.

Pension freedoms have reframed pensions from being an 'income for life' to 'money for retirement'. Members now fundamentally see their DC pots as just another form of savings. This reframing from 'an income for life' to 'money in retirement' is a subtle one, but appears to be having significant behavioural consequences. Present bias and the 'ostrich effect' mean that members' withdrawal plans typically ran for a maximum of 20- 25 years and that few expected their money to last longer than 10 years.

Common rationale

Rationale	Quote
Take it when I need it	"I just want to take lump sums whenever needed as a top-up income or for ad hoc treats, with no plan how long it might last."
SPA dependent	"Take my pot value today and divide by x years until SPA."
Make it last the 'active years'	"Take my pot value today and divide by 20 or 25 years."
Cover immediate living expenses	"I need x amount to live off and will take that until the pot runs out."
Stay under tax threshold	"What should I take each year to make sure I pay no income tax?"
Total encashment without tax	"I want to cash in my pot as quickly as possible but I don't want to pay tax. How much can I take?"
Provider withdrawal rules	"Provider rules say I can have x withdrawals of x per year."

Rare rationale

Rationale behind respondents' plans for their drawdown pots

Members will need to understand that there will be an extended period (of twenty years or so) in which they probably will not be able to work and they will need to have finances in place to realistically cope with this. But we have seen that the 'ostrich effect' means that members will not want to face up to unpalatable situations, and think that it will all somehow work out. Present bias means that they will place more value on 'living for today'. Given that these powerful behavioural biases are at play, members are unlikely to be able to generate a decent replacement income in later life for themselves, and default solutions will be needed to deliver better outcomes for members.

Members are not getting support to make the 'big decision'

Although there is a plethora of well-publicised support available to members, their sense is that this is almost exclusively focussed on helping members understand the options now available to them under the new freedoms, namely: leaving their pension where it is, securing a guaranteed income for life (buying an annuity), taking their pension a bit at a time (through drawdown or UFPLS), or taking it in one go (full encashment).

Once they have taken the plunge into drawdown, our members felt that they had been left to their own devices to decide how to take their money. We prompted our drawdown respondents to see if they had come across any tools (for example, cash-flow modelling tools) or guidance (for example, the 4% rule of thumb) in this area. The vast majority had not, and would not even know where to go to find this support. But nevertheless, they felt that these sorts of things would be very useful indeed. Our observations firmly support the PLSA's conclusion that "work on supporting older members in drawdown is incomplete".[7] However, member inertia suggests that even if such guidance is available, take-up is likely to be poor.

FCA pathways will nudge savers accessing their pension for the first time to allocate their pension savings into one or more of four investment pathways, according to their objectives. But our drawdown respondents struggled to identify themselves with the correct FCA pathway. They wondered what would happen to people once the five years had expired. Some questioned whether there was anything similar planned for people like them, especially as our not-advised respondents had not subsequently had any contact with their provider to see if their investment choices were still appropriate. They felt that they had somehow fallen through the gap.

The concept of 'guided drawdown' was strongly welcomed by members

Drawdown members overwhelmingly found the idea of a guided drawdown product very useful. Members particularly valued the flexibility to change their mind at any stage, and that the 'experts' were making the difficult choices for them. They might not have taken up the guided drawdown themselves, but nonetheless, it would have provided a benchmark against which to assess their own thinking. Most, including some with a financial adviser, said that they would have at least considered this option if it had been available to them.

Since pension freedoms were introduced, the FCA's retirement income market data suggests that more than three million pots have been accessed for the first time, and around a third went into drawdown. Drawdown is not subject to the same value for money quality requirements, defaults or price cap policies as DC pension savings. As new and cheaper drawdown products are developed, perhaps even embedding Responsible Investment as a default, the industry would do well to remember that it generally operates in an environment where member inertia prevails. But with nearly a million policies already in place, the last thing our industry needs is another legacy product scandal to tarnish members' already fragile trust. A nudge is seldom enough. Existing members will need to default into new products, unless there is a good reason not to.

Conclusion

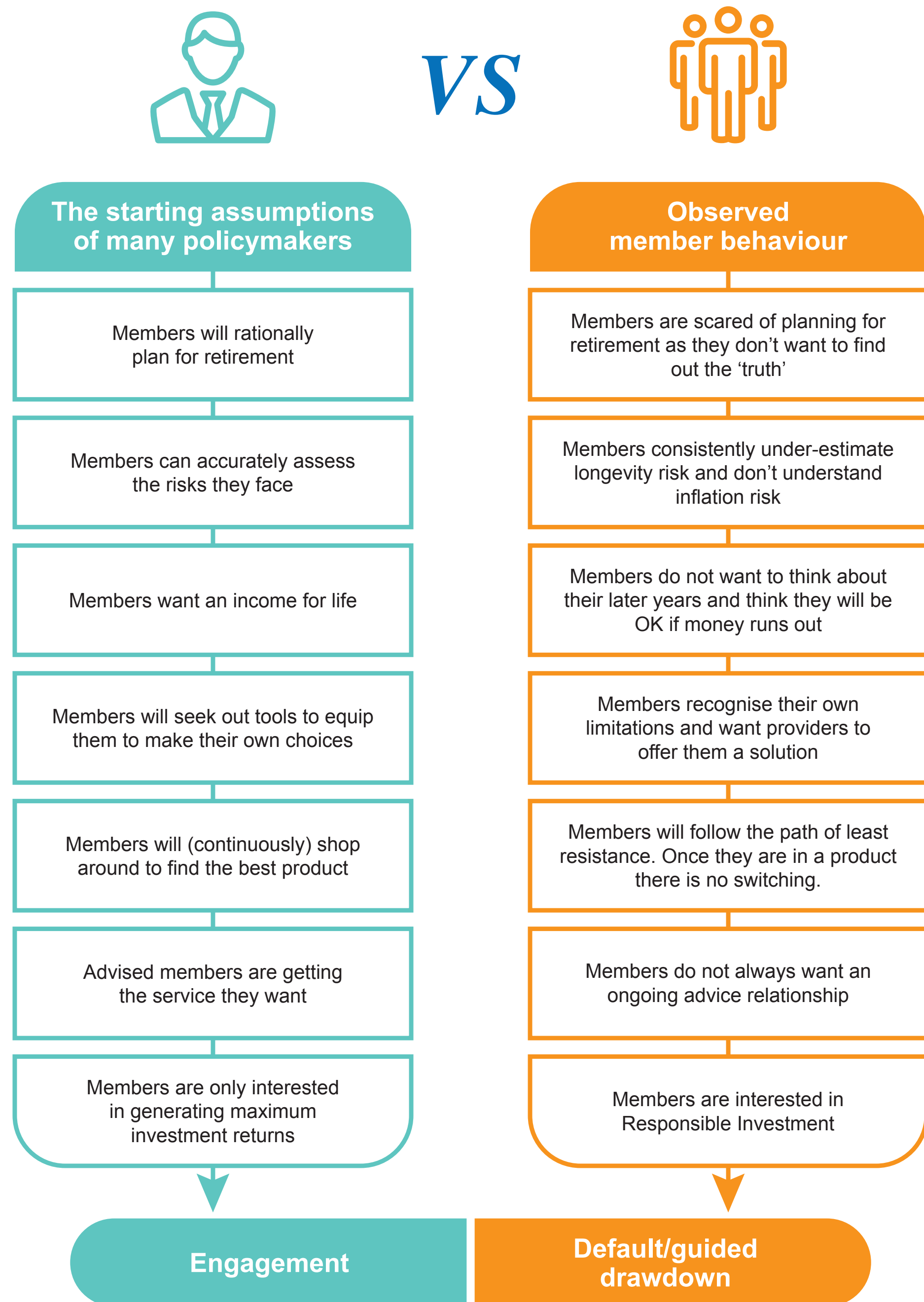
At the moment, members entering into drawdown are faced with a binary option of working through the very difficult decision by themselves or paying for ongoing financial advice. Most are choosing the former, and are doing the best they can, given the impossible task we have set them. Their observed behaviours appear to be illogical and irrational, and yet in the context of their bounded rationality feel like reasonable plans to them. Without help, they will continue to behave in very different ways to how the 'industry experts' would expect and poor member outcomes will follow. Members going it alone are riddled with behavioural biases which prevent them thinking about their later years, they struggle with numbers, they have no knowledge of investments, and consistently mis-understand or are ignorant of the risks they face.

Better engagement simply cannot solve these fundamental issues and will only make a difference at the margins.

This situation is far from ideal, and members themselves want more 'do it for me/do it with me' solutions. Their tendency to want to follow the 'path of least resistance' suggests that their own provider will be their first port of

call for such support. Knowing that a reputable company/ scheme has set up a solution to "do it all for them" in much the same way that a financial adviser would - but at a lower cost - was very much welcomed in principle.

Members do not know the difference between a trust-based scheme and a contract-based scheme and do not understand why there would be any difference in the support they are offered from scheme to scheme. They expect a level-playing field and are surprised to find out that is not always the case. If it is not possible for their own provider to step up and offer this type of support (for example, in the case of subscale trust-based schemes) then members would hope that there would be some signposting to a 'preferred' solution. In this brave new world of guided drawdown, it is easy to imagine the emergence of a panel of 'providers of last resort' with the master trusts playing an important role in plugging the gaps in the trust-based environment - as they do in the accumulation phase.



Summary of the policy implications set out in the report

The way that people are responding in practice to pension freedoms suggest that both policy makers and pension providers should revisit a number of their assumptions. In order to assist policy makers, we have set out in summary below those that specifically merit review by them.

1. Behavioural biases mean that members may not be able to generate a decent retirement income from their DC pensions. Pension providers should be required to offer a default retirement product that mitigates the main financial risks posed by retirement. This should, among other things, include protection against longevity risk in order to deliver better outcomes for members.
2. The DC pension is meant to work in combination with the state pension to ensure people have at least a minimum reasonable income throughout their retirement. We suggest that targeted, repeated communications to members over 50 about increases to the State Pension Age and the age at which DC pensions can be accessed will be necessary to increase awareness of the change. Policymakers also need to carefully consider inter-generational fairness against the impact of any changes to the pensions triple lock on future pensioner poverty.
3. Given the pension gap between men and women, policy makers may need to consider whether specific communications are mandated to 'nudge' part-time working women (in their mid-40s and beyond) to understand the impact of an extra day or two a week of work and therefore pension contributions will have on the size of their pot.
4. Future regulation around minimum standards for drawdown products need to take into account outcomes for legacy customers. Policy initiatives are currently focused on those entering drawdown, but with nearly a million policies already in place, the drawdown market may be the next pension scandal waiting to happen.

2 Background to the study

New Choices....

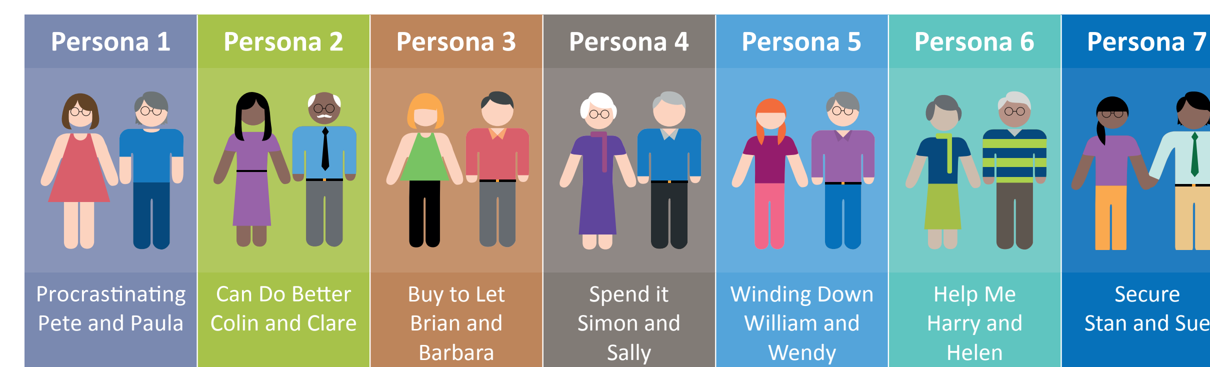
Pension freedoms, introduced in April 2015, have radically changed how people can access their DC pension pots after the age of 55 and much can be learned from the first cohort of decision-makers who are forging new paths through the complexities and challenges of this new landscape.

In the first wave of our longitudinal study, we followed 80 people over the course of eight months (from April 2015 to February 2016) as they grappled with their initial decisions under the new freedoms. These people were deliberately selected to represent those for whom their DC pots would become increasingly important. They all had between £30-£250k in their combined DC pots, the majority were not advised and we screened out any who had more than one buy-to-let property. In our discussions, we found out that most had pots worth £50k or more, and had similar sums in other types of savings. We excluded people from our study where defined benefit (DB) was likely to form a major source (more than 60%) of household income in retirement. That said, many households had small DB pensions providing a small underpin of secure, inflation-proofed income in addition to their state pension.

Our findings were published as part of the New Choices, Big Decisions[1] series of reports and have been widely disseminated to industry, policymakers, regulators and government. One year later, we checked in with our brave pension pioneers to find out how they had been getting on, to see how their lives have changed, and to understand (with the benefit of hindsight) how they felt about the choices they made.

While every person in our study had their own unique set of issues and perspectives, we also found common themes in how individuals approach their decision. We identified seven pension personalities, from the Procrastinating Petes and Paulas, who were overwhelmed by the task at hand, to the I can Do Better Colins and Claires who had lost all faith in pensions and would rather have the money in their control.

