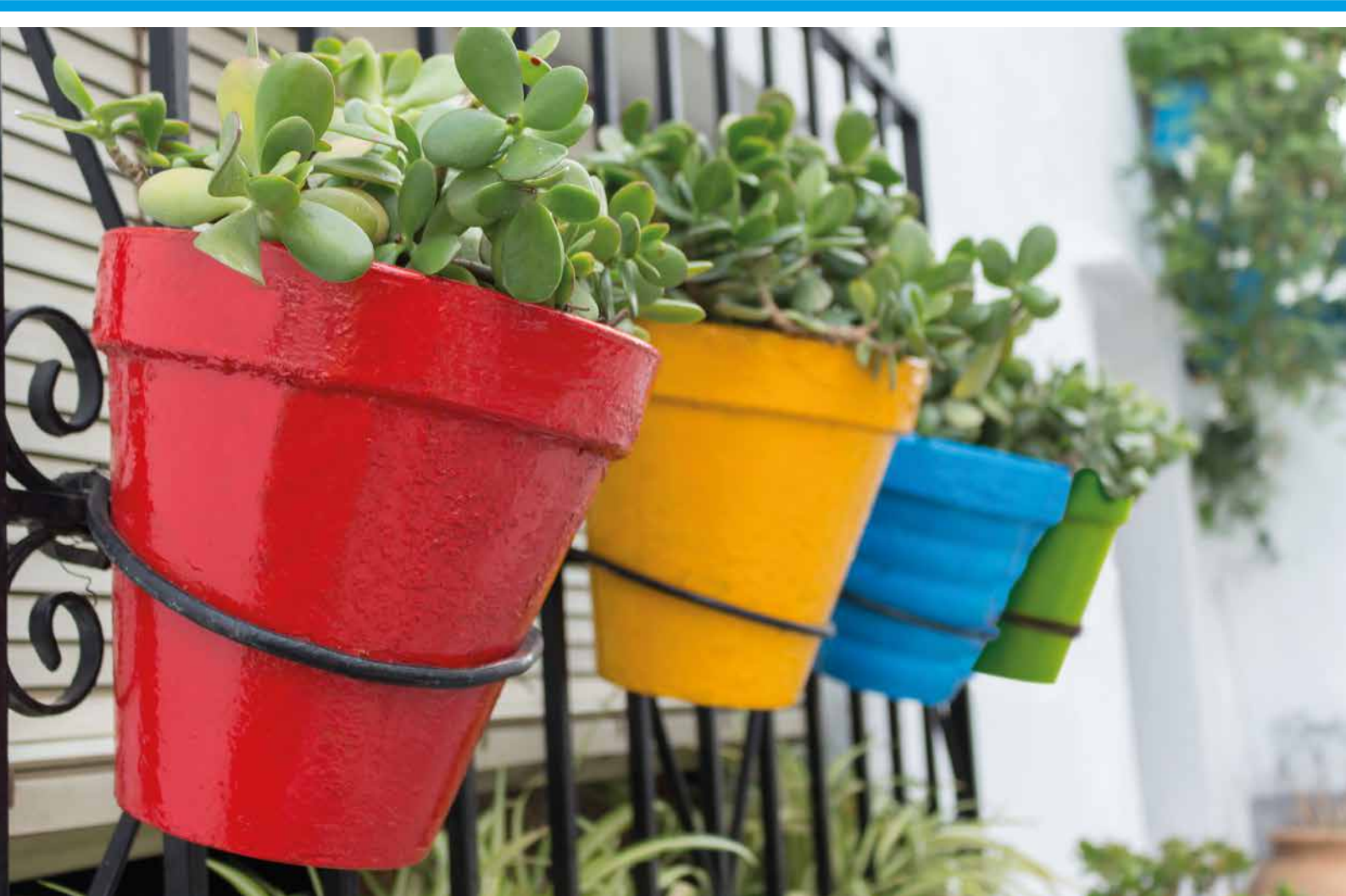


Four pots for your retirement:

Creating personalised solutions



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Foreword

The landscape for defined contribution is changing – for savers and retirees, employers and trustees, and for those who are responsible for managing client assets.

