PENSIONS POLICY INSTITUTE

PPI

PPI policy seminar: Supporting DC members with defaults and choices up, into, and through retirement

The Pensions Policy Institute (PPI) held a policy seminar on 15 January 2015 to launch its latest report *Supporting DC members with defaults and choices up to, into, and through retirement: Qualitative research with those approaching retirement.* The research was sponsored by State Street Global Advisors. The PPI's research on Transitions to Retirement is also sponsored by Age UK, Fidelity, The Investment Association, Partnership, The Pensions Advisory Service (TPAS), The Pensions Regulator (TPR), and The People's Pension.

This report is the first stage in a two stage research project, which is itself the third phase of the PPI Transitions to Retirement research series exploring how people access pension savings. This report draws heavily on insights from fresh qualitative research conducted by Ignition House. The purpose of this research is to explore preferences for how those approaching retirement might want to draw an income, the trade-offs they are willing to make in retirement, and the potential to develop defaults and strategies that could support them.

The seminar was attended by around 90 people representing a broad range of interests within Government, the investment industry, the pensions industry and the third sector.

Otto Thoresen, Governor of the PPI, chaired the seminar.

Mel Duffield, Deputy Director, PPI Director, introduced the report.

- The report builds on the findings of the first report of the series *how complex are decisions that pension savers need to make at retirement?* This research found that decisions around DC savings are amongst the most challenging of financial decisions for an individual and are becoming more complex. It also found that around 40% of those aged 50-SPA expected to be in the "at-risk"group; as a result, their retirement outcomes are likely to be dependent on the Guidance Guarantee service and defaults being in place.
- This first stage of the research uses qualitative research with DC savers approaching retirement to explore the extent to which default solutions are likely to appeal to savers and whether there is enough commonality for them to be designed. New insights from this research could inform policymakers, industry and employers about the range of circumstances

and likely preferences of DC savers approaching retirement and provide the foundation for further design work around default strategies into retirement.

Janette Weir, Director, Ignition House presented the qualitative research findings.

- The approach focused on those individuals who will be likely to rely on DC savings in retirement. This reliance combined with poor knowledge around financial issues suggests that this group might be particularly at risk under the new flexibilities.
- Research participants did not feel well-equipped to make decisions around their pension savings. In retirement, individuals will need to make decisions based on questions that can be difficult to understand such as their likely life expectancy, how much money they will need to withdraw from their pot as income and what investment return the pot will need to generate to make sure that they don't run out of money.
  - Many participants indicated that, after withdrawing the tax-free cash, they would withdraw their pension pots gradually. However, some indicated that they would like to withdraw their pension pot immediately, and then think about what to do with it, or place it somewhere else, particularly in an ISA or a buy-to-let property as they were more likely to feel confident about investing in property.
  - In addition, participants did not know who they should trust to give them financial advice. They also underestimated the cost of advice. Overall, lack of knowledge and understanding mean that they are likely to need some nudging or guidance to make the right investment decisions.

- The concept of default funds resonated with research participants, with the majority being supportive of default funds, managed by experts, for the decumulation phase.
  - o Most participants would want a small number of choices (no more than six) of default funds. When presented with options which varied in terms of risk, the majority selected a low or medium risk portfolio.
  - o In terms of trade-offs, most individuals would trade some risk for higher returns, with potential losses of 10-20% being acceptable. Most would also accept less access to their money for a higher rate of return; typically they would be happy to retain £10,000 and lock away the remainder for up to 5 years.
  - o In addition, participants did not know who they should trust to give them financial advice. They also underestimated the cost of

advice. Overall, lack of knowledge and understanding mean that they are likely to need some nudging of guidance to make the right investment decisions.

- Participants tended to under-estimate longevity, which has implications for how well they are able to plan.
  - A task designed to assess participants' understanding around longevity found that they tended to underestimate longevity – when shown the statistics participants were surprised how many men and women live beyond the age of 80. In turn, they were surprised to find out how long their pension pot would have to last.
  - However, many participants were warm to the idea of longevity insurance, depending on cost – for a £5,000 secure income starting at age 85, with premiums commencing at age 65, a cost of between £500 and £1,000 per year would be acceptable.

