PRESS RELEASE
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"Rules of thumb could help individuals manage their DC pension pots in retirement" says Pensions Policy Institute

The Pensions Policy Institute (PPI) is today publishing '*Myths and rules of thumb in retirement income*', a report sponsored by State Street Global Advisors. This new research comes at a critical stage with the retirement income reforms having gone live in April this year and many DC pension scheme members now considering how they might make the best use of their retirement savings.

The research finds that simple rules of thumb could help individuals manage their DC pension pots. This includes the "4% rule", which provides a guide for how much income pension scheme members can take from their pot in retirement while limiting the risk of running out of money in later life. Another potentially useful rule of thumb involves securing enough regular income to cover essential needs before considering using riskier investments.

Rules of thumb will not necessarily achieve the optimum outcome for a particular individual. They are not intended to replace financial advice or guidance. They are, however, simple and easy ways to understand a course of action that is broadly appropriate for most people, and likely overall to result in better outcomes than if the rules were not followed.

The research highlights the commonly used guidance *"eat five portions of fruit and vegetables a day"* as an example of a simple non-financial rule of thumb, that is widely recognised and understood, and in most circumstances helpful.

The research also finds the risk that unhelpful "myths" could lead individuals to take actions that may not result in good outcomes. Examples of "myths" include the idea that buy-to-let property provides a better means of retirement income than pension fund investments, and that members should withdraw assets from their pension scheme so they can invest somewhere better. Both courses of action were commonly cited by scheme members in earlier phases of the research.

Whilst the idea of purchasing a buy-to-let property is easy to understand, individuals do not necessarily do better using their DC savings in this way – factors such as voids and on-going costs lower the yield on property. Other issues for consideration are the risk of investing in a *single* asset within *one* asset class, and potential problems where individuals need quick access to their capital.

Melissa Echalier, PPI author said:
"There are a number of myths surrounding pension pots at retirement. Some, such as spending 4% of your pension pot each year, or securing enough income to meet your basic needs, can be useful rules of thumb for people to remember – they are not universally true but can help to point people in the right direction. Others, such as

taking money out of pensions to put somewhere safer, or buy-to-let being a better investment than leaving money in a pension might be true for some people but have a high risk of poor outcomes.

There is the possibility that individuals will not get the most from their retirement savings without adequate guidance. While rules of thumb will not necessarily ensure the optimum outcome for an individual, they can be a useful starting point. How such messages are communicated is of great importance, as people will do what they understand."

Alistair Byrne, Senior DC Strategist at State Street Global Advisors added:

"Well founded rules of thumb can help people make the most of their retirement savings, alongside more formal guidance and advice. At the same time, we must do what we can to prevent unhelpful myths that lead investors to poor outcomes."

This report is the second stage of a two stage major research project, and builds on the findings from the first stage, which consisted of qualitative research with individuals approaching retirement exploring their preferences for how they might want to draw their retirement income.

The research also builds on discussions from a round table hosted by State Street Global Advisors and attended by representatives from charities, advice providers and consumer bodies, to consider how rules of thumb might support DC savers when setting their strategies for retirement. The discussion focused on what is a 'rule of thumb' and suggestions for guidelines that can provide practical instructions for completing a task, such as withdrawing pension income.

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Notes for editors

1. The Pensions Policy Institute (PPI) is an educational research charity, which provides non-political, independent comment and analysis on policy on pensions and retirement income provision in the UK. Its aim is to improve the information and understanding about pensions policy and retirement income provision through research and analysis, discussion and publication. Further information on the PPI is available on our website:www.pensionspolicyinstitute.org.uk.

2. '*Myths and rules of thumb in retirement income*' is the second stage of a two stage major research report, sponsored by State Street Global Advisors, and part of the PPI's Transitions to Retirement research series. It builds on the findings from the first stage, which consisted of qualitative research with individuals approaching retirement exploring their preferences for how they might want to draw their retirement income. This report from the first stage of the research is available here: http://www.pensionspolicyinstitute.org.uk/publications/reports/transition-to-retirement-defaults

3. The first major report of the Transitions to Retirement series, published in November 2014, focused on the complexity of decisions DC savers face at retirement and is available here: http://www.pensionspolicyinstitute.org.uk/publications/reports/transitions-to-retirement---'how-complex-are-the-decisions-that-pension-savers-need-to-make-at-retirement

4. The second report, published in April 2015, used international evidence to consider how the UK pension system might evolve. This report is available here: http://www.pensionspolicyinstitute.org.uk/publications/reports/transitions-to-retirement---how-might-the-uk-pensions-landscape-evolve-to-support-more-flexible-retirements

5. The Transitions to Retirement research series should serve as a timely, invaluable and independent assessment of how well equipped the UK pensions landscape is to support good member outcomes in retirement. The series as a whole is being sponsored by a consortium: Age UK, Fidelity Worldwide Investment, The Investment Association, Partnership, The Pensions Advisory Service, The Pensions Regulator, the People's Pension, and State Street Global Advisors.

6. For nearly four decades, State Street Global Advisors has been committed to helping financial professionals and those who rely on them achieve their investment objectives. We partner with institutions and financial professionals to help them reach their goals through a rigorous, research-driven process spanning both active and index disciplines. We take pride in working closely with our clients to develop precise investment strategies, including our pioneering family of SPDR® ETFs. With trillions* in assets under management, our scale and global footprint provide unrivaled access to markets and asset classes, and allow us to deliver expert insights and investment solutions. State Street Global Advisors is the investment management arm of State StreetCorporation.