The pension freedoms ushered in during the 2015/16 tax year have been widely welcomed, but they are not without their challenges. Cash has been king to date with the majority of over 55s taking, at the least, their tax-free cash. Annuity purchases have fallen away considerably, with some slack being picked up by a growing interest in drawdown.

However, this is all very new and many members are in a scheme's default pension plan, so likely to be unengaged, and possibly unprepared to make significant decisions about their impending retirement. It is clearly a very personal journey. While there is plenty of information available on choices at retirement there is little engagement with members to ascertain how they, individually or at the household level, plan to live in this third stage of life.

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Acknowledgements

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We would also like to thank our regional qualitative recruitment specialists for meeting the challenging requirements of this project and the individuals who gave up their time to be interviewed with such good will and patience.

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Executive summary

1.1 BACKGROUND

The pension freedoms implemented during the 2015/16 tax year by the UK government have resulted in a seismic shift in the way that the 34 million people¹ who are currently saving into a pension will be able to access their money. No longer is there a 'one size fits all' approach; now people have the opportunity to take their money in more flexible ways that suit their individual circumstances.

It will take some time to adapt to this new way of thinking and, three years on, the market is still in the early stages of development. Nevertheless, there is a growing body of evidence to suggest that current solutions are not quite working. The Financial Conduct Authority (FCA) acknowledges that firms are generally doing their best to support consumers in making the right decisions, and that there is a variety of information available to help them make informed decisions. But customers do not always read this information when they first access their pension savings and those that do quickly find that it tells them a lot about their *options* but absolutely nothing about *what they should do with their money*, given their particular set of circumstances. They are often left feeling a bit short-changed, and none the wiser.

Legal & General Investment Management (LGIM) has developed a new concept, 'four pots for your retirement', which takes a customer-centric, rather than product-centric, approach to helping members make decisions on what to do with their defined contribution (DC) pension money. The starting point for this new concept is to recognise that a fresh approach is needed; one which takes a bottom-up approach that is entirely focused on the individual, on how they want to live their lives, and the resources they have to do that.

In essence, LGIM has identified that there are four possible uses for DC pension money to live off in both the active and later years of retirement, to take lump sums to pay for holidays and rainy-day emergencies,

and, possibly to leave an inheritance. In this new approach, DC pension holders have to decide how they want to allocate their money across these four pots. Each pot has a different time horizon for when money will be needed. Sitting behind each is an investment solution, so in the same way that the vast majority of members do not make an active choice on their investments today, their money will be managed on their behalf by the provider to achieve their retirement goals.

The idea that people will want to 'compartmentalise' their money is built on solid behavioural economics foundations. The recent Nobel prize winner, Richard Thaler, first introduced the concept of mental accounting in 1988², describing how people mentally frame assets as belonging to either current income, current wealth, or future income. So, in theory, this concept should resonate well with members, but will this be true in practice?

1.2 RESEARCH OBJECTIVES AND METHODOLOGY

To test members' reactions to the new concept we used a mixed qualitative methodology, with focus groups allowing for more exploratory discussions and individual face-to-face interviews to understand reactions to the concept in depth. In total, 45 non-advised people with DC pensions worth between £30,000 and £250,000, and aged between 55 and 65, took part in the research. Fieldwork took place in June 2018 in city centre locations across the UK to ensure a good geographic spread.

As the concept is a 'needs', rather than 'product', based approach, we felt that it was important to spend some time to uncover what members' retirement needs actually are. Our extended deliberative sessions uncovered attitudes towards retirement planning and the extent of current plans, before taking respondents on a journey to explore their sources of income and spending patterns in retirement. We sought feedback on the concept and tested both their comprehension and preferences for engagement.

1. Regulating the pensions and retirement income sector: Our strategic approach, Joint call for input by the FCA and The Pensions Regulator

2. Shefrin, Hersh M.; Thaler, Richard H. (1988). "The behavioural life-cycle hypothesis". *Economic Inquiry*. 26 (4): 609–643.