Alistair Byrne, Senior DC Investment Strategist, State Street Global Advisors provided some comments on the findings from State Street's perspective. He described how many of the research participants had indicated that DC savers approaching retirement would benefit from having someone explain how the new pension flexibilities apply to their own circumstances as Janette Weir the research facilitator had done.

He highlighted the research findings that individuals are ready to approach decisions around their retirement savings responsibly and would welcome a framework that would help them to do this. The fact that individuals do not know when they will retire, may do so gradually and are not sure how they are going to use their assets required the development of strategies that are robust to uncertainty and guide them towards taking a level of risk that is appropriate for their stage of life.

Alistair contended that individuals wanting to get access to their assets at retirement does not mean that they want to make choices around the management of these assets. Ideally, assets would roll smoothly into the decumulation phase, with simpler and cheaper drawdown products becoming available. He also highlighted particular risks around the fact that individuals say that they would withdraw their money from their pension without knowing what it is currently invested in.

Geoff McKenzie, Head of Pensions, Vodafone Group Services Ltd provided a view of the findings from an occupational pension scheme manager's perspective. He indicated that Vodafone is currently reviewing its pension scheme in view of the new flexibilities. However, this study that considers individuals aged 55 and over does not reflect the general make-up of Vodafone's employees. Vodafone currently has an open DC plan, with 15,000 active and 25,000 deferred members, which uses lifestyling to de-risk pension funds as individuals approach pension age.

Geoff described how informal research conducted with Vodafone scheme members had found that people do not understand the new flexibilities. At the time of the launch Vodafone had not yet made a final decision around the scheme's default for decumulation. However, Geoff suggested that the prevalence of small pots for members over age 55 in the scheme may mean that the initial default chosen will be cash, as there is currently no viable income drawdown product available

The Vodafone pension scheme is currently focusing on information provision and communication; however the fact that the Governments is drip-feeding information makes this task difficult.

Geoff highlighted a risk of the loss of credibility for the pensions industry if it does not make available all of the three options of cash, annuitisation and drawdown, as people may think they only have two options. He also emphasised the risk of providing rushed solutions that are not sufficiently thought through.

Paul Todd, Assistant Director of investment, NEST provided a view of the findings from a Master Trust's perspective. He suggested that qualitative research often brings up more questions than it answer; however, this piece of research has provided some actionable findings. He described how NEST is a young scheme with many small pots, meaning that default options are limited.

The fact that older people are more likely to engage with pensions, and the participants in this piece of research were aged 55 and over, suggest that these research participants are the cream of the crop, in terms of understanding around pensions. Paul argued that large groups of DC savers should have a sensible set of options rather than being thrown to the market. He also described how there is an appetite for professionals that DC savers can trust.

Paul also highlighted the problem that individuals think they can access their pots while making a decision around how to use them. He argued that the industry should work harder to develop solutions that offer individuals a lot of what they want.

The following points were raised during the questions and discussion section. They do not necessarily reflect the views of the PPI or the PPI seminar speakers.

- There was a discussion about the issues with the Guidance Guarantee; the fact that it is intended to be in place by April 2015 and how much would be achievable in a 45-minute slot, as well as a plea for the industry not to limit itself to what can be achieved by April 2015.
- Concerns were expressed around those individuals who fall in the middle grouping; those who do not use financial advisers but who will not simply want to take their whole pension pot as cash. Other issues raised were the fact that people are encouraged to think in terms of the size of their DC pot (rather than in terms of what income it could provide) and issues brought about by cognitive decline over the course of retirement.
- There was discussion around the meaning of the concept of financial education, and arguments were put forward that there is some confusion between financial capability and expertise around investments.
- It was expressed that individuals might like someone to tell them where to invest and how much to take each year. While employers are doing this during the accumulation phase, it is not clear who might do this during the decumulation phase.