* *Assets under management were $2.4 trillion as of June 30, 2015. Please note that AUM totals are unaudited.*

Executive Summary

This PPI report, '*Myths and rules of thumb in retirement income*', is the second stage in a research project sponsored by State Street Global Advisors. It builds on the findings from the first stage, which consisted of qualitative research with individuals approaching retirement exploring their preferences for how they might want to draw their retirement income.

These individuals were selected because they had relatively low levels of Defined Benefits (DB) pensions, and sufficiently large Defined Contribution (DC) pension pots that they might prefer to leave these invested (rather than withdrawing them in their entirety as a cash lump sum). As a result, this group was most likely to be reliant upon DC savings for their retirement income and would be adversely affected if they did not manage them effectively. This earlier research found that while these individuals have made preparations for retirement, they have not thought through their financial position or spending needs in any detail. As a result, they are unlikely to be well placed to make decisions about investments either in the run up to, or during, retirement.

This stage of this research considers how rules of thumb might help retirees to think about and manage their DC pension savings. A round table, hosted by State Street and conducted by the PPI, was attended by representatives from Age UK, Citizens Advice, the Money Advice Service, NEST, The Pensions Advisory Service, The People's Pension, TUC and Which?. This discussed what "rules of thumb" are, how they differ from received wisdom and how they might support DC savers when setting their strategies for retirement. This report reflects these discussions, along with additional analysis and modelling drawing the following conclusions:

Rules of thumb could help individuals manage their DC pension pots
In the absence of defaults or financial advice there is the risk that, by following what others say or what they perceive to be accepted wisdom, individuals will not always act in their best interests (although they may think they are). In such situations, rules of thumb could be used as a guide (or as a target).

Rules of thumb are not necessarily a way to achieve the optimum outcome for a particular individual. They are not intended to replace financial advice or guidance. What they are, however, is a course of action that is broadly appropriate for most people in a particular group. The central question around the use of rules of thumb is whether, for the group who use them, outcomes are better than if the rule of thumb were not used.

Round table attendees considered the "*five portions of fruit and vegetables a day*" recommendation to be an effective demonstration of a rule of thumb. It is considered easy to understand, is in the general best interests of a person and, even where individuals do not manage to eat five portions, they may take the positive action of increasing their consumption of fruit and vegetables.

There needs to be a clear distinction between a rule of thumb, which offers an appropriate course of action for many people and a received wisdom, which generally does not.

Received wisdom may be true, but not in every case
The two received wisdoms considered in the report ("purchase a buy-to-let property" or 'withdrawing my pension pot to find somewhere better / safer to invest") may be the best course of action for some. However, there are many instances when it will not be the right course.

Whilst the idea of purchasing a buy-to-let property is easy to understand, individuals do not necessarily do better by using their DC savings in this way – factors such as voids and on-going costs lower the yield on property. Other issues for consideration are the risk of investing in *one single* asset within *one single* asset class, and potential problems where individuals need to access their capital quickly.

Similarly, while some individuals' circumstances may mean that they benefit from withdrawing their entire DC savings at retirement, many do not do better by "putting them somewhere safer". Risks include giving up the benefits of some institutional funds (better governance, lower fees) in order to place their savings in potentially costlier retail investments and relying upon themselves to select the correct investment vehicle. They also risk paying a higher amount of tax when they withdraw their entire pension pot in one tax year rather than over a number of tax years.

Rules of thumb need to be carefully phrased and the language needs to make them easy to understand
The round table participants shared the belief that if financial rules of thumb are to be as successful as '*five a day*' these need to be conveyed using language that is both accurate and easy to understand, and financial education and literacy are essential.

Previous PPI research[1] identified a group of 694,000 individuals with low levels of financial education at high risk of using their DC savings in a way that is unaligned with their circumstances.[2] This supports the need for clear language that individuals with low levels of financial education or literacy understand.

Certain rules of thumb could be helpful to UK individuals under the new pension flexibilities
The two rules of thumb considered in the report ("4% rule" and "secure a basic income") are considered to be generally in the best interests of an individual.

[1] PPI (2014)
[2] These were individuals projected to have between £19,400 and £51,300 of DC savings and no DB entitlement at State Pension Age – financial literacy is not generally that high amongst this group of individuals who are likely to depend to a large extent on their DC savings in retirement.

The "4% rule" is where an individual could withdraw this amount of their DC pension pot in the first year and, in subsequent years, the same amount indexed by inflation. The rationale behind this rule is that using it should make the fund last their lifetime. This specific rule of thumb could be helpful in the UK, as it addresses a general lack of understanding around life expectancy and awareness of the probability of living until age 90 or 100. Its strength also lies in the fact that it can be used as a guide or as a target. Even if it is not followed to the letter, it provides a reasonable basis for most people in terms of managing their expectations of income from their pension pot.

The "secure a basic income to meet essential needs" rule could also be helpful in the UK as it addresses the risk that UK individuals will be at risk of drawing down their pensions too quickly. In terms of language, it is relatively easy to understand and it can be used as a guide or a target.