**The focus
is on client
needs**

1.3 KEY FINDINGS

Pension freedoms have moved us away from a one-size fits all approach for delivering retirement income

Most, but not all, of our respondents were aware of the new pension freedom rules; those that were, welcomed the change. Even amongst our relatively small group of people there was a wide range of suggestions about what they might want to do with their DC money, reflecting their multiple sources of wealth for retirement. Few thought they would purchase an annuity, even though most knew very little about the product and how it works.

Eight of our 39 respondents still in work had accessed one or more of their DC pensions, and several more were seriously thinking about it.

Respondents were concerned how they will manage financially when they stop working

Many of our respondents more than six months away from giving up work said it was 'scary' to think about how they would manage financially in retirement, and that they preferred to ignore the question until it became absolutely necessary to think about it.

As a result, there is a lot of confusion and uncertainty about how much they will have, whether they will have enough saved, and whether they can make this money last throughout their lives. Partly, these worries are driven by the media and the industry themselves. Respondents reported constantly hearing messages that people have not saved enough for their retirement, without really understanding how much they need, or whether this holds true for them.

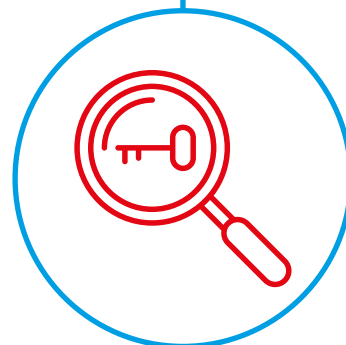
One of our first tasks during the research was to take respondents through a structured process to identify spending and sources of income in retirement. This exercise was a real eye-opener, as, for the first time, they saw in black and white how much money they will need in retirement.

Although there is a plethora of information and guidance available to them, which many are taking full advantage of, our respondents told us that it is not really helping them. Reading again and again about the different options available to them does not help them make a decision about what to do with *their money*.

Respondents were very happy to hear about an alternative approach

We showed our respondents some stimuli to describe the four pots for retirement concept. Initial member reactions to this were very positive. Our respondents recognised that this was a simple approach, which focuses entirely on their needs and lifestyle in retirement and does not require them to have any prior knowledge.

The respondents we spoke to felt somewhat relieved that a provider had recognised that people are struggling to understand the options currently open to them and were looking to do something different. They felt that this was a solution that is personal to them, which provided 'reassurance', 'security' and 'took away the worry' of the decision-making process.



During the exercise to explore sources of income in retirement they already talked about the money they had for everyday living expenses, having money put away for emergencies and using their house to pay for (residential) care or an inheritance, so they were quickly able to understand, in very broad terms, how this concept would work with their money. The fact that humans are predisposed to mentally place their money in different accounts is a powerful tool, and the intuitive nature of the concept is perhaps its greatest strength.

They said that this was a ‘fresh approach’ which would appeal to a lot of people, especially those with medium size pots. Many respondents felt that significantly less than £50,000 would not be enough to justify splitting their money across several different pots. At £20,000, the money is either being used for holidays or rainy days or to live off for a few years.

The positive feedback we heard in this research, with ordinary members approaching their retirement years, certainly suggests that there could be significant consumer appetite for a blended solution of the nature tested here.

The concept is a simple, customised solution, not a default

Our respondents recognised that this concept is a tailored solution based on each individual’s circumstances and desires, rather than a default, one size fits all, solution. At face value, this seems to fit well with the types of innovation the FCA is driving towards in its recent consultation paper.

The retirees understood that they would be making a decision on what to do with their DC pension money, and that this decision would be unique to them. A minority felt that the concept was almost too simple to be true. They were astonished to think that their choices could fit neatly into four boxes and tried, without success, to find exceptions.

This new way of presenting choices meant that respondents did not opt to put all of their DC money in low risk investments

Our respondents had a high propensity to hold cash-based savings. Very few held investments or equity ISAs; most said that this was because they did not want to take a risk with their money. Given their current preferences it is likely that they would naturally want to put their DC money into low, or no-risk cash options.