Figure 1: Pension personalities



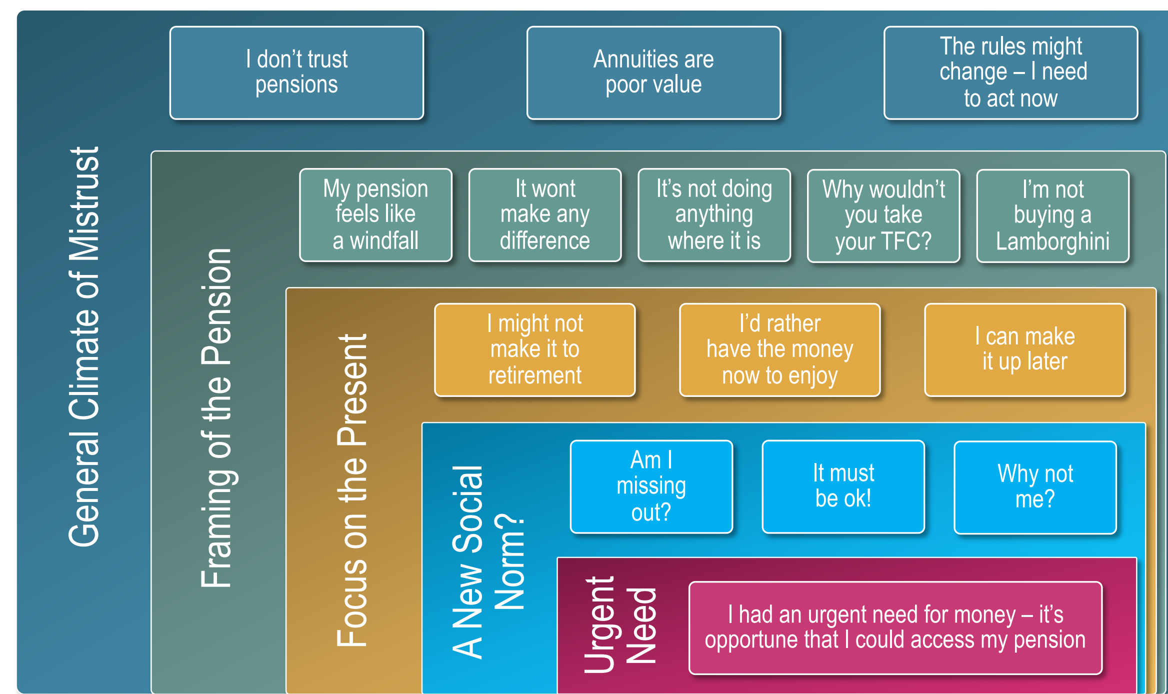
Source: https://bandce.co.uk/wp-content/uploads/2016/06/15805_1_SSGA_TPP_Pension-personalities-Part-2.pdf

1 https://bandce.co.uk/wp-content/uploads/2016/03/ssga-tpp-report-new-choices-big-decisions.pdf
https://bandce.co.uk/wp-content/uploads/2016/06/15805_1_SSGA_TPP_Pension-personalities-Part-2.pdf
https://bandce.co.uk/wp-content/uploads/2017/04/16047_SSGA_TPP-SSGA-Joint-Research_FINAL-COMPLIANCE-APPROVED.pdf

These early studies clearly showed that pension freedoms have switched the mental accounting of DC pensions from a future retirement income choice to a consumption choice. We identified the decoupling of the decision to take tax-free cash - often seen as a 'no brainer' by members - from deciding what to do with the remaining 75%. This second decision is, understandably, widely recognised to be much more difficult. These views have been echoed in several subsequent studies[2] and, as evidenced by the FCA's retirement market data[3] (collected pre-Covid-19), still very much hold true today. This data shows that in 2019/2020 two thirds (66%) of those moving into drawdown - a way of using your pension pot to provide you with a regular retirement income by reinvesting it in funds specifically designed and managed for this purpose - took their tax-free cash only and left the rest invested in some form of zero income drawdown.

Recent discussions with members conducted by the DWP[4] once again confirmed that, by and large, members are doing much the same things with their money (a new car, a new kitchen, home repairs, a holiday, weddings, or helping family members) as they did five years ago, and that the drivers behind their initial decision, summarised in Figure 2 (taken from the FCA's Retirement Outcome Review), have not materially changed over time.

Figure 2: Factors motivating respondents to access their DC pension



2 https://www.fca.org.uk/publication/market-studies/retirement-outcomes-review-interim-report-annex3.pdf
3 https://www.fca.org.uk/data/retirement-income-market-data
4 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/929728/pension-freedoms-research-study.pdf

Big decisions...

Five years ago, many of our respondents – particularly those who simply took their tax-free cash and left the rest in zero income drawdown - were still working and thoughts of full retirement were quite far away. Over the years, we found that not much had changed and they had no need for further withdrawals; either the initial sum was still being spent, or they were receiving an income from work which covered their needs. This time lag has meant that there has been very little research conducted into the 'big decision' – how members are actually using the remaining 75% of their pot.

But five years on, many of our respondents have now reached an age where the need to live off their drawdown money is becoming real - either through their own choice to stop working completely, or due to the current economic climate. So, what plans do they have for their money, and how have they come to these decisions? Did they get the support they needed, and what behavioural drivers are influencing their choices?

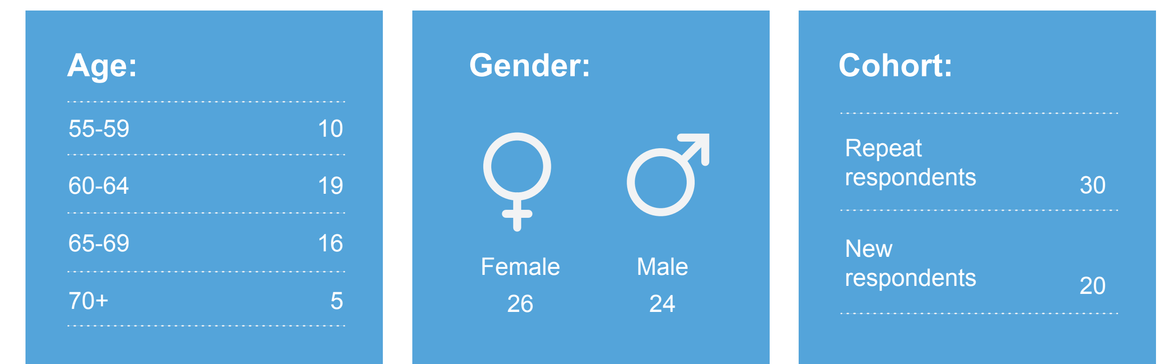
There is much concern in the pensions industry about designing 'sustainable withdrawal rates' and ensuring members have an income for life. But in reality, members seem to be choosing a very different path. While the FCA retirement market data paints a clear picture of what people are withdrawing, there is very little which provides robust insights into why they're behaving in this way or indeed, whether these withdrawal rates are perfectly rational given their household circumstances. Our new research fills this important void in our understanding by focusing on the decision-making processes of those in drawdown who are close to, or actually in, full retirement.

Of course, not everyone is going into drawdown. Aligning the latest FCA data to our own sample (by excluding pots of £30,000 or less) we see that 68% of pots accessed for the first time went into drawdown/Uncrystallised Funds Pensions Lump Sum (UFPLS), 16% were used to buy an annuity and 17% were totally encashed.

Now that they are older, and with the benefit of hindsight, do those who fully encashed have any regrets, or have the recent events surrounding Covid-19 given them a different outlook on life? What do they think of the government's announcement to increase the access point from 55 to 57?

When we caught up with them last, some of those who had bought an annuity expressed regret at giving up the flexibility. Do they still feel the same way, or has Covid-19 changed their perspective? Would they have done anything differently if 'do it for me' solutions and investment pathways had been around at the time they made their decision?

Figure 3: Sample Composition



One eye on the next five years

DC pension decisions are not taken in isolation, and the value of this particular study is that we have a holistic view of our respondents. We have taken the time to understand their family situation and their finances at the household level, rather than looking through the rather unsatisfactory lens of an individual pot. We understand that the decisions people make today are not set in stone, and that people will face many more challenges as they get older and their mental faculties start to decline.

To ensure that our study can continue to deliver robust insights for the next five years we have topped up our original gang with a fresh set of respondents, all of whom have taken their tax-free cash and are now making further drawdown withdrawals, either as lump sums or as an income. Further details of our sample can be found in the Appendix.

Sleepwalking into retirement

Despite the plethora of risks they face, members are sleepwalking into retirement

Retirement will look very different for this generation compared to their parents, and they will face many more risks

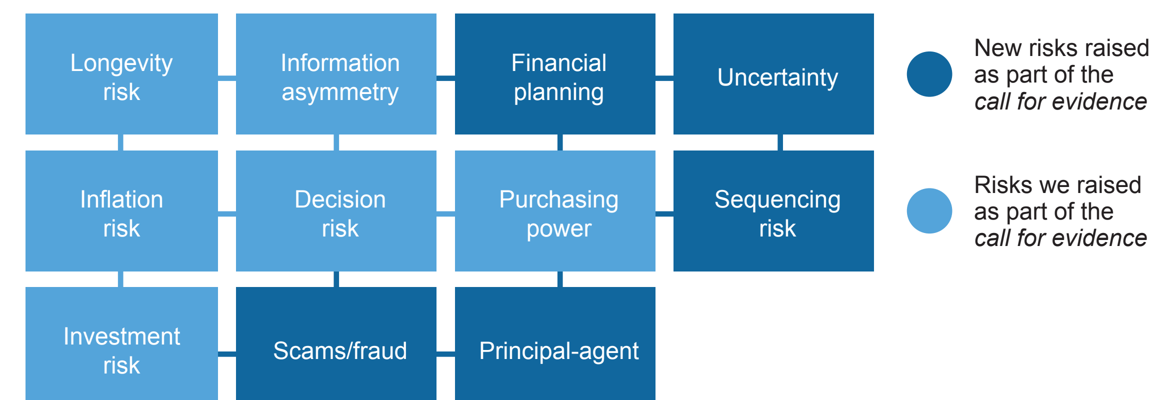
Our plucky pension pioneers are the first generation of pension savers who will navigate retirement under the new freedoms. By 2050 the number of people over 90 will have grown from 600,000 today to just over 1.4 million. Most will have retired under pension freedoms, but the experience of 'retiring' is less clear-cut than it was for previous generations. Compared to the mid-1980s, the labour market for the over 50s has dramatically changed. Today, the vast majority of those aged 55 to 59 and nearly half of those aged 60 to 64 are in work. Double the amount of 70- to 74- year olds are still in employment compared to 30 years ago.[5]

'Retirement' is no longer seen as a short period of relative inactivity; rather it is characterised by a number of years of relatively high activity before real 'old age' sets in. Compared to previous generations, income needs will not be as consistent through retirement. This generation is likely to spend more in the early active years of retirement – for example on travel, leisure activities, or on their home — than they do later on in their retirement when activity levels fall significantly.

The length of these 'active years', will vary from person to person and will be highly dependent on an individual's family history. The mortality distribution has also changed significantly over time, increasing the risk that members will get this important factor very wrong. The latest mortality statistics suggest that if you are 65 today you are just as likely to die in the next 10 years (14%) as live to celebrate your 95th birthday (18%), whereas in the 1970s the probability of dying in the first 10 years was roughly 14 times greater than the probability of living to age 95. The single most likely age at death today (the mode - the value that appears most often in a set of data) is 91, but this is not reflected in members' expectations (as the most commonly cited statistic by the media is the mean). And so their frame of reference is out by about seven years. Research by the IFS indicates that those in their 50s underestimate their chances of survival to age 75 by around 20 percentage points.

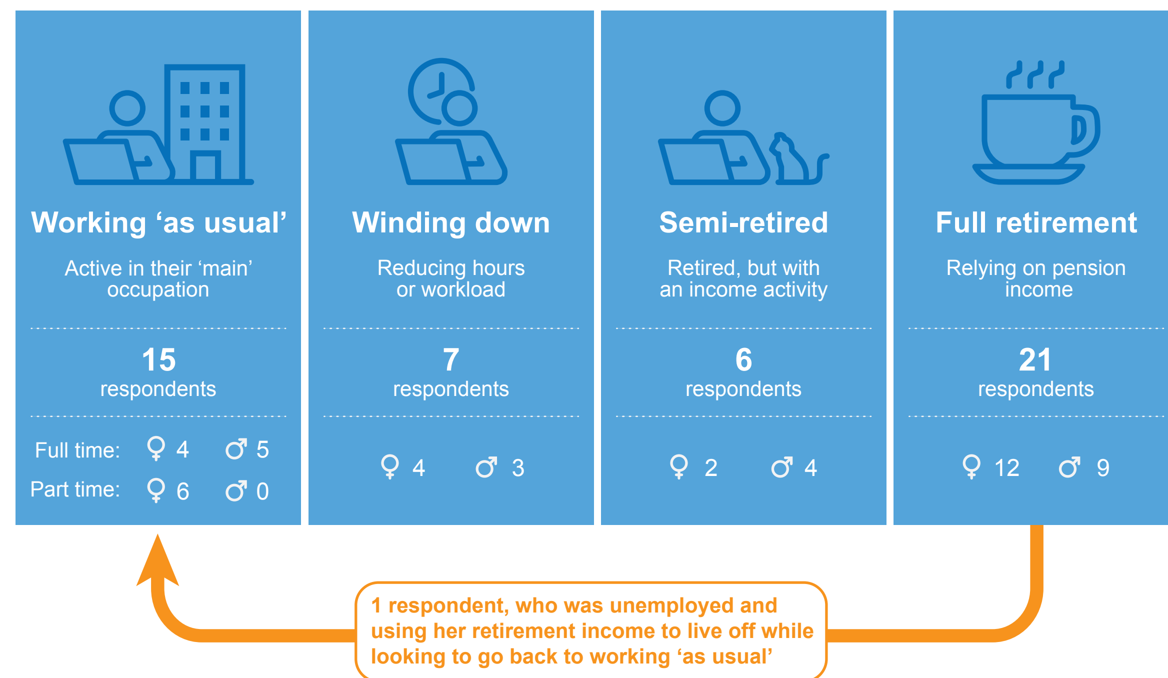
Misunderstanding longevity is not the only issue. Freedoms have firmly switched the balance from institutional to retail decision making and, as the PLSA has identified, our pension pioneers will need to navigate a plethora of risks. However, looking at member behaviour and the behavioural biases that drive our observations, we can clearly see that at best they under-estimate the impact of the risk, and at worst they are unaware such risks even exist or misunderstand the nature of the risk.

Figure 4: PLSA's summary of risks faced by DC savers



5 https://www.lgim.com/landg-assets/lgim/_old-document-library/solutions/four-pots-for-your-retirement.pdf

Figure 5: The 'grey areas' of retirement



Members cannot see themselves working much beyond 70 – and present bias means that they are storing up trouble for later life

These findings are very much reflected in our respondents' experiences. As shown in Figure 5, 21 of our 50 respondents were already fully retired, but the rest were still in some form of employment and expected to be doing some form of work until their late 60s or early 70s. Some were happy to access money in their mid to late 50s as they believe that they would be able to 'make it up' in the next ten years or so. Others were looking to use the money specifically so that they could reduce their hours and bridge the income gap until the state pension kicked in.

It was very rare for us to find anyone who fitted the 'old school' binary model of retirement seen in previous generations, where people worked in full-time jobs until state pension age (SPA), and then never worked again. In the minority of cases where this was observed, it was far more prevalent amongst men than women. These findings very much fit with broader survey data. For example, according to a survey conducted by the DC Investment Forum in 2019[6], one in three (32%) of non-retired DC members over 55 expected to be working into their 70s.

A further 13 respondents were still in some form of phased retirement. However, we observed that women and men often followed different paths to reach the same outcome. Our sample is small, and it is not possible to robustly draw wider inferences, but these indicative findings certainly suggest this is an area worth further exploration.

Women were much more likely to self-report as 'part-time' or 'winding down'. Many of our female respondents had been working part-time for some time, having switched fairly early in their working lives due to childcare commitments. Many had not subsequently returned to full-time work once their children became more independent. Just 8 of our 26 female respondents are working full time now or were just before they fully retired. When probed, a few women expressed regrets that they had not thought more about the consequences of this on their pension provision, which they recognised to be inadequate. Present bias again means they had not thought through the future impact of working three or four-day weeks on their pension pots and on their financial well-being in retirement.