However, getting respondents to think about the potential different uses for their money, rather than focusing on the risk profile of the underlying investments, appears to have a fundamental impact on their thinking. Presenting the choice architecture in this way resulted in very few thinking that they would put all of their DC pension money in the low risk ‘rainy days and holidays’ pot. Interestingly, given the struggle to get people to think beyond a five-year time horizon, most also said that they would put some of their pension into the ‘later years’ income’ pot.

Our respondents were all in default funds with their current DC pension, and were generally happy for ‘the experts’ to manage their money in retirement

None of our respondents could recall ever making any investment choices for the money in their DC pension pots, and they said that they would be worried about taking this task on now as making a mistake when they will shortly need the money to live off would be disastrous. The vast majority felt that managing investments was the key role that their DC pension provider had up until now, and they were very keen to see this responsibility continue in the future.

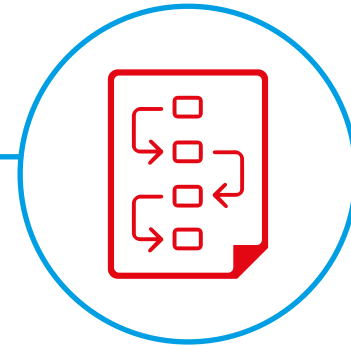
Respondents felt the proposition was a DIY version of what they might get from a financial adviser

Unprompted, some respondents suggested that the concept was doing the work of a financial adviser for them, but without the “hefty fees”. Knowing that a reputable company had set up a solution to “do it all for them” in much the same way that a financial adviser would was very much welcomed in principle.

Although members said that this was a decision they would make for themselves, and they therefore did not see the concept as ‘advice’, we did not fully explore whether the choice architecture was driving them one way or another. Further work will be needed to see whether this is truly guidance.

Flexibility will be key to success

Respondents were told that they could move the money around without penalty any time they wanted, and as many times as they wanted. They all valued this flexibility as they were unsure how their retirement years would pan out and may need to shift money around as and when their circumstances change. They were worried about making a mistake; they don’t want to be locked in to making a one-time only decision. They were worried that the goalposts might shift – state pension age or entitlement might change, the NHS may not cover all their needs, or social care delivered by local councils might be further reduced.

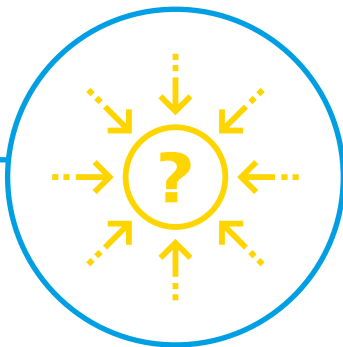


Planning tool or proposition?

When asked how they would describe the concept to a friend, our respondents often failed to mention the investment strategy, re-counting the proposition simply as a way to plan their finances. This will need to be clearly articulated in any marketing materials.

Without interventions, it will not be easy to get members to proactively conduct detailed income and spending exercises of the nature tested in this research until they are very close to retirement. Even then, there may be many gaps in their knowledge. Industry innovations such as the Pension Dashboard, national income targets and external factors such as open banking will all help but will take some time to come to fruition. In the meantime, basic messages about the state pension, directing to the Pension Tracing Service and ‘lighter touch’ solutions, such as a retirement quiz, will certainly help.

That said, the FCA’s dual proposals to start sending wake-up packs at 50, and that “before proceeding with an application to access or transfer a consumer’s pension savings, firms must ensure that the consumer has either received appropriate pensions guidance or opted out of receiving it” look like they could have the potential to be a game-changer for early engagement, but we will need to wait and see how these initiatives develop.



Understanding capacity for loss, not attitude to risk, will be critical

Most of our respondents had multiple sources of income for their retirement and savings they could call on in an emergency, but not all were so fortunate. Even amongst the 45 people we spoke to, a small number of people will be reliant on the state pension and their DC pension to cover their everyday spending. For these people it will be absolutely critical for them to understand whether they could bear any investment loss at all, and for how long. If even a small, short-term loss will tip them over the edge, then they will need to be directed outside of the concept to think about whether a guaranteed income for life is, perhaps, the best thing for them.

When probed, the majority felt that they could sustain falls of 5-10% in any income generated by their DC pension over a couple of years. Beyond this, they would question the value of the concept and whether the investment strategy was working for them. They would be likely to move into cash. To date, the stock markets have been kind to our new cohort of drawdown investors, so we have not seen any behavioural responses to sustained falls in fund values in action.



Conclusion

The very positive member reactions suggest to us that this concept is an idea that certainly merits further exploration. Hopefully the evidence presented in this report will act as a catalyst for future development, particularly when it comes to designing solutions for those with more modest pot sizes. It is likely that there could be many variants on the approach we have tested, but this research hopefully provides a foundation for the industry to build on.

Why do this research?

Pension freedoms have resulted in a seismic shift in the way that the 34 million people³ who are currently saving into a pension will ultimately be able to access that money. No longer is there a 'one size fits all' approach; now people have the opportunity to take their money in more flexible ways that suit their individual circumstances. And that is what they have been doing in droves. The annuity market is a shadow of its former self, and the majority of defined contribution (DC) pension pots accessed since April 2015 are in some form of non-advised drawdown.

Early concerns that consumers will want to blow all their money on fast cars and luxury living have, of course, proved to be unfounded. People are generally very mindful that their pension is an important resource for their later lives. And yet they are happy to take some tax-free cash to spend today. It has taken some time to recognise that the decision to take 25% tax free cash is driven by a completely different set of motivations from what to do with the remaining 75% of their pot. This decoupling of the 'access decision' from the 'retirement income' decision is an important distinction to make, both for regulators and in product design, and we are only just starting to have conversations about whether the old crystallisation rules make any sense in this brave new world.

Of course, it will take some time to adapt to this new way of thinking and, three years on, the market is still in the early stages of development. Nevertheless, there is a growing body of evidence to suggest that current solutions are not quite working. Consumers are often confused by their choices, particularly between Uncrystallised funds pension lump sum (UFPLS) and drawdown. Many are focused on taking their tax-free cash, and ultimately end up taking the 'path of least resistance' with their current provider. The Financial Conduct Authority's (FCA) own research suggests that people are ending up in cash-based investments which may not give them the best outcomes in the longer term. There are many well-documented behavioural barriers to making optimal decisions; most notably present bias, the ostrich effect, the bandwagon effect, and the windfall effect.⁴

The FCA acknowledges that firms are generally doing their best to support consumers in making the right decisions, and that there is an array of information available to help them make informed decisions. But customers do not always read this information when they first access their pension savings and those that do may find that it tells them a lot about their *options* but absolutely nothing about *what they should do with their money*, given their particular set of circumstances. They are often left feeling a bit short-changed, and none the wiser.

There is a body of evidence which shows that members, even those who have made a pension decumulation decision, are confused by the options currently on offer for their DC pension money. For example, a recent data bulletin from the FCA⁵ on how the pensions and retirement income market is evolving showed that a quarter of people who have accessed a defined contribution pension in the last two years report that they get an income or have taken a cash lump sum but are not sure how this works.

Furthermore, when tested on their understanding of the specific product features of annuity and drawdown, many were confused about what product features related to each. Only six in ten (59%) knew that a single life annuity would give them a guaranteed income for the rest of their life; 11% thought that there was a risk that the value of their fund could go up or down. There are also misconceptions with income drawdown; around one in ten (8%) thought it gave a guaranteed income for life. The distinction between flexi-access drawdown and uncrystallised funds pension lump sums (UFPLS) is a mystery to most.

3. Regulating the pensions and retirement income sector: Our strategic approach, Joint call for input by the FCA and The Pensions Regulator

4. New Choices, Big Decisions: Exploring consumer decision making and behaviours under Pension Freedom and Choice, Ignition House, 2016

5. <https://www.fca.org.uk/publication/data/data-bulletin-issue-12.pdf>

Introducing the four pots for your retirement

The starting point for this new concept is to recognise that a fresh approach is needed; one which takes a bottom-up perspective that is entirely focused on the individual, on how they want to live their lives, and the resources they have to do that.