6 https://dcif.co.uk/wp-content/uploads/2019/11/dcif-2019-evolution-not-revolution-final-1.pdf

Policy Implication

Automatic enrolment (AE) means that all qualifying employees are now offered the opportunity to contribute to a workplace pension, benefitting from tax relief and employer contributions. Specific communications could be helpful to 'nudge' part-time women (in their mid-40s and beyond) to understand the impact of having/not having an extra day or two a week of pension contributions on the size of their pot.

There is much more of a grey area between being 'fully retired' and 'semi-retired' or 'winding down' amongst our male respondents. Here, both the language and the nature of their part-time work was different. Men commonly described themselves as "retired" from their former occupation, but actually had "something on the side" to keep them active or "a little money earner". Rather than salaried employment, as with the women, these tended to be short periods of sporadic, or ad hoc employment, part-time self-employment, or running their own micro-businesses on a part-time basis.

Some found it difficult to identify the specific time when they became 'fully retired', as their work naturally dwindled over time.

> *I exported pharmaceuticals to the Middle East and sold the company a few years ago. Then I did a bit of consultancy with an old client. And we used to meet up three times a year and I used to get paid for a bit of consultancy. Then it ran down a bit, and the deal was that I'd still do a bit of consultancy, not get paid anything, but he'd take me out for a few lunches and he'd entertain me when he came down to London. So, it was like that type of relationship. This year that's finished, so we don't see each other and I barely do anything for him, but whether it'll pick up again in the future, I doubt it, but I did enjoy doing it because it gave me something to do one day a week.*
>
> **Male, Age 70+**
> Repeat Respondent, Total Encashment

I just sort of told the Inland Revenue, look, I'm not really earning money anymore, so I don't want to be filling all these tax forms in. So, I just kind of wound down… I wasn't actively going out and looking for work anymore… I just want to enjoy life without having the sort of stresses of work, but I was still doing the occasional job.

Male, Age 65-69
Repeat Respondent, No Decision

Policy Implication

Pension freedoms have been welcomed by members as they reflect the 'new world' rather than the traditional retirement model. Given this wide range of experiences, providers may wish to consider how they are framing 'retirement' in both the language and visual images used in member communications. Products should be flexible enough to accommodate the plethora of situations faced by the over 55s. Providers may need to consider whether the concept of a 'normal retirement date' should be updated/clarified to reflect this phased approach.

Covid-19 has given people both a push and the mental headspace to set up their own business. We heard examples of people setting up enterprises ranging from food delivery businesses to selling potted plants during lockdown, to capitalise on the increased time spent at home.

I've always wanted to do something in food, ever since I was 11, but didn't have the confidence and I didn't have supplies and I didn't really have the money. And I always traveled a lot and I was never really in one place. And then I was just working and working for other people non-stop. And I thought if they can do it, why can't I start my own business? But I've never had the competence. And my eldest daughter just said to me, you've got to stop working so hard. Why don't you do this? So, I did.

Female, Age 55-59
Repeat Respondent, No Decision

I decided not to go back to my old job in healthcare, instead I set up a little business selling pot plants. I had actually been doing a certificate in practical horticulture part-time. So, I started a little nursery in my back garden in my greenhouse… every space in my house is covered with house plants. And that's been going really well… and I also started making conserves; jam and marmalade.

Female, Age 60-64
Repeat Respondent, Drawdown

We also heard several stories of people who have already recognised that they do not have enough pension money saved to live on and are taking on innovative ways to 'top-up' their retirement income. Examples ranged from invigilating at schools, being a medical case study, becoming a treasurer at a local club or playing Father Christmas during the festive season. Others were monetising hobbies or passions, such as buying and selling old/expensive watches, fixing up and selling motorbikes, offering photography services, investing in gold coins and gambling on cryptocurrencies. Again, it is unlikely that they can continue in the same way throughout their retirement.

As soon as I stopped working, I looked around and thought, hang on a minute, I need a bit of money. So, I've been doing acting and the film extras and Santa at Christmas and things like that, which were great, you know, there's no pressure.

Male, Age 65-69
New Respondent, Drawdown

But it is questionable to what extent these economic activities will contribute to their long-term sustainable retirement income. Present bias means that people only plan for the short term, a five- or ten- year time horizon is the norm, and that was certainly the case here. Our respondents recognised that there would come a time where they would no longer have the same energy and drive to do these activities, and most were adamant that they could not see themselves working in any capacity much past 70. These findings seem to fit with the broader picture. The latest ONS figures, published in November 2020, show that the number of people over 65 in employment (including the self-employed) currently stands at 1.32 million. However, the number of people over 70 and in work drops to just over 500,000.

Policy Implication

By pulling back the decision-making point to 55, policymakers have inadvertently increased the extent to which people think that working in retirement can compensate for the impact of early access. However, there are two key flaws in such logic: few are willing to work past 70; and the types of activities they are undertaking to earn additional money are unlikely to deliver a reliable and sustainable income over a long period of time.

Members will need to understand that there will be an extended period (of 20 years or so) in which they probably will not be able to work and they will need to have finances in place to realistically cope with this. But the ostrich effect means that members will not want to face up to unpalatable situations, and think that it will all somehow work out. Present bias means that they will place more value on 'living for today'. Given that these powerful behavioural biases are at play, members are unlikely to be able to generate a decent replacement income in later life for themselves, and default solutions will be needed to deliver better outcomes for members.

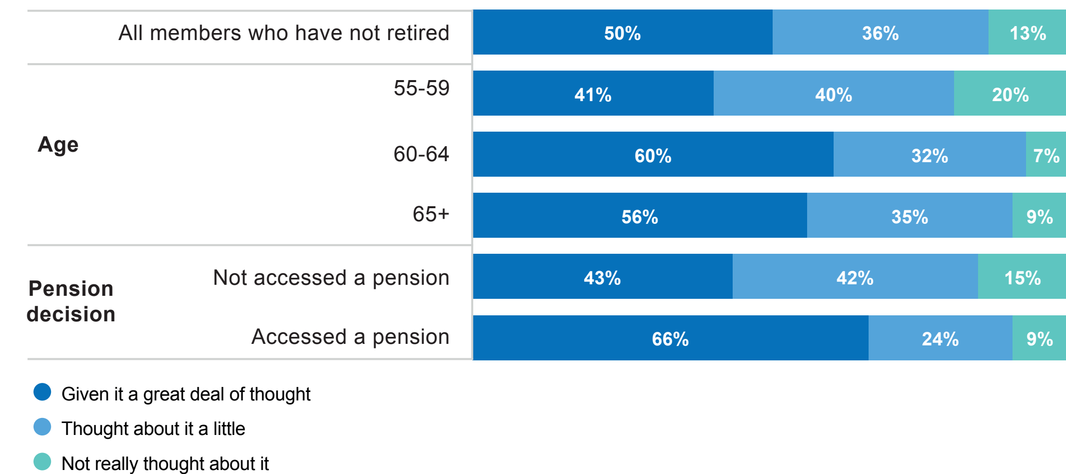
Most people do not plan their retirement finances

Across the board, we found that financial planning for retirement is left very late - if it is done at all. It was rare to find a member who had made any detailed calculations of their future basic living expenses. Almost all were taking a 'suck it and see' approach, even those who were less than six months from their expected retirement date. Their focus was more on trying to assemble information on all their pensions and the 'fun stuff' - envisaging what they are going to do with their time - rather than tackle the practical issue of how they will be paying for it. And even where there is "planning", it is not orientated to the plethora of risks they face.

I haven't done any budgeting or anything like that but what I've got will probably be adequate when I do retire. I will get what I'm getting now, and I've got another pension. So, I probably will have enough to sort of see me through. I mean, as we get older, we need less, don't we? We don't have the high life where we're going out partying every night and things like that. I know I'll get my state pension when I'm 67. I know that because my friend told me, but as to what I'll get from that, I have no idea.

Female, Age 55-59
New Respondent, Drawdown

Figure 6: Members' financial plans for retirement



Source: Five Years of Freedom, Evolution, Not Revolution, DCIF 2019

Recent survey data very much supports this finding. For example, a 2019 survey[5] conducted by the DC Investment Forum found that 50% of members aged 55 and over who had not yet retired had not given much thought to retirement planning. Shockingly, almost one in ten of the over 65s say they have not really thought about it at all, and a further 35% of this cohort said they had only thought about it a little.

We also observed that the way that people manage their finances does not change as they give up work completely. If they were budgeting in detail before retirement, they carry on doing so. If they just did it 'roughly, in their head' and by checking their online bank balance and spending once or twice a month, that's how they continue in full retirement.

There is no epiphany where the act of fully retiring turns previously poor financial planners into fully rational economic agents.

That said, we did hear our newly retired respondents express some nervousness about the change from having a regular, reliable inflow of money to having to think about living off the amount they had saved for the rest of their life. They talked about being 'careful' not to spend too much until they got used to the new situation. Most felt that this 'honeymoon' period would last for about a year or so until they were fully confident.

I used to be quite methodical in managing our money [at the start of retirement], but then got fed up with it and now I just go with the flow really. I've got a pretty good idea of what our household income and expenditure is and what roughly is in hand at the end of each month. So, it's pretty relaxed now really.

Male, Age 65-69
Repeat Respondent, Drawdown

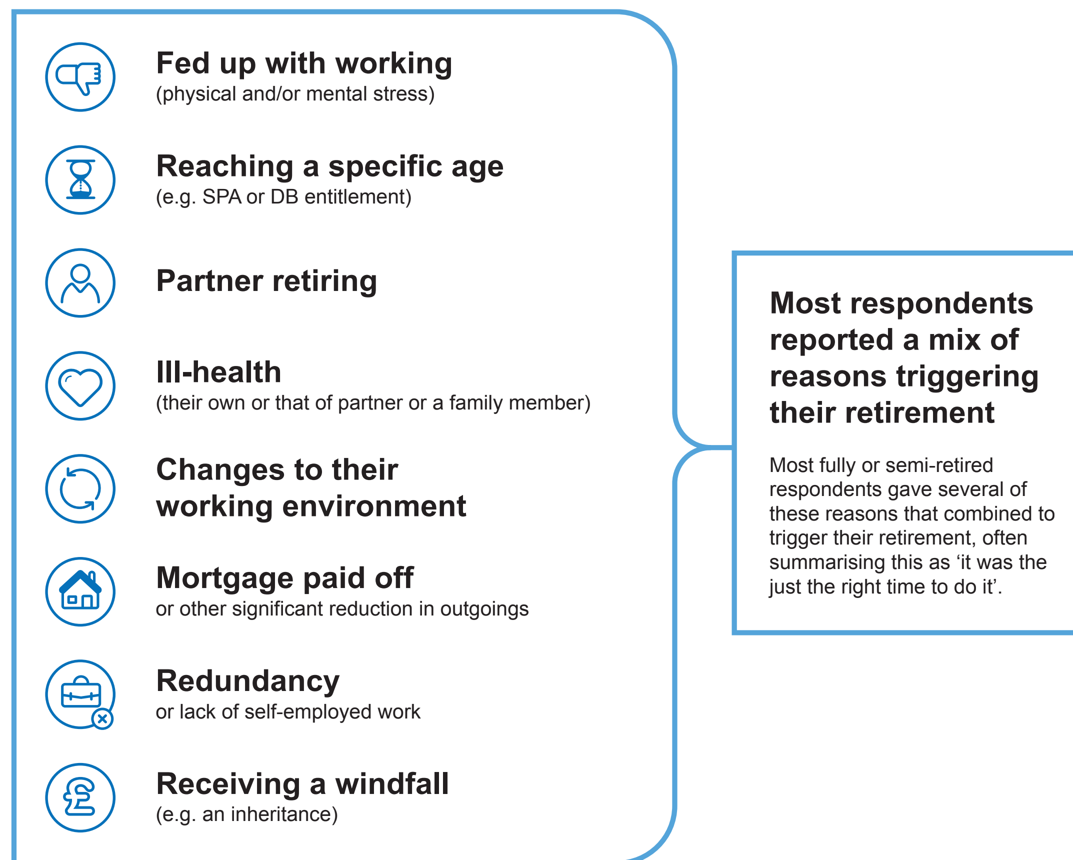
Finances are rarely the key decision driver for full retirement

Given what we heard about the general lack of financial planning, it was perhaps no surprise to find that our respondents' decisions to fully retire had generally not been driven by a calculated decision that they have finally accumulated enough money to last the rest of their life. It is more to do with personal circumstances: e.g. reaching a specific age (SPA remains an important anchor for full retirement), their partner stopping work, or an unexpected event such as redundancy or ill-health (Covid-19 has exacerbated this trigger).

We found that the rationale for working beyond SPA is polarised – they either can't afford to retire or have a flexible job which they enjoy.

We had a few examples where respondents felt that the changing nature of the workplace was enough to tip them over the edge into full retirement. Again, Covid-19 has exacerbated this factor as some of our respondents have lost the important social aspect of being in a physical workplace and have had to grapple with digital working.

Figure 7: Triggers for retirement



Most respondents reported a mix of reasons triggering their retirement

Most fully or semi-retired respondents gave several of these reasons that combined to trigger their retirement, often summarising this as 'it was the just the right time to do it'.

> *My husband really wanted to retire at 60 as well, but he's going to keep going past 65 and that's basically because we still have a mortgage.*
>
> **Female, Age 60-64**
> New Respondent, Drawdown

Figure 8: Reasons respondents kept working beyond SPA

Members are anchored on the ability to access a pension at 55

In the wake of pension freedoms, accessing a tax-free lump sum has become the common social norm. The latest FCA retirement market income data shows that by far the most popular choice is to access some tax-free cash and move into drawdown, and there has been little change in members' decisions in the last four years. In common with our existing gang, many of our new cohort of drawdown respondents had taken their tax-free cash at 55, or soon after the freedoms had come into effect.

> *I just thought that if I cashed my pension in and took a certain amount, that can pay for me to go part-time and I'd have enough to keep me comfortable and I know that I've still got something for the future… I just thought I'm not getting any younger and I want to have a bit more time to see my grandchildren. And one of my friends dropped the bombshell that she has cancer… and I thought if anything like that happened, I would be in the same position. So, I took my pension and took all the family on a massive holiday with it… and had some home improvements done. And now, I just feel like it's sort of back to square one. I've gone back to work and am getting a salary.*
>
> **Female, Age 55-59**
> New Respondent, Drawdown

We explored whether the recent announcement that the access age would, indeed, be increasing from 55 to 57 would have been an issue for our drawdown respondents. Given that they were mostly working, took only their tax-free cash and parked the rest, and often used this money for discretionary spending which they could have covered from other savings, their resounding response was that this imminent change would not have been a particularly big issue for them.