Figure 1: Stimulus used to explain the concept to respondents

Four pots for your retirement money



The first stage in the process is to get members to identify the kinds of things they will be spending their money on in retirement (essentials such as food, heating, clothing, insurances, and utility bills, plus additional spending such as holidays, emergencies, and luxuries) and how these spending patterns might change between their active and later years of retirement.

Once members have thought about the lifestyle they want to lead, the essentials they will need to cover at different stages of their life and what they want to do in terms of any inheritances, the next step is to consider

where the money might come from to pay for this. There are a variety of resources that those aged 55-65 might have, and this concept recognises that people will not make decisions about their DC pension money in isolation. They are likely to have regular, inflation-linked income payments (i.e. their State Pension plus any defined benefit (DB) income), lumpy sums of money which they can draw down (i.e. savings, investments and DC pensions) and some may have the ability to release housing wealth through downsizing or equity release.

Figure 2: Description of potential income and wealth sources at a household level provided to respondents

Other pieces of the financial puzzle

Potential wealth and income sources on a household level



With these other pieces of the financial puzzle in place, members can then think about how they would want to allocate their DC pension money across the four pots. The choice architecture makes no mention of annuities, or UFPLS, or flexi-access drawdown.

Some will need to use all of their DC pots to live off, others may have more than adequate income from other sources and choose to use their DC pot for an inheritance. Some will want to have a combination. The patterns of how people might want to allocate their money are likely to change over time as 'Generation DB' is replaced by 'Generation DC'.

The concept recognises that circumstances might change, and so people can move money from one pot to another, or access all or part of their money with no penalty.

Sitting behind each of the four pots is an investment solution. In the same way that the vast majority of

members do not make an active choice on their investments today, their money will be managed on their behalf by the provider to achieve their retirement goals.

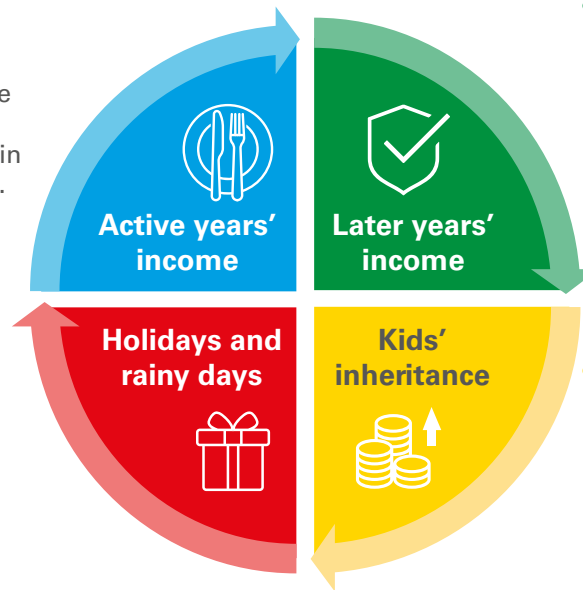
We included a description to help members understand the purpose of the fund. At face value, this approach appears to tally well with the FCA's stated desire that "each investment pathway should have a description and a risk profile. Both must be communicated to the consumer clearly and prominently and that the name of the investment pathway should reflect its objective".

The choice architecture does not require members to make an *explicit* choice around high, medium or low risk funds. Many over 55s are risk averse and have a high propensity to want to hold cash-based savings, which is not always the optimal investment strategy for all of their money. This approach is designed to overcome this tendency, so that any money that is set aside to be used in the later years remains invested and has a chance to beat inflation.

Figure 3: Description of the investment approach provided to respondents

Once you choose how much of your DC pension money goes into each of the four pots we invest your money into funds to help you to meet your retirement goals.

- Your DC pension savings will be invested into funds that aims to provide you with an income in your earlier years in retirement.
- Your DC pension savings will mainly be invested in cash with some growth potential so you can take money out when it suits you.