> *It's only two years. I mean, it's irrelevant, if they were jumping five or six years, that could have an impact on people that need the money. But two years is neither here nor there in my opinion.*
>
> **Male, Age 70+**
> Repeat Respondent, Drawdown

Our respondents could understand why the change was coming, acknowledging that people were living longer and SPA was increasing.

> *Obviously people are living longer these days and working much later than they used to. Some people because of their situation, probably can't think about retirement until at least 65. So, it's like everything, the state pension age has just gone up. I just think because everybody is living so much longer these days that you have to be prepared. I don't think it's unrealistic for this to happen, to be fair.*
>
> **Female, Age 60-64**
> New Respondent, Drawdown

However, most had not picked up the announcement and felt that this change could easily be missed by members. There was a strong feeling that the access point has been mentally anchored at age 55 and that younger members approaching this age will be disappointed to find out their plans may need to change. The timing of the change was also felt to be an issue, as there was a widespread recognition that the fallout from Covid-19 means that members in their 50s who cannot find a new job might need this financial lifeline.

> *For the people who are counting on it and think they can get it at 55, two years – when you need your money – is a long time. And I do think people in this country are quite dejected with the pension age going up… And I think now that we are in uncertain times… I think it will affect people because they could have been counting on it… so, I don't think it's particularly good.*
>
> **Female, Age 60-64**
> New Respondent, Drawdown

Policy Implication

Providers will want to avoid another Women Against State Pension Inequality (WASPI) situation. Targeted communications to members over 50 about the increase will help to increase awareness of the change, and this message will need to be repeated frequently. This will need to be balanced against the risk that there are unintended consequences of further normalising making withdrawals at the earliest opportunity.

Front line staff will need to be well-trained to deal with irritated members who see this as yet another goalpost moving and a barrier preventing them from accessing their own money. It is entirely possible that this policy will see an increase in total encashments as members' trust in pensions is once again shaken.

Behavioural biases will make it very difficult to engage members with retirement planning

These findings clearly suggest that sleepwalking into retirement is the norm, with too many moving parts and retirement itself 'scary' to think about. These observed behaviours seem very different from how the industry and policymakers would want or expect members to approach planning for retirement. So why is there this apparent disconnect between the expectations of the behaviour of a rational economic agent on one side, and what we are observing in reality?

As with so many aspects of pensions, our detailed probing revealed that member behaviour is driven by deep-seated behavioural biases. Some respondents also felt that, beyond enjoying their job and it giving them a purpose, it also provided them with a sense of identity and self-worth which they were frightened to give up.

Figure 9: Behavioural barriers to retirement planning

Present Bias	• Too easy to put off for another day – and they don't want to think about it
Ostrich Effect	• 'Retirement' seems old, and they don't want to think about it • Having no more income coming in is scary, and they don't want to think about it
Complexity Aversion	• Whenever they start thinking about retirement – their retirement options, when they might stop work, estimating their future income needs, and working out their saving pot – it just feels like there are too many moving parts

Policy Implication

Guidance is already widely available to help members plan effectively for retirement. For example, provider websites contain many useful planning tools and models. Providers are adopting the PLSA's Retirement Living Standards as a consistent benchmark for living standards. 'Wake-up packs' are being sent earlier and providers are introducing mid-life MOTs. But if there are fundamental behavioural barriers to overcome to actually get members to use them, then the impact of these initiatives on member behaviour will be limited.

It is important both for providers to recognise the challenges that these biases present when thinking about member communications, and for policymakers to assess whether these inherent behaviours mean that, in reality, members will not proactively engage earlier with retirement planning. Is a different approach, a default model, needed?

Sleepwalking into retirement

Present bias

Present bias is driving contentment with life in the early years, but risks disappointment in later years

Covid-19 has re-framed retirement expectations to focus on the simple pleasures of life – but the younger cohort do not expect this to be a permanent switch

Most of our retired respondents reported that they are having a comfortable retirement, and although it is not quite their 'dream', it is not too far off. All they want is their health, and to have enough money to pay the bills, do a bit of socialising and have a few holidays a year. They may have initially used their tax-free cash to have a big trip (to visit children, to pay for a wedding abroad, to celebrate a milestone birthday), but they have done nothing like that since. Those in full retirement appear to have a much more moderate view of what a 'dream retirement' is all about, compared to those who are yet to take that leap.

> *My dream was just to holiday more, socialise, and just have free time – not get up in the morning and have to be rushing, looking at the clock all the time. And that kind of happened, yes.*
>
> **Female, Age 65-69**
> New Respondent, Drawdown

Pre-retirement expectations are often vague about what they will actually do, beyond that one big retirement trip and a few holidays per year.

> *My dream retirement would be to have plenty of money to live on and enjoy all the travels that I like to do - basically to have the same standard of living that I am used to. But I'd need an awfully big pension for that because we like to travel a lot. I'd like to think that we'd still be able to travel, maybe not to as exotic places or as expensive as we have been for the moment, and maybe just go more off-peak than we do.*
>
> **Female, Age 60-64**
> Repeat Respondent, Annuity

So far, most of our respondents appeared to be coping financially and we did not find any evidence that they have, or intend to, dip further into their DC pensions directly due to Covid-19. Fully retired respondents, particularly those with an annuity in payment or with some DB in their household felt somewhat shielded from the economic fall-out.

> *With Covid… to be honest, I was quite happy being in a bit more for a while, having a good rest and reading lots of books, doing lots of gardening. Seeing my grandchildren over the fence, that was all I was able to do… that was the worst thing really. [Financially], I have a steady amount coming in each month and that will continue ad infinitum until I die, so I feel quite secure in that way.*
>
> **Female, Age 65-69**
> Repeat Respondent, Annuity

> *Pre-Covid, life was definitely a lot more interesting. Two of my major interests in life are travel and photography… the whole Covid experience has made me realise just how lucky I am because I haven't got the concerns of people, maybe like yourself, in employment; wondering what's going to happen there.*
>
> **Male, Age 65-69**
> New Respondent, Drawdown

That said, this finding comes with several caveats. Firstly, our fieldwork was conducted before the second lockdown, so the full economic impact of Covid-19 had not yet been felt. Secondly, we have deliberately excluded total encashment cases from our batch of new respondents and so are missing some of the most financially vulnerable. Finally, our new respondents were specifically selected to ensure that they had taken further withdrawals from their drawdown pots. It is unlikely enough time would have elapsed for those taking tax-free cash directly due to Covid-19 to have taken a further payment.

By necessity, most of our respondents had reduced their spending habits due to Covid-19 as they had cancelled holidays and no longer felt safe socialising outside the home. As a result, their initial tax-free cash withdrawal had lasted longer than expected, and some were actively increasing their savings pots. Older respondents (those in their early to mid-70s) felt that the behavioural changes due to Covid-19 would result in a permanent decrease in their spending as they no longer felt physically able to go on the expensive long-haul holidays they had previously enjoyed, whereas the younger cohort in our sample saw this as a temporary situation and expected to revert back to their original plans in a year or so.

> *I save a certain amount each month, but I've also lived well. One thing I haven't had this year is any holidays, which I suppose takes up a lot of income, but I haven't needed them to be quite honest, because my life here is so full anyway… I haven't missed them.*
>
> **Female, Age 65-69**
> Repeat Respondent, Annuity

> *I'm not going out for the £60 meals with my friends…now I go to this café near me and other than that, I have friends over for dinner, which is a lot cheaper. So, my outgoings are far less. At the moment I am just sort of ticking along, but when we go back to normality I will have to make the decision as to whether I increase the drawdown, because I am probably £600 a month short on what I'd need, should I want to carry on living at the level I was living at before.*
>
> **Female, Age 55-59**
> New Respondent, Drawdown

> *I just can't spend it at the moment… it's crazy. I just bought a new car, had the house decorated and am struggling a bit to spend it. I don't want to sound blasé, but that's how it is at the moment. And with the lockdown, it's made it even harder, we've cancelled our holidays and, you know, you can't do anything… going to the pub or going for a meal, I don't feel comfortable doing things like that.*
>
> **Male, Age 60-64,**
> New Respondent, Drawdown

Covid-19 (via the Furlough Scheme) gave some of our working respondents a taste of retirement, both in terms of living off a reduced income and having more leisure time, and views were mixed. Some loved the experience of being at home every day, whilst others simply couldn't wait to get back to work.

> *Everybody thought we were going to be lockdown for three weeks. And in the beginning I thought, this is quite good; this is like another holiday. And then it was another three weeks and then another, and by the end of it I was just 'climbing a pole'. It was absolutely hellish and I hated every minute of it and was desperate to get back to work, but nervous about going back too, I have to say. Not nervous from a Coronavirus point of view, but just about remembering how to do everyday things again suddenly when you haven't done it for three months… It's absolutely crazy.*
>
> **Female, Age 65-69**
> Repeat Respondent, Total Encashment

For those who wanted to return to work, some had concerns about the security of their job and whether they would be made redundant. If this were to happen, they did not expect to be able to get another job and yet are not ready to retire, either financially and/or emotionally. Economic commentators expect the over 55s to be hit hard by the economic fall-out from Covid-19, and so these fears are not unfounded.

> *My wife works for a local solicitor as a receptionist, and they furloughed her in March until the end of October, which is two weeks away now and, basically, she hasn't heard anything. She's the receptionist and people don't 'walk-in' as they used to off the street, people have to make an appointment to see the solicitors and the people who phone up have the direct line for the solicitors and she really doesn't know if they are going to want her anymore… she would like to go back, she likes her job.*
>
> **Male, Age 65-69**
> Repeat Respondent, Total Encashment

> *[Covid's] a big problem, because the business I'm in is going into people's homes to sell them the product and doing a presentation and it's drastically cut down the appointment levels. We've not really been busy and it's had an effect on the company and obviously an effect on myself and my finances. We are still out there working, but not as hard as we should or could be… It's up in the air. I'm 72 and I'm pretty fit and need to be busy… But this will be my last job. When this goes, that's it. I certainly won't be going for interviews.*
>
> **Male, Age 70+**
> Repeat Respondent, Drawdown

Even within our relatively small sample, we have a couple of examples of financial difficulties due to Covid-19 leading to a 'de-retirement'.

Case study: Going back to work after retiring

Nicholas

- **Gender:** Male
- **Age bracket:** 60-64
- **Working status:** Semi-retired, working PT
- **Cohort:** Repeat respondent
- **Pension decision:** Taken TFC, but made no further withdrawals

Their situation

Nicholas is a divorcee, who has recently remarried and owns the home he lives in outright. His wife sold the house she had been living in before they got married and they have been using that money 'to get by'. He had retired in his mid-50s, shortly after the pension freedoms had come in. He took his TFC moved the rest into FAD, but not made any further withdrawals.

His wife stopped working about a year ago when she was diagnosed with cancer. And as they know their pension pots are not large enough to last them throughout retirement, their plan has always been to sell their large house, downsize and live off the remaining money. They live in the SE and are in London and willing to move to a cheaper location, so this seems to be a financially feasible retirement plan.

However, CV-19 has seen Nicholas's step-daughter and her partner (who is an airline pilot) struggle financially, and they have moved back into the annex of the house. Their plan to is to stay there until next year, to allow them to save enough money for a deposit on their own home. This has meant that Nicholas and his wife have had to put their moving plans on hold for a year. And while they have savings to live off and can make ends meet, Nicholas has gone back to work. He found a job in the local Amazon sorting centre, which is close to his home. He works there two days a week, with plenty of overtime, and is classed as a 'key worker'. This income has kept their 'head above water', without having to draw on any of his pensions.

Parents' experiences of living off a basic income are framing their expectations of how they will manage financially if/when their DC pot runs out

Our respondents were much clearer and more consistent in describing what kind of lifestyle they did not want for their retirement years. They would not want to have to worry about paying for the essentials, such as food and their utility bills. Fortunately, few expected to have any substantive housing costs in retirement (none of our 50 respondents were renters, and many owned their home outright), and so this relieved a huge pressure on their finances.

> *We paid the mortgage off about 15 years ago, we paid it off early, and then our outgoings became very simple, as it's just the two of us.*
>
> **Male, Age 70+**
> Repeat Respondent, Total Encashment

When thinking about the later years, once their DC money had potentially run out, they were often using their own parents' and family members' retirement experiences as a frame of reference, relating stories of close relatives in their mid to late eighties who 'aren't doing much now' and who are 'slowly deteriorating'. Their impression is that these family members are managing perfectly well on relatively little income from the state, and so can they. They have not considered that the causation might well be the other way round, for example, that lack of income is a factor in both physical decline (e.g. no access to private physio) and cognitive decline (not socialising as much).

> *I look at my mum and all she has is her state pension. She doesn't have anything else. And she manages, she doesn't, worry about anything, she's happy with the little bit that she gets.*
>
> **Female, Age 55-59**
> New Respondent, Drawdown

> *When I actually looked into how much my outgoings were, I took away the amount I was paying for car parking, petrol and clothes for work. I worked out that I didn't really need an amazing amount because our house is paid off. …I would struggle slightly, but the state pension would probably be enough to cover the bare essentials.*
>
> **Male, Age 60-64**
> New Respondent, Drawdown

In the back of their minds, they are worried that any unused money will simply be used to pay for long-term care.

That said, they have not particularly thought how factors such as increasing life expectancy, the future of state pension, the availability of state support for long-term care, changes to wealth taxes in the post-Covid-19 world and so on will make their future look very different to that of their parents. This 'planning blight' means that, at this time, they are not particularly concerned about what will happen if their DC money runs out and they have to fall back on state pension alone. And of course, in the back of their minds, downsizing their house is always their Plan B.

> *My accountant said it was a good idea to put the money into the house because at least it will always be there, it's not going to fall away. If things went pear-shaped, we can always sell the house and wouldn't lose any money.*
>
> **Male, Age 55-59**
> Repeat Respondent, Drawdown

To some extent these findings are supported by data from the 2019 DC Investment Forum survey[6] which suggests that just 61% of DC members aged 55 and over who think their money will run out before they die say they "are not too concerned if my pension money runs out before I die, as I plan to live off other savings or investments".

Fifty two per cent were "not too concerned if my pension money runs out before I die, as I can manage on my state pension". Sixty six per cent said they were "not too concerned if my pension money runs out before I die, as I can use money from my house, either through downsizing or equity release".

Policy Implication

It is important to remember that the state pension provides an inflation-linked income for life, and so even if DC money does run out, people are not left completely destitute. State pension is expected to be the core of later years' provision for this cohort.

With the triple lock currently under threat as the economic cost of Covid-19 grows day by day, policymakers will need to carefully consider inter-generational fairness against the impact of any changes on future pensioner poverty, given the powerful behavioural biases at play encouraging members to deplete pots in their active retirement years.