- Your DC pension savings will be invested into funds that aim to grow your pension pot or provide you with a guaranteed income for life through purchasing an annuity, to provide security for your later years in retirement. You can decide when you want to start receiving an income from it.
- Your DC pension savings will be invested into higher risk funds that aim to significantly grow the value of your inheritance savings.

The idea that people will want to 'compartmentalise' their money is built on solid behavioural economics foundations. The recent Nobel prize winner, Richard Thaler, first introduced the concept of mental accounting in 1988⁶, describing how people mentally frame assets as belonging to either current income, current wealth, or future income.

So, in principle, the concept appears to have the building blocks in place for success. But will it resonate with real members? Will they be able to understand it? Can they allocate money across the four pots? Are there any unintended behavioural consequences?

Did you know? – Flexibility is at the centre of your choices. Your life changes so your choices may change. We will offer you the chance to review and make changes at any time, we will even regularly remind you to review.

6. Shefrin, Hersh M.; Thaler, Richard H. (1988). "The behavioural life-cycle hypothesis". *Economic Inquiry*. 26 (4): 609–643.

RESEARCH METHODOLOGY

To test members’ reactions to the concept we used a mixed qualitative methodology, with focus groups allowing for more exploratory discussions and individual face-to-face interviews to understand reactions to the concept in depth.

In total, 45 people aged between 55 and 65 took part in the research. Fieldwork took place in June 2018 in city centre locations across the UK to ensure a good geographic spread.

As the concept is a ‘needs’, rather than ‘product’, based approach, we felt that it was important to spend some time to uncover what members’ retirement needs actually are. Our extended deliberative sessions uncovered attitudes towards retirement planning and the extent of current plans, before taking respondents on a journey to explore their sources of income and spending patterns in retirement. We sought feedback on the concept and tested both their comprehension and preferences for engagement.

Figure 4: Interview structure



All participants in our research had at least one DC pension, preferably held with Legal and General Investment Management (LGIM). Many held multiple pots, reflecting their varied work histories. We excluded people who had less than £30,000 and more than £250,000 in all of their DC pots combined. Some may have had financial advice when originally setting up some of their pensions, but they were currently not paying for regulated financial advice.

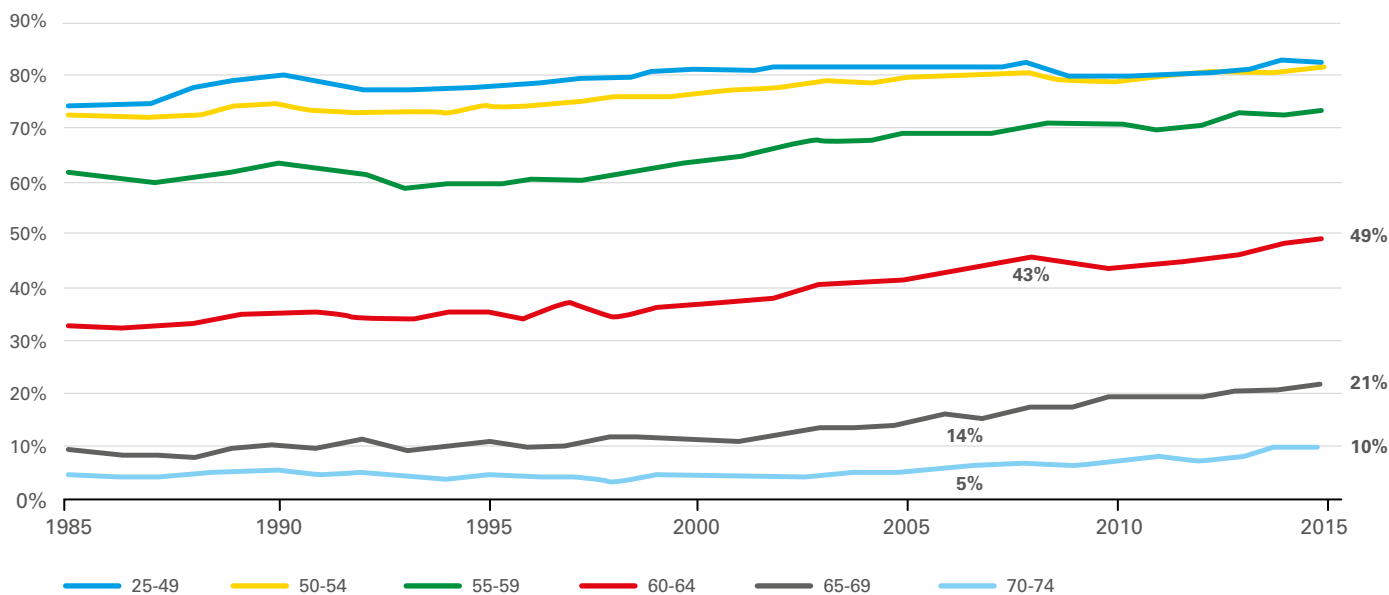
It is important to note our respondents are all aged over 55 and are therefore able to fully encash all their DC pensions if they wish - but have not done this. Of the 45, eight have taken a partial cash lump sum, but the remainder is still invested. Our group of respondents is, therefore, a specific sub-set of current DC pension holders and is not reflective of the population as a whole.