The evidence in this section brings out the importance of owning a house without a mortgage for the sufficiency of the state pension in later life. The over 50s in the UK have substantial property wealth, with recent estimates putting this at £2.29 trillion by mid-2015. This is not going to be replicated in future AE generations.[7]

Covid-19 has reinforced the decision to take and spend their tax-free cash

In our earlier studies, we heard the pension tax rules were a strong driver of consumer behaviour; in particular, the fact that they can take 25% of their pot tax-free. Having this money "tax-free" is very attractive as it sounds like a "win", or a "win against the Government", making access to the pension pot seem much more attractive than taking money out of other savings vehicles. As a result, many of our respondents described taking the tax-free money as a "no brainer" and many chose to access their tax-free cash from their pension rather than dip into cash-based savings accounts. Most used their tax-free cash to purchase big-ticket, discretionary goods such as new cars, holidays, new kitchens or other home improvements, or used the money to help their family (university fees, house deposits, and so on).

Reflecting back on these decisions, Covid-19 has meant that both our original 'gang' and our new drawdown respondents generally felt vindicated that they had made the right choice to travel and enjoy the money while they could, to spend money on home improvements given they are spending so much time in the house and to have the special memories from their family events, given that these are no longer possible.

> *"I always said to people, I'm doing these trips because you never know what's going to happen. Covid wasn't something that came to mind, it was always my health or something happens to my mum and I can't leave, I can't go away. But I just thought, I've got to do these things while I can do them. And as I said, I don't expect the pot to run out, but there is an element of let's worry about those sorts of things later and let's live now."*
>
> **Female, Age 55-59**
> New Respondent, Drawdown

> *"The 25% lump sum was a huge amount for me. I just enjoyed every minute, and it didn't take me long to spend. It took me about a year to blow absolutely the lot. We had one of the greatest holidays and all the things I had done to the house, I could have never done if I'd not taken it… Absolutely, definitely, Covid has confirmed that this was the right decision. My brother, who is a nurse, got Covid and was seriously ill and had to have open-heart surgery for 12 hours… he's cashed in every single pension he's got and now he's bought a house in France and he said, 'I don't care, I'm living for today'. And I think you'll find that a lot of people are now living for today because we don't know what's around the corner now… you could go out one day and just get it and just be gone."*
>
> **Female, Age 55-59**
> New Respondent, Drawdown

While they don't feel it is necessarily a "regret", many of the more 'under-informed' and less savvy respondents would advise their past-selves to spend more time looking into their options and making a more informed decision.

A minority still has some of their tax-free money sitting in the bank "earning nothing" and is now aware that they haven't got enough saved for retirement, but again this 'regret' is the exception rather than the norm.

7 Retirement Sorted? The Adequacy and Optimality of Wealth Among the near retired, The Institute for Fiscal Studies, 2014

> *I would say [to my past self] look into it a little bit more. The situation I was in back then, the decision I made then helped me in what I wanted to achieve at that time. Looking back with the information that you've been telling me today; I'm completely blown away by some of it.*
>
> **Female, Age 55-59**
> New Respondent, Drawdown

> *I would probably [advise myself] to do a bit more research into it and not jump in too quickly. So, preparation, probably more thorough preparation.*
>
> **Female, Age 60-64**
> New Respondent, Drawdown

Despite the current economic uncertainty due to Covid-19, our Secure Stan and Sues still had mixed feelings about their annuity purchase

In total, ten of our original 80 respondents bought an annuity. With our group of Secure Stan and Sues a couple had not quite understood what they had done and some had been advised to buy an annuity as part of a blended solution. Others had either been confused and felt overloaded by too much choice, reverting to an annuity as the simplest option, or felt that they did not want the constant worry about investment returns and making the right decisions associated with drawdown. One year later, and perhaps somewhat perversely, we found that those who had purchased a secure income for life were the most likely group to have some initial regrets, questioning whether they should have taken advice or could have received more money if they had waited longer, or whether the inflexibility of the annuity is really the right thing for them given that circumstances can change quite rapidly. In the back of their mind is a niggling disappointment with current annuity rates and the thought that rates might get better in the future.

Five years on, we spoke to three of the original ten (plus another five that had subsequently made an annuity purchase). Perhaps surprisingly, given the backdrop of Covid-19 causing a large drop in stock markets, and the prospect of a no-deal Brexit, we found that their initial views had not particularly changed. Those who were happy with their choice back in 2016/2017 remained pleased today; those who had doubts still felt the same.

> *Yes, I feel as though I've done very well, really. I'm just amazed really at how well I've come out, I've had a good working life, but emerged from that and still have a good income, so it just amazes me every day… I don't think I'm knowledgeable enough to manage it myself to be honest. So, I'm quite happy to have a regular income.*
>
> **Female, Age 65-69**
> Repeat Respondent, Annuity

> *Just that we're not relying on my pension as such, so total amount might be more appealing to me than the regular money I'm receiving now… [In hindsight] I would have definitely looked into it more and deeper and looked at what other options there were.*
>
> **Male, Age 60-64**
> Repeat Respondent, Annuity

Our total encashment cases had no regrets

17 of our 80 original respondents totally cashed in their pensions. They did so for a variety of reasons (and spanned a number of our Pension Personalities); for example, because they did not trust pensions, or they felt they could do better themselves, or they saw a projected retirement income figure in their latest annual statement which showed that their pension would be "next to nothing".

We spoke to six of the original 17. We will explore their journeys in more detail in our next report but, in summary, they have no regrets and are happy to have the money under their control. When probed to see whether what they had done with the money had made back the tax they had paid, or kept pace with what they could have got as an investment return from their DC pension, none had made this comparison.

> *I'm quite happy with the decisions I have made. I don't think I've made any wrong decisions and I'm quite happy that the money that I had is still there, I haven't lost money on anything… I'm quite happy that I got the lump sums that I did and put them in the bank. I know it's there and I can get it any time. So, I don't have any regrets about anything I've done from a financial point of view.*
>
> **Female, Age 65-69**
> Repeat Respondent, Total Encashment

5 Mismatch between members and policymakers

Behavioural biases are resulting in a mismatch between members' drawdown behaviour and policymakers' expectations

Pension freedoms have reframed pensions from being an 'income for life' to 'money for retirement'

Historically, the vast majority of DC pensions converted to an annuity and delivered an income for life, mirroring the basic tenet of DB pensions. Pension freedoms have fundamentally shifted how people think about their pensions firmly away from the view that DC money is simply there to deliver a regular income for life. Members now fundamentally see their DC pots as just another form of savings. This reframing from 'an income for life' to 'money in retirement' is a subtle one, but appears to be having significant behavioural consequences.

A myriad of household circumstances means that members stated objectives for their drawdown pots do not follow a 'one size fits all approach'. However, stated intentions to use the DC pot as a 'top-up' or to 'pay for treats' were the most common mentions amongst our respondents. Members frequently had savings which they could have used instead of making a further pension withdrawal. It has not crossed their mind to consider the most tax-efficient way of accessing their various retirement savings jam-jars. Money they have actively set aside out of income into their savings account very much feels "safe" and their "their money" and they are reluctant to use it, whereas pension money somehow feels very different.

> *I can manage on what I've got. That money in my pension fund is like savings. If I need care or when I die, my son will get that money. So, in a way I'm not looking to get my hands on it. Really, it's just the cushion to sit on.*
>
> **Female, Age 60-64**
> Repeat Respondent, Drawdown

Figure 10: What their drawdown pension is for

Pensions are often 'jam-jarred', and consequently few drawdown cases have accessed more than one pot over the last five years

A small number of our respondents had consolidated their pensions ahead of withdrawing their tax-free cash. This is often with the help of an Independent Financial Adviser (IFA), although a couple of the most sophisticated had moved into Self Invested Personal Pensions (SIPPs) on direct to consumer (D2C) platforms, typically with Hargreaves Landsdown. However, consolidation was the exception, rather than the rule, and most of our respondents had more than one pot. It is important to remember that we have deliberately selected a specific sub-group of the DC population (i.e. those with £30k - £250k in their DC pensions) and so have deliberately excluded people with just one small auto-enrolment pot and those who have enough DC money to warrant paying for ongoing financial advice. That said, our finding is also broadly supported by data from the FCA's 2017 Financial Lives Survey, which suggests that three in ten of all DC pension-holders over 55 have more than one pot.

Those with multiple pots tended to earmark their pension money for different purposes and different periods of their life. Looking back at how our respondents selected which of their pensions to access first, the decision drivers ranged from picking the smallest pot, picking the pot which was not perceived to be going up in value as much as the others, or simply picking the one where 25% of the value best matched their spending need.

Five years on, and a couple had depleted their original pot and had started drawing on the next, but most had money left to drawdown. This 'jam-jarring' approach means that it was very common for us to hear that our drawdown respondents still had pension pots untouched that they have yet to access. This echoes the findings from a DC Investment Forum survey conducted in 2019[6], where seven in ten (71%) of DC members over 55 who had accessed one of their DC pots since April 2015 said that this was the only pot they had touched.

> ***I do have another little [DC] pension that is going to be for the future. … [The pension I accessed] was my biggest one, it had the most in it and that's why I took the 25% from that one.***
>
> **Male, Age 60-64**
> Repeat Respondent, Annuity

26 of our 30 drawdown respondents (all of our new respondents plus six of our original 'gang') had started to make further withdrawals. When making the decision which pot to get this money from, we probed to see whether they considered the relative tax advantages of taking tax-free cash from a new pot or a further withdrawal from their original pot. This thought had typically not crossed their minds, and the vast majority were drawing on their original pot.

Case study: Making a taxable withdrawal, rather than taking the tax free cash from another pot

Everett

- **Gender:** Male
- **Age bracket:** 60-64
- **Working status:** Working PT & winding down
- **Cohort:** Repeat respondent
- **Pension decision:** Taken TFC & made further withdrawals, also has an annuity

Their situation

Everett has a number of different pension pots, some of which he has accessed. He works as a consultant and has been reducing his workload, winding down to full retirement.

He has taken the TFC from one of his pots, moved into drawdown with the same provider and bought himself a new car, 'which is his pride and joy' and used the rest to pay off some of his mortgage. He has since made a further withdrawal of £4k from this drawdown pot to top-up some of his income and to have a bit of money to support his daughter, who is currently planning her wedding.

As he still has another pension pot with a different provider that he has not accessed. He could have taken the TFC from this, rather than the taxable withdrawal. When asked he said that he had mentally 'parked' that pension to be accessed at a later date (either when other drawdown is run out or he had retired fully).

> *"You're right, financially speaking, maybe I should have taken that one... I guess you've hit a bit of a raw nerve here. To be honest with you, I parked that one because I didn't think it was significant. It's [worth] less than my other one. You are absolutely right, I could have probably taken £10-20k tax-free from it and I didn't. Your take on it does make me realise that perhaps I haven't made the best decision."*

Consolidation, both at a scheme level and at the individual member level, is currently a 'hot topic' for the industry, particularly with the possibility of a Pensions Dashboard on the horizon. Whilst, on the one hand, consolidation can be very good for members (via reduced costs) on the other, it may result in overall poorer member outcomes due to unintended consequences. We know that members are anchored onto taking a 25% tax-free cash lump sum. If widespread consolidation takes place and nothing is done to break this ingrained behaviour, members are likely to access 25% of a single, much larger, pot - taking out much more money than they actually need. Current actions strongly indicate that any left-over money will simply sit in cash-based savings, losing absolute value over time due to inflation, and relative value compared to leaving it in their pot in a well-governed investment strategy.

Policy Implication

If consolidation is the norm, partial tax-free lump sum withdrawals over time will need to be allowed to avoid the risk of member detriment. Members will need to be educated to understand firstly that they can withdraw less than 25% in the first instance, and secondly to help them understand why spreading the 25% lump sum tax-free cash withdrawal over time would be better for them.

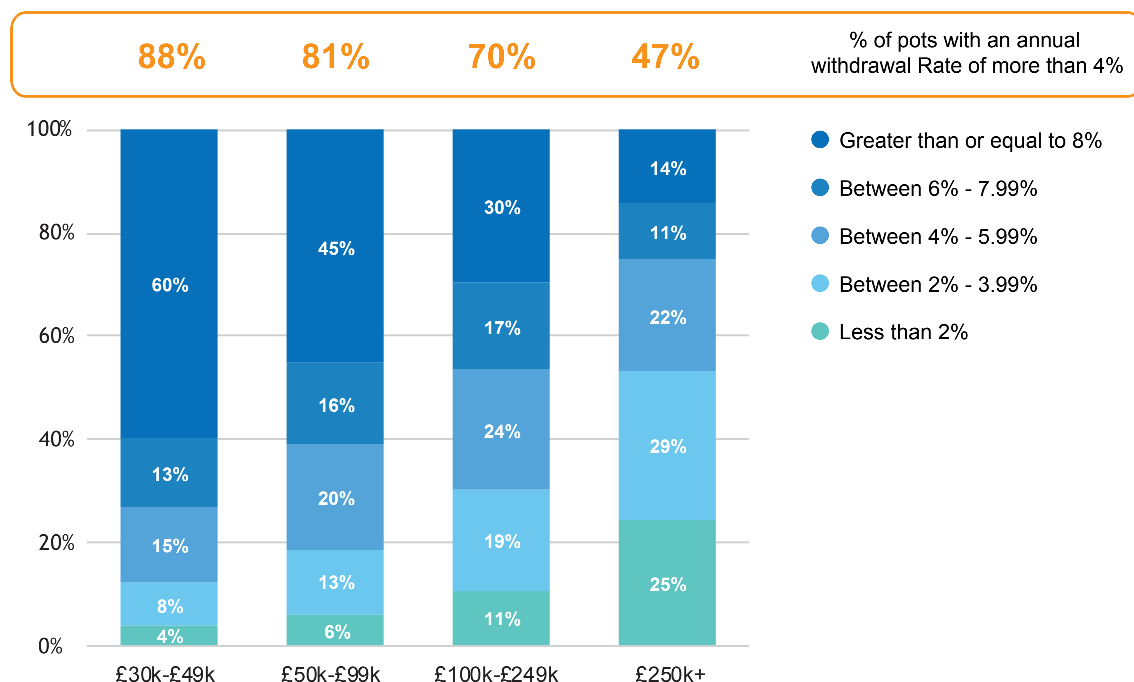
However, given the strong behavioural anchor, it will be very difficult to change member behaviour. Embedding this feature into guided drawdown will have more impact.

Present bias and the ostrich effect mean that members do not expect their DC money to last for life. They do not want to think about living beyond 90

There is much focus in the industry on designing 'sustainable withdrawal rates' and ensuring that members have an income for life. There is widespread concern, supported by the FCA's retirement market data, that members are drawing out 'too much' and will run out of money. The FCA data suggests that, overall, 42% of regular withdrawals were withdrawn at an annual rate of 8% or more of the pot value in 2019/20, up from 40% in 2018/19. We are mindful that this aggregate data is not directly comparable with our respondents, as we have deliberately excluded smaller pots under £30,000. Looking only at the FCA data for pots of more than £30,000, we find that this overall number drops to 35%.

Of course, as Figure 11 depicts, this masks large variations by pot size.

Figure 11: Annual withdrawal rates by pot sizes over £30,000, 2019/20



Furthermore, taking 4% as the sustainable income 'rule of thumb', our calculations based on the FCA data suggest that almost nine in ten (88%) of those with pots between £30,000 and £50,000 are taking more than this. Perhaps more worrying, a significant proportion (47%) of those with pots of more than £250,000 appears to be on track for their DC money to run out before they die.

Looking at these numbers, it important to remember that the FCA data presents a very narrow point-in-time, single-pot perspective. As we have seen in this research, some members are withdrawing their smaller pots first and are running these down over time before accessing the next one. So, the withdrawal rate seems large but might actually be much lower when a more holistic view is taken across all of their pots. Furthermore, the FCA data tells us nothing of what happens to this money once it is withdrawn, and the period over which it is spent.

We also know from our qualitative work that framing matters and that people like to think in round numbers. We heard some of our respondents suggest that withdrawals of less than £3k are not really 'worth it'. Some respondents also told us that their provider had set a minimum amount that could be withdrawn per transaction. In both situations, we observed members withdrawing more than they need, parking the rest in their current account and spending it over time, again artificially inflating the observed withdrawal rate.

That said, we observed that our members' withdrawal plans typically ran for a maximum of 20-25 years and that few expected their money to last longer than 10 years. Interestingly, the minority of drawdown respondents who had had advice from an IFA also reported that their adviser has used average life expectancy figures (mid-to-late-80s) as the frame of reference for their drawdown strategy.

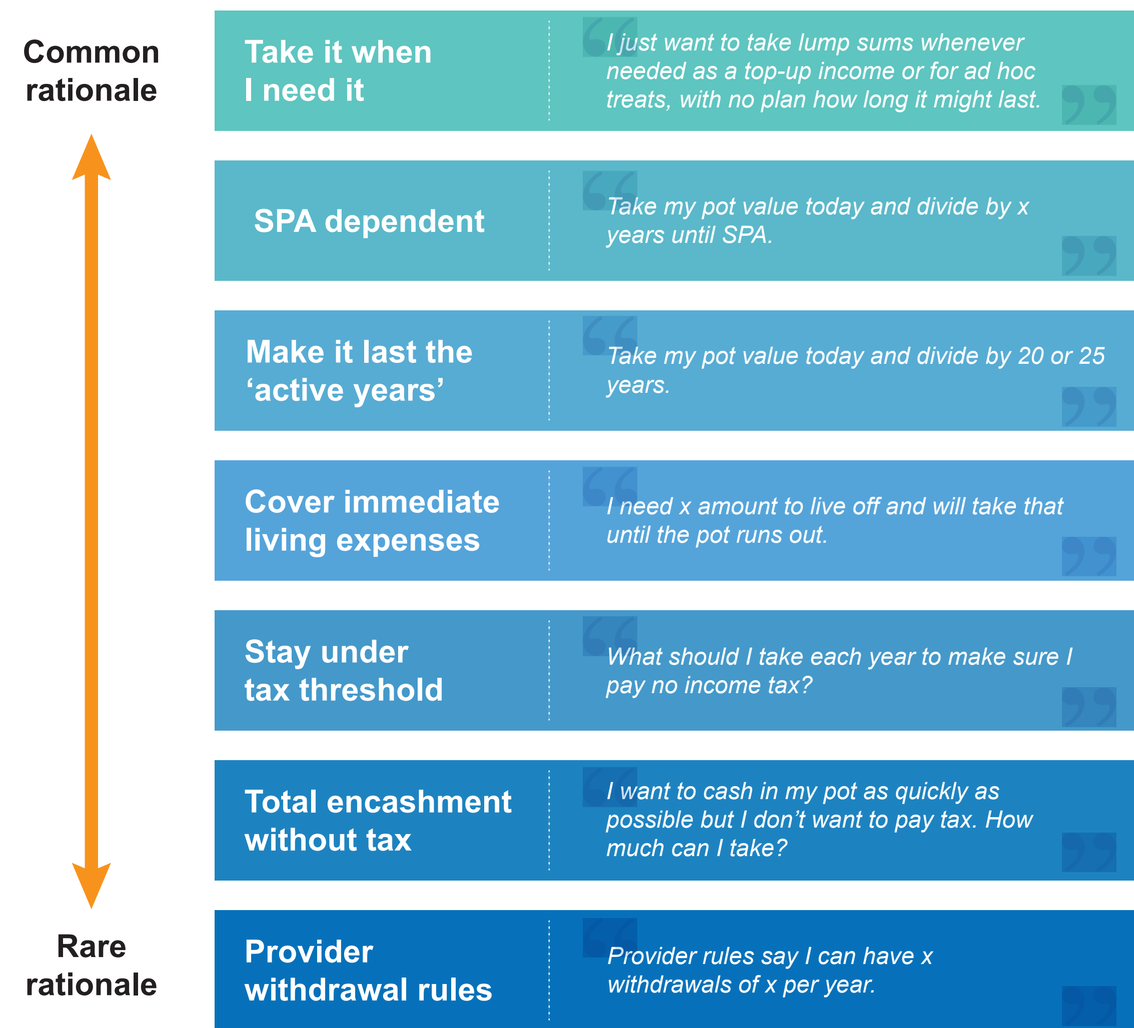
> *We kind of calculated on a twenty-year basis, I think. Depending on how my investment achieves or doesn't achieve, they've given me an amount I could have each year. If you take the pot as a whole and divide it by 20, how much I could have annually, which would last me 20 years. My thought is that if it lasts till I'm 90 that's OK. And I still have my little final salary pension and the state pension and that should be enough to live off.*
>
> **Female, Age 65-69**
> Repeat Respondent, Annuity & Drawdown

Current withdrawal behaviour appears to fall into several distinct segments

Perhaps this disjoint between member behaviour and the industry perception that pots should deliver a sustainable income for life should come as no surprise. Members do not like annuities as they see the stream of income generated by the current annuity product design as a 'pittance'. Currently, they certainly do not want to replicate this experience with their drawdown money by trying to eke out a small pot for a very long period of time. Data from the DC Investment Forum's 2019 report[6] suggests that just three in ten (31%) of their survey respondents had combined DC pot sizes of more than £100k.

> *If I did my calculation and it came back that I was taking out £3,000 a year, then I'd panic and I'd say that doesn't work. And I find my own formula. So, I'll cross my fingers and hope for the best.*
>
> **Female, Age 65-69**
> New Respondent, Drawdown

Figure 12: Rationale behind respondents' plans for their drawdown pots



Looking at the stories behind the numbers, members making withdrawals above 4% justified their actions on the basis of the overall size of their pot, their holistic household financial position, and their expectations of future income needs. A selection of their stories is presented in the case studies below.

Case study: Runs out of money at 75, doesn't know how much the state pension is that he expects to rely on

James

- **Gender:** Male
- **Age bracket:** 65-69
- **Working status:** Fully retired
- **Cohort:** New respondent
- **Pension decision:** Taken TFC & made further withdrawals

Their situation

James is a widower with no dependents. He worked as an engineer for a telecoms company and was incentivised to take retirement with a generous 'leaving' package. James is financially comfortable, he owns his house outright and received two sizable inheritances when his mother and mother-in-law died prior to him retiring.

He went to see someone at a wealth manager on the basis of a recommendation of a friend. He liked what he was told and went into drawdown, choosing low risk investments. James has been drawing down to fund his quality of life ('a nicer bottle of wine') and his twin passions – travel and photography.

He is aware that at his current withdrawal rate the money will be gone by the time he's 75. He feels happy with that, as it feels like a 'reasonable figure' and was in-line with something he picked up in a pension workshop organised by his work – that you need most of your money between 65 and 75.

James plans to continue to 'enjoy' life as much as he can and feels OK about falling back on the state pension and his house should he need to in later life. However, he has not looked into any of this in any detail.

> *"So basically the idea is that, as I'm now 65, if I keep going at the current rate [of withdrawals]for another 10 years – that gets me to 75. The need for money drops off the older you get and that looks quite good to me, to be 75 and still have at least the equity I have in the house, if I really get to the stage where I have spent everything else, then I'll take equity out of the house. On the basis that I've got no dependents to leave it to, I'll take as much nor, rather than leaving it to the government or whomever."*

> *"I can't worry too much about it, and if all else fails, I've still got the house. If I can't go anywhere or do anything, the house is paid for and state pension will give me at least enough to by me food and water and keep me warm…. To be honest, I'm not quite sure how much the state pension will be. I would think that some things would have to be cut back. That's the problem, we don't know what our needs are going to be when we're 75… it's a big thing to think about."*

Case study: Will exhaust pension savings before state pension age, unclear whether she has thought about the long-term consequences

Lisa

- **Gender:** Female
- **Age bracket:** 60-64
- **Working status:** Unemployed/retired
- **Cohort:** New respondent
- **Pension decision:** Taken TFC & made further withdrawals

Their situation

Lisa is divorced, has three adult children and is living together with her new partner. She took some time out of work when her mother died to look after her father, and found it difficult to find a job when she wanted to go back to work. She didn't think about retiring as such, it was forced by her financial situation.

> *"I never thought about retiring, it just gradually became the 'actually, that's what I've got to do now'."*

She had taken her TFC after her divorce to purchase a new house, which has meant she no longer is paying rent, reducing her outgoings. While she is still actively looking for work and doing whatever 'bits and pieces' she can find, Lisa is drawing down on her pension to top up any income, up to the current tax threshold.

> *"It was several months after [I bought the house] that I wasn't working and that happened gradually. I did a bit of part-time work with my partner initially, so money was coming in initially that way. And then I realised that if I waited a whole year I could draw on my pension again. I'm allowed to earn £11k a year, but if I had only earned £5k a year, it meant that I could get £6k out of my pension without paying tax. So I realised that I could do that and that's what I've done over the last few years."*

Case study: Drawing down as and when needed as a 'top up' to DB income

Laura

- **Gender:** Female
- **Age bracket:** 60-64
- **Working status:** Working PT & winding down
- **Cohort:** Repeat respondent
- **Pension decision:** Taken TFC & made further withdrawals

Their situation

Laura still does some work providing mobile beauty services, but is winding that down at the moment; partly because of CV-19 making her work more difficult and partly because she 'had planned to cut down anyway'.

Her work brought in 'a bit of pocket money', as Laura's husband 'takes responsibility for everything financially in terms of utilities, food and everything connected to the home'. Her husband is also retired and his pension provision covers their every-day income needs.

Laura has accessed her pension and made a couple of withdrawals, spending the money on treating herself and her husband.

> *"That one is always going to be used for things like weekend breaks and if we wanted to do something special, I would always be in the situation, independently, to help, and say to my husband, I'll contribute to it, rather than him paying for everything."*

As she has earmarked this pot of money solely for discretionary spending, she is making withdrawals as and when she needs them.

> *"Yeah, that's what I was doing [withdrawing as and when needed]. I haven't actually taken any since April, because I haven't needed it."*

Case study: Drawing down the entire pot over the next couple of years to bridge the gap until state pension age, money in the DC pension is considerably less than in savings and investments

Damian

- **Gender:** Male
- **Age bracket:** 60-64
- **Working status:** Fully retired
- **Cohort:** New respondent
- **Pension decision:** Taken TFC & made further withdrawals

Their situation

Damian retired at the same time as his wife, who is a few years older than him. They wanted to spend more time with their young grandson and support their daughter and son-in-law by being available for childcare.

Damian's wife retired at SPA, she also has a few small workplace pots from her PT employment – all of which make her income 'greater than when she was working, which takes the pressure off'. Damian still has three and a half years to wait until SPA and has accessed his pension to bridge that gap. He is expecting to draw down on his pension pot completely over that time period.

"With the private pension that I've got, basically all I have to do is survive three and a half years until I get my state pension and then we'll be pretty much sorted."

Damian and his wife have separate investments and savings with which they plan to top-up their state pensions throughout retirement.

Looking back at the risks outlined in Figure 5, we did not find evidence that members were thinking about any of these issues when making their decisions. Despite this, living well in their later years may turn out to be possible for this cohort who do have the benefit of DB pensions, savings and other income to fall back on. Data from the 2019 DC Investment Forum Survey[6] suggests that 50% of members who have accessed a DC pension under the freedoms have more than £20k in other savings and that 38% have more than £50k. One in ten have a second property. This will not hold true for future cohorts.

Drawdown respondents struggled to identify themselves with the correct FCA pathway

Most of our drawdown respondents understood that their remaining money was invested, but some did not. A few respondents were adamant that they chose options without any risk. Typically, these people had felt overwhelmed by the paperwork and had one of their children or family members fill it out on their behalf.

> *My son filled out the forms so I'm not that clear. I've always rejected doing investments. I'm not risky, I want the security rather than the risk part… I do remember now, you're bringing it back to me… and I went for no risk, I didn't want any risk at all.*
>
> **Female, Age 65-69**
> New Respondent, Drawdown

Many more were certain that they were invested in very low risk, almost cash-like, assets. Other than the handful of 'hobby-horse investors' who actively enjoyed playing the markets, 'medium' was the highest risk our respondents were prepared to take.

> *Compared to some of my friends who have pensions, mine seem to have done exceptionally well, I think because they're a little bit older they have theirs on a very low risk. I'm on a medium risk, took the chance and thankfully it's not failed. After I get my state pension, I'll just put it onto low risk.*
>
> **Male, Age 60-64**
> New Respondent, Drawdown

The FCA's Investment Pathways, due to be fully implemented by February 2021, go some way to help address the issue that not advised members' strong preference for cash has the potential to place them in unsuitable assets for a long period of time. Pathways will nudge savers accessing their pension for the first time to allocate their pension saving into one or more of four investment pathways, according to their objectives.

When tested with our drawdown respondents, the drawdown pathways fell somewhat short of meeting member needs. Thinking back to their original decision, many reported that they had wanted to take lump sums out of their drawdown account on an ad hoc basis over time. They could not match this plan to any of the pathways shown. Others wanted to take all of their money out, but over a longer time period. When pushed to choose one of the four on offer, they would probably have gone for Option 3 even though they did not see themselves as taking a long-term income.

Figure 13: FCA Investment Pathways

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

That said, asking about how they wanted to use their money was felt to be a much more useful reference point than trying to assess their risk preferences.

Our original respondents were now five years away from their original decision. Based on the descriptions above they could not see how this choice framework related to them anymore. They wondered what would happen to people once the five years had expired. Some questioned whether there was anything similar planned for people like them. Those respondents who did not get advice had not subsequently had any contact with their provider to see if their investment choices were still appropriate. They felt that they had somehow fallen through the gap.

Policy Implication

FCA Pathways will often offer an incomplete solution to member circumstances. We should, as an alternative, be considering the use of a default solution that covers the main retirement risks urgently.

Since pension freedoms were introduced, the FCA's retirement income market data suggests that more than three million pots have been accessed for the first time, and around a third went into drawdown. Almost one million pots have therefore already moved into drawdown and have missed out on a much-needed policy intervention.

Members don't fundamentally change their views the moment they access their tax-free cash, so why is Responsible Investment not widely on offer in drawdown?

In a similar vein, our respondents were shown a definition of Responsible Investment (see Definition of Responsible Investment) and asked whether they had been asked about their preferences at the time they moved across into drawdown, or subsequently. Just a handful had had a conversation about ethical investing. Sometimes this had been prompted by the respondent themselves.

> ***I came to this drawdown thing and my adviser showed me the spread of companies and things that were available. And then I said, I wanted as far as possible to have an ethical fund.***
>
> **Female, Age 60-64**
> Repeat Respondent, Drawdown

Definition of Responsible Investment

Responsible investment means investing in a way that takes into account not just how companies are managed, but other issues too, from the impact they have on the environment to the role they play in society. People do this because there's evidence that these issues affect how companies perform over the long term – and therefore what happens to the money that's invested in them. For example, if a company you invested in was involved in an oil spill, found to be treating its workers poorly, or accused of bribing politicians in another country, it would damage that company's reputation and its share price. If that happened, you'd lose money. Ignoring issues like these might mean you miss out on opportunities too. For example, a company manufacturing hybrid cars might do better over the long term than one making diesel cars. A company that invests in training its workforce might outperform its competitors. A company paying its executives reasonable bonuses might return more value to its shareholders. In each of these examples, considering how the company treats the environment, how it treats people, and how it's managed, over the long term could enhance the company's performance and may make you more money.

Awareness of the issues underpinning Responsible Investment is increasing, and the vast majority of our respondents confirmed that they have recently started to think more about environmental issues, social responsibility and corporate behaviour. This change in attitude has been driven by a range of factors – the media, pressure from their family members and the impact of Covid-19. That said, it came as a surprise to many that they could make a difference with their pension money.

A small number had had ethical funds in the past and had banked with ethical providers. With hindsight, they were very disappointed that they had not been offered this option when they moved into drawdown, as they would have certainly invested this way.

> ***I've been feeling more determined that my money should be used in a responsible way, and the investments I've made in the last few years have all been in that field. The social aspect would be my priority and then the environment and then the corporate governance.***
>
> **Female, Age 65-69**
> Repeat Respondent, Drawdown

When told that some large providers (for example NEST) had started to adopt Responsible Investment and carbon-neutral portfolios as their default investment strategy in accumulation, our respondents were confused as to why such things were not routinely offered for those moving into drawdown too.

> *You shouldn't have to ask for it. But actually, it would be good to think that I made that choice, so I'm a really good person because I chose to do this rather than, well, they just did it anyway and it has nothing to do with me.*
>
> **Female, Age 65-69**
> Repeat Respondent, Drawdown

> *Yeah, [responsible investment] should be on offer when you're in drawdown as well. I certainly would have done it.*
>
> **Male, Age 70+**
> Repeat Respondent, Drawdown

> *I'd be comfortable having a default like that.*
>
> **Male, Age 70+**
> Repeat Respondent, Drawdown

In line with findings from the 2020 DC Investment Forum's Responsible Investment tracker survey[8], our respondents would typically be willing to take a lower return (as long as it did not exceed 10%) and be happy to pay slightly higher costs. In practice, evidence suggests that better run companies make better returns, so they would not need to make this trade-off. However, they definitely would not be willing to take more risk. This will need careful positioning by providers.

Inertia prevails, so will the drawdown market be the next legacy product scandal?

Five years ago, we observed that not advised members moving into drawdown typically did not shop around and simply went with what their pension provider had on offer. The 'path of least resistance' was seen as both easiest and the safest route, particularly as members felt ill-equipped to shop around due to concerns about scams and no easy way to compare products. These early findings have been replicated in study after study.

With this in mind, we were keen that this study built on these findings and added to the body of knowledge by exploring whether those already in drawdown had subsequently looked at their products to see if they are still getting the best deal.

Sadly, it appears that inertia prevails here as well. Amongst our not advised drawdown respondents there has been no further shopping around or reviewing to see if their drawdown plan is still 'suitable'. Once it's done, it's done. Often there is also no understanding that moving/shopping around is an option for them - at any point.

8 https://dcif.co.uk/wp-content/uploads/2020/07/the_key_to_unlocking_member_engagement.pdf

> *I shopped around initially, but there wasn't a great deal of difference between providers, so I just left it where it was. My wife did that, I guess based on best performance on the percentage earnings… I've not looked at it since.*
>
> **Female, Age 65-69**
> New Respondent, Drawdown

Of course, this would not be an issue if we could be sure that those already in drawdown were consistently getting the best product in the market. Whilst innovation has been slow, it would be unrealistic to believe that the product's drawdown providers put in place under extreme time pressure five years ago will not be much improved on over the next five or ten years. Indeed, a recent report by the PLSA suggests that "both the trust- and contract-based sectors are developing and anticipate developing new solutions that can deliver simpler and lower cost routes to drawdown"[9].

Policy Implication

Inertia prevails in the drawdown market. Members do not shop around at inception and do not keep a close eye on product innovation.

To date, the limited policy initiatives appear to be focused on delivering better outcomes for those entering into drawdown. Drawdown is not subject to the same value for money/quality requirements, defaults, or price cap policies as DC pension savings. But with nearly a million policies already in place, without action to protect the legacy customer, the drawdown market may be the next pension scandal waiting to happen.

9 https://www.plsa.co.uk/Portals/0/Documents/Policy-Documents/2020/The-Evolution-of-Drawdown-2020-Addendum.pdf?ver=2020-07-28-114628-000

Mind the support gap

Members do not have the knowledge or skills to make the 'big decision' alone

Members recognise that deciding what to do with their remaining 75% is a 'big decision'. But, by deciding not to buy an annuity, they are effectively moving from an environment where inertia prevails to one where they have to make some ongoing, active, and complex choices. Figure 14 below is a reminder of the 'skills' members in drawdown will need.

There is now a substantive body of research consistently which points to the fact that the vast majority of DC members are simply not equipped to understand or effectively trade-off the numerous and complex risks they face. We found no evidence to the contrary in this study. Five years on, our drawdown respondents have not spent this time building up their investment knowledge, beefing up on the latest mortality statistics and working on their cash-flow projections. They were simply "hoping for the best" back then, and the same applies today.

Figure 14: Retirement income decision factors

Big questions for consumers to answer if they don't want an annuity...

1. *How long will I live?*
2. *How much money do I want to take out of my pot as income?*
3. *What investment return will the pot need to generate to make sure I don't run out of money?*
4. *How can I limit my tax liability?*
5. *What is the long term inflation risk?*

So, they now have to be...

- Fortune tellers
- Actuaries
- Investment managers
- Tax accountants
- Economist

Currently, they are not using any support to make the 'big decision'

Although there is a plethora of well-publicised support available to members, their sense is that this is almost exclusively focussed on helping members understand the options now available to them under the new freedoms; namely leaving their pension where it is, securing a guaranteed income for life (buying an annuity), taking their pension a bit at a time (through drawdown or UFPLS), or taking it in one go (full encashment).

Once they have taken the plunge into drawdown, our members felt that they had been left to their own devices to decide how to take their money. We prompted our drawdown respondents to see if they had come across any tools (for example, cash-flow modelling tools) or guidance (for example, the 4% rule of thumb) in this area. The vast majority had not, and would not even know where to go to find this support. But nevertheless, felt that these sorts of things would be very useful indeed. Our observations firmly support the PLSA's conclusion that "work on supporting older members in drawdown is incomplete".[7]

> *I just thought it was done and dusted. I just thought if I've got a question I'll ring [my provider's] helpline. As I say, when I saw Pension Wise [being advertised] I just thought it was if you worked for the government… so, I learned something new today… To have a conversation with a party that wasn't involved in me making my decisions, to chat to someone and say this is my situation… I think that would be very helpful to put your mind at rest or guide you the right way.*
>
> **Female, Age 60-64**
> New Respondent, Drawdown

However, when prompted, members also disclosed that they did not actively look for any help, nor have they been triggered to do so by any provider communications. Given inherent member inertia, it also difficult to see how they will access this type of support without some strong 'nudges'.

Policy Implication

The first request for a further withdrawal is a useful trigger for providers to deliver a package of communications, including links to online tools and further guidance on sustainable withdrawal rates.

However, member inertia suggests that even if such guidance is available, take-up is likely to be poor.

Pension Wise is a valued service but did not offer our members the 'advice' they needed

Awareness of what exactly Pension Wise does remains low, especially amongst the group of respondents whom they could help most (those who don't really fully understand their options).

> *I don't know whether I've heard of them, spoken to them, or been on their website… Are they the independent thingy?*
>
> **Male, Age 65-69**
> New Respondent, Drawdown

Five years ago, many of our respondents who went to see Pension Wise reported that they found the session to be useful to confirm their options and clearing up any misunderstandings, but of limited help when it came to actually deciding what was right for them. This sentiment was repeated amongst our new drawdown cohort. They were looking for a personal recommendation based on their own situation which is not something Pension Wise was set up to deliver.

Based on this experience, our drawdown respondents reported that Pension Wise was simply not on their radar to support them with their remaining 'big decision'. And their overarching suspicion is that it does not provide this type of 'advice'. None of those who had made an online or physical appointment with Pension Wise could recall any discussion at all about how to generate a sustainable income from their pot.

> *I did have a conversation with Pension Wise… and I got a pack through with lots of questions that I looked through. It was fairly useful, but I guess I'd kind of made up my mind by then. They probably can't advise on individual pension funds and with the overall planning. Like you've been saying about an end amount that I am trying to get to, that I need to work out from scratch to reach that goal if you like.*
>
> **Female, Age 55-59**
> New Respondent, Drawdown

> *Pension Wise was OK. There wasn't a lot of information and they just confirmed what I wanted to do. …No, they didn't talk to me about making the money last. And they can't push you in a certain direction. They're just going to tell you the information that is available anyway.*
>
> **Male, Age 70**
> Repeat Respondent, Drawdown

Ongoing adviser models did not appear to fit particularly well with our members' support needs

In the past, our respondents have talked about getting professional help when the time came to make their 'big decision'; ten of our drawdown respondents did just that. Most were recommended their adviser by a friend or family member.

However, others had been put off seeking advice as they felt that they simply needed some one-off support from an 'expert' to help them with basic planning and investment choices. They were either unwilling to pay an ongoing fee for the adviser to continue looking after them and their money or felt that their pot was too small to justify this. Some have had bad experiences in the past and did not trust advisers to deliver independent advice.

> *Nope, [wouldn't consider using an IFA] because they cost money, and whether they're really independent?! That's another thing.*
>
> **Male, Age 65-69**
> New Respondent, Drawdown

Our advised respondents tended to have larger pots (in excess of £50k). They were commonly advised to consolidate DC pensions where this was appropriate (often onto a platform) and to take full tax-free cash. Typically, the adviser used a risk questionnaire (where they usually came out as a medium to low risk) to put them into model portfolio risk-rated funds. Few were taking any regular income from their drawdown policy at inception.

They were generally happy that their adviser has been 'doing well' over the last few years. However, this perception is entirely based on how their fund has performed. That said, they have not benchmarked their fund performance against the market, nor do they appreciate that their adviser is usually not actively managing their investment portfolio.

All reported having the typical ongoing service relationship with their adviser. Annual meetings were usually held face to face, but Covid-19 has recently shifted meeting this online. Members are happy that this advice relationship is giving them "peace of mind".

> *They're keeping an eye on it where it's invested, and they will be there if ever I need them. Any time I feel I've got any queries or if I want to do anything else. And they'll be contacting me annually if I don't contact them beforehand.*
>
> **Female, Age 65-69**
> Repeat Respondent, Annuity & Drawdown

When probed, these meetings were little more than check-ins to see if anything had changed. None of our advised respondents were aware of cash-flow modelling tools and very few had had any detailed conversation about budgeting and withdrawals. A couple went as far as to suggest that their relationship was quite transactional and that their adviser has no real awareness of how they want to use their money.

> *So, each year he said, you know, well, what about the balance of where everything's invested? Are you maintaining your low risk attitude? And I've said, yes. And then that's it. End of story. We have a long chat about his family and his holidays and he's very nice. And I'm like, you're a very nice young man, but really, you know, are you worth two grand? I'm not sure it really is. But I didn't know what else to do. I don't know how.*
>
> **Female, Age 60-64**
> Repeat Respondent, Drawdown

They usually have a vague notion that there are some adviser charges which are taken directly off their fund, but there is a general perception that these are 'small'.

> *If the pension isn't doing well, he will talk to me and that's the thing reassurance. I don't mind him charging me. It doesn't bother me. I believe it's a monthly fee, but not much. I suppose because it's a friend that I haven't really looked into, it really, the embarrassment factor of it. So again, it goes back to me having trust in him.*
>
> **Male, Age 65-69 70**
> New Respondent, Drawdown

> *They charge a certain percentage, is it 1.25, or something like that a year?! I honestly can't remember. I do get a full statement [where it's in pounds and pence] but I don't look at it because it would only upset me. It's the price of doing the deal. … [On percentage cost over time] I certainly haven't thought about that and you have given me food for through, yeah, what do I get for my 1.5 percent?! I might well call him and ask him that.*
>
> **Male, Age 65-69**
> New Respondent, Drawdown

Advice relationships are based on inertia. Since signing the initial documents, our respondents had not subsequently thought about whether actually they needed an annual review. Nor whether they can ask for anything different.

But when prompted to do so by the moderator, some agreed that this is not particularly necessary as their financial situation is very stable. In such cases, they suggested that ad hoc reviews every couple of years, or when a major change happened (such as giving up work) seemed better suited to their particular advice needs. That said, they also expressed concern that they do not know how to break off the relationship with their adviser and are worried about what will happen to their investments if they do, as they do not want to take on this responsibility themselves.

> *Sometimes you kind of almost put it in your folder and forget about it. It kind of will make me look about a little bit closer after my next review.*
>
> **Female, Age 55-59**
> New Respondent, Drawdown

Policy Implication

Current support models are not particularly fit for purpose. Inertia means that members are unlikely to access the guidance that is on offer. Pension Wise cannot offer what members want – an 'expert' to offer a solution to them. Inflexibility in the advice market means that some members who would like to have one-off or ad hoc advice to simply help them get into a drawdown solution are currently paying for an ongoing service.

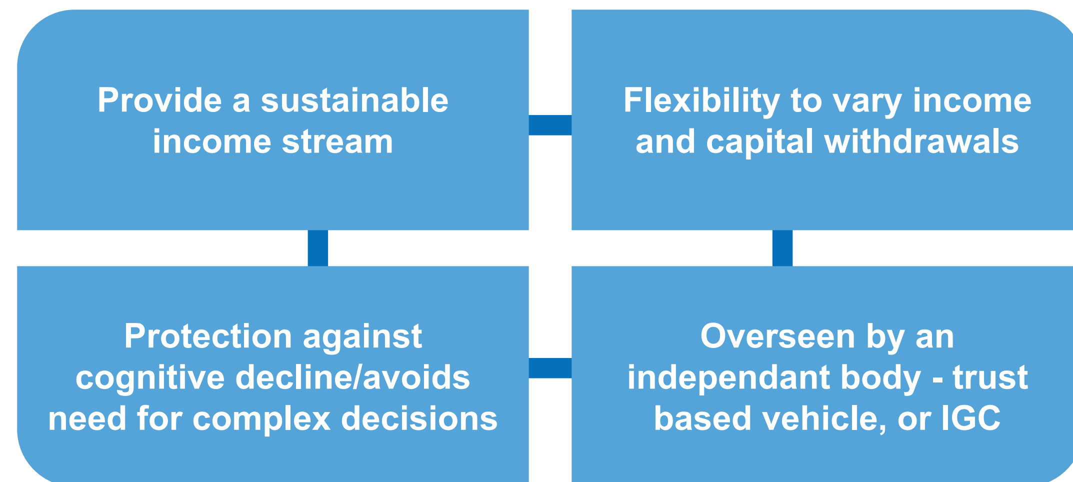
If the advice market cannot deliver more flexible solutions, then alternative 'do it for me' solutions will be needed for all, and not just some, in order to fill the gap.

The concept of 'guided drawdown' was strongly welcomed by members

The concept of 'guided drawdown' has the potential to fill this advice gap. There are several propositions already in, or close to being in, the market, but rather than test one in particular we used a broad, conceptual description that was firmly aligned with the principles outlined in the PLSA's latest policy paper[7].

Drawdown members overwhelmingly found the idea of a guided drawdown product very useful. Members particularly valued the flexibility to change their mind at any stage, and that the 'experts' were making the difficult choices for them. They might not have taken it up themselves, but nonetheless, it would have provided a benchmark against which to assess their own thinking. Most, including some with a financial adviser, said that they would have at least considered this option if it had been available to them.

Figure 15: PLSA's overarching principles for guided drawdown



It might have made me think again and look at that route [instead of getting a financial adviser]. Obviously, if I could have avoided paying charges, then that would have been good to look at.

Female, Age 65-69
Repeat Respondent, Drawdown

That said, a minority raised the concern about whether they could trust that their provider would be acting in their best interest.

That is the problem with most financial institutions. You have this feeling that they're not to be trusted. You swallow it like a bitter pill. You deal with them like taking a really nasty medicine. That's obviously because you don't feel there's much alternative.

Female, Age 60-64
Repeat Respondent, Drawdown

We also tested this concept with our annuity cases to see if it resonated with them. For some, it would have made no difference. But a couple who were initially 'too scared' to go into drawdown reported that it would have removed much of the complexity and the feeling of choice overload and might have resulted in them making a different decision.

These findings are very much in line with the DC Investment Forum's 2019 result[6]. Here, almost eight in ten (77%) DC members said that they would like some form of guided drawdown.

Figure 16: Member's preference for the type of support offered by their provider

		Do it for me	Do it with me	Do it myself
	All members who have not retired	23%	54%	22%
Pension decision	Not accessed a pension	20%	61%	19%
	Accessed a pension	27%	46%	27%

- Do it for me - I would just like my pension provider to offer a single plan
- Do it with me - I want to adapt any plan offered by my pension provider so that it's somewhat tailored to suit me
- Do it myself - I am confident that i can create a bespoke plan for myself which is tailored exactly to my needs

Source: Five Years of Freedom, Evolution, Not Revolution, DCIF 2019

7 Conclusion

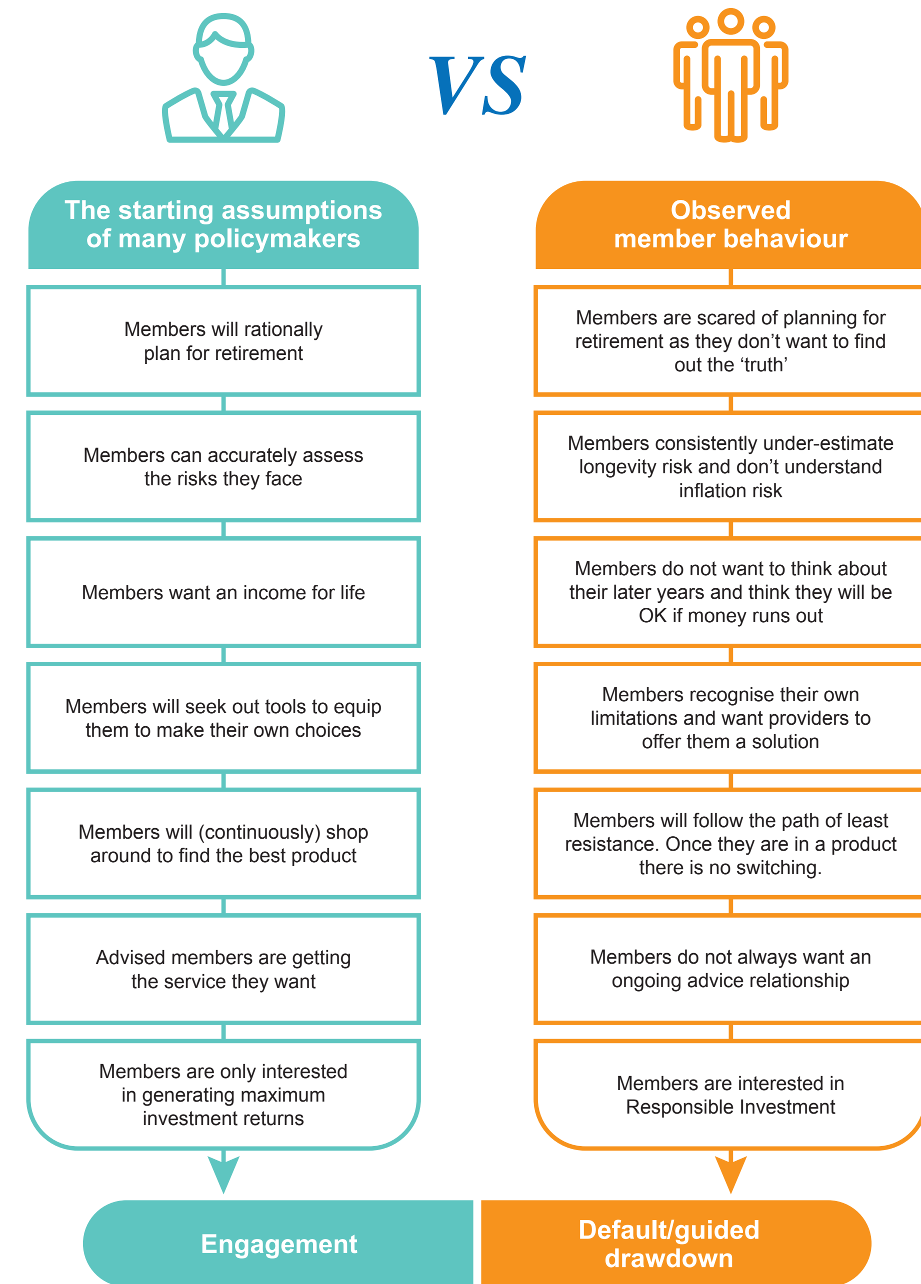
Almost a million pots have entered into drawdown since pension freedoms were introduced, the majority (two thirds) of which have been £100k or less. Members are starting to make the 'big decision' on the remaining 75% of their money. At the moment, they are faced with a binary option of working through the decision by themselves, or paying for ongoing financial advice.

Most are choosing the former, and are doing the best they can, given the impossible task we have set them. Their observed behaviours often appear to be illogical and irrational, and yet in the context of their bounded rationality feel like perfectly reasonable plans to them.

Without help, they will continue to behave in very different ways to how the 'industry experts' would expect and poor member outcomes will follow.

Anyone questioning the complexity faced by members entering into drawdown need only think about how providers go about designing a drawdown product; a team of seasoned 'experts' is required, each bringing a different skill set to the party. Members going it alone are riddled with behavioural biases that prevent them from thinking about their later years, they struggle with numbers, they have no knowledge of investments, and consistently misunderstand or are ignorant of the risks they face.

Figure 17: Disjoint between industry assumptions and observed member behaviour



Better engagement simply cannot solve these fundamental issues and will only make a difference at the margins.

This situation is far from ideal, and members themselves want more 'do it for me/do it with me' solutions. Their tendency to want to follow the 'path of least resistance' suggests that their own provider will be their first port of call for such support. Knowing that a reputable company/scheme has set up a solution to "do it all for them" in much the same way that a financial adviser would - but at a lower cost - was very much welcomed in principle.

Members do not know the difference between a trust-based scheme and a contract-based scheme, and do not understand why there would be any difference in the support they are offered from scheme to scheme. They expect a level-playing field and are surprised to find out that is not always the case. If it is not possible for their own provider to step up and offer this type of support (for example, in the case of subscale trust-based schemes) then members would hope that there would be some signposting to a 'preferred' solution. In this brave new world of guided drawdown, it is easy to imagine the emergence of a panel of 'providers of last resort' with the master trusts playing an important role in plugging the gaps in the trust-based environment - as they do in the accumulation phase.

Finally, we sound a note of caution. As new and cheaper drawdown products are developed, perhaps even embedding Responsible Investment as a default, the industry would do well to remember that it generally operates in an environment where member inertia prevails. Our research strongly suggests that the drawdown market is no exception. Members will not shop around to benefit from the product enhancements. The pensions industry has long been focused on winning new business, often to the detriment of the legacy book. Let's take a moment to think about what we need to do collectively to ensure that good member outcomes are also the norm for the brave pension pioneers who are already in drawdown, as well as the next generation. The last thing our industry needs is another legacy product scandal to tarnish members' already fragile trust. A nudge is seldom enough. Existing members will also need to default into new products, unless there is a good reason not to.

Conclusion

8 Appendix

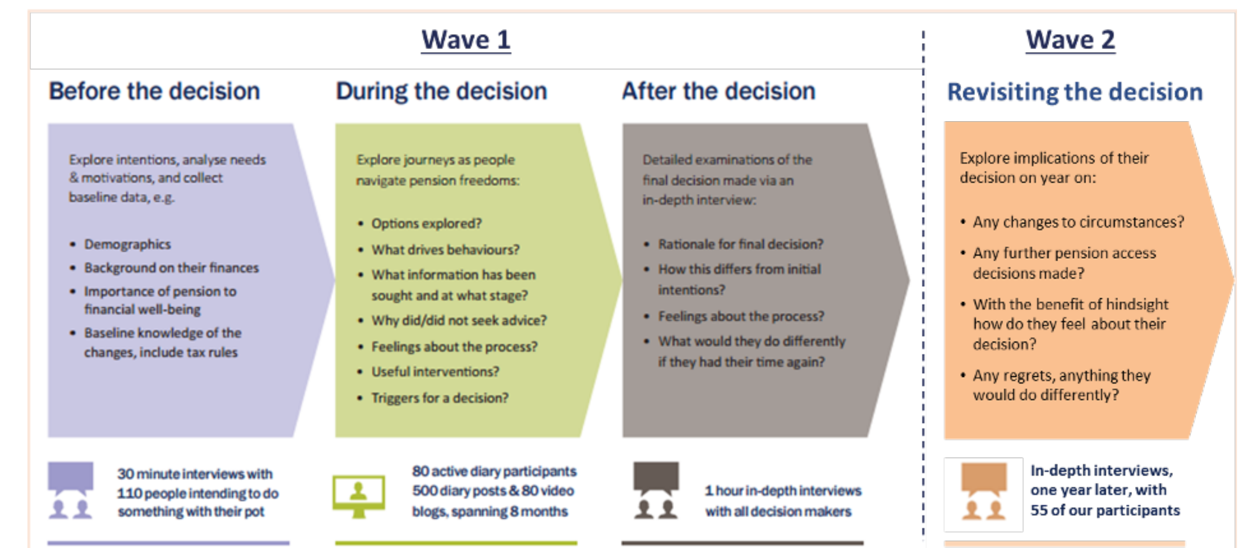
Research methodology

Wave 1

In Wave 1 we tracked 80 people between April 2015 and February 2016 exploring their intentions, needs, and motivations in detail, before asking them to keep an online diary for the duration of their decision-making process. They detailed their thoughts, feelings, and frustrations in these diary entries, which were recorded using a mixture of video blogs, written online blogs, emails, and phone interviews. At the end of this study, we conducted hour-long depth interviews with each respondent to explore the rationale for their final decision.

Wave 2

In Wave 2, we re-contacted our survey participants to explore how their lives had changed over the past 12 months, and whether this led them to take any further actions, or made them question their original decision in any way. In total, 55 of our original 80 participants took part in this follow up research. Fieldwork took place between November 2016 and January 2017 and consisted of 30-minute follow-up telephone discussions and additional face to face interviews to further probe interesting cases. We had a good mix across our various groups.



Wave 3

In this Wave, we spoke to 50 respondents, 30 from our original cohort, and 20 new respondents. The fieldwork took place in October 2020. The hour-long interviews were all conducted online.

Age breakdown by type of respondent:

		Age Bracket			
	All respondents	55-59	60-64	65-69	70+
All respondents	50	10	19	16	5
Repeat respondents	30	3	14	9	4
New respondents	20	7	5	7	1

Gender breakdown by type of respondent:

		Gender	
	All respondents	Female	Male
All respondents	50	26	24
Repeat respondents	30	16	14
New respondents	20	10	10

Working status breakdown by type of respondent:

		Working status			
	All respondents	Working 'as usual'	Winding down	Semi-retired	Fully retired
All respondents	50	15	7	6	22*
Repeat respondents	30	10	7	3	10
New respondents	20	5	0	3	12*

Note: *Includes 1 unemployed respondent who is looking to go back to working 'as usual'

Pension decision by type of respondent:

	No decision	Total encashment	Annuity	TFC & no further withdrawals	TFC & further withdrawals
Repeat respondents	7	6	8*	5*	6*
New respondents	–	–	–	–	4^

Note: *Includes 2 respondents who are double counted, as they bought an annuity and went into drawdown with different pots. ^Includes 1 respondent who had only wanted to take their TFC, but 'didn't read the provider form properly and ticked the wrong box' and received one further pay-out before pausing these.

What is the 4% Rule?

The 4% rule is used by some as the amount a retiree should withdraw from their pension each year. This rule merely provides a steady rate of income to the retiree while also trying to maintaining an account balance that helps provide income throughout retirement. Experts are divided on the safety of the 4% withdrawal rate, as the withdrawals will not always consist primarily of interest and dividends. In some market conditions it will also include capital withdrawal that may damage future income provision.

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