The changing face of retirement

The baby boomer generation has always been at the forefront of new ways of living – baby boomers were, of course, the first teenagers – and now as they enter the later stages of their lives they are breaking traditional moulds once again. All the evidence now suggests that people are working longer and retiring later. Aged 60/65 is no longer seen as the watershed when working life ends and retirement begins.

We explored with our respondents how they felt about heading towards this new phase in their lives, what plans they had made, and what concerns they may have about their future.

Figure 5: UK employment rates



Source: Department of Work and Pensions, 2016, Economic labour market status of individuals aged 50 and over since 1984 (experimental)

FLEXIBLE RETIREMENT IS NOW THE NORM

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.

This was certainly true of our respondents. Just six of the 45 people we spoke to had fully retired. Many had, or were about to, move into part-time work and this winding down process was seen as a natural and desirable path. But, our respondents were very aware that many things – sudden illnesses, redundancy, or family issues – could affect these plans, and often at very short notice.

“

Although we retired there is still the opportunity for me to do some consulting work if I need to. It's been a bit of a phased approach, because my wife is a bit younger than me and her (state) pension age was different to mine.

(Male, 55-65)

”

We generally observed that the more financially sophisticated and highly educated amongst our respondents wanted to continue working as long as possible, whereas the state pension age was a key target date for full retirement for our lower earners. That said, very few could see themselves working into their 70s.

“

It was because there were a few of us being made redundant and we were given all this information about our pensions and so some of us got together and had a bit of a 'pension club' at work. If it wasn't for the redundancy, I would probably still be working.

(Male, 55-65)

”

“

I think I have to continue working until 67, or something like that until the old age pension. I don't think I can think about retiring earlier.

(Female, 55-65)

”

“

I haven't got any retirement plans, because of the nature of my work – it's not very physical – and because I enjoy it, I haven't made any plans for retirement and think I will continue as long as I feel like it and I can.

(Male, 55-65)

”



RETIREMENT IS GOING TO BE VERY DIFFERENT FOR THIS GENERATION COMPARED TO THEIR PARENTS

'Retirement' was no longer seen as a short period of relative inactivity by those we spoke to; rather it is characterised by a number of years of relatively high activity before real 'old age' sets in. The implications of this are that their income needs are no longer as consistent through retirement as their parents. This generation are 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.

Our respondents believed that the length of these active years will vary from person to person and will be highly dependent on an individual's family history. Nevertheless, there was a general consensus that most people will slow down by their mid-80s.

“As you get older you probably will stop doing things or you'll do less. I can't see myself living the same lifestyle when I'm 80 as I am doing now.

(Female, 55-65)

Although our respondents were aware of the impact and costs of later life care through experiences with their own family or friends, they simply did not want to think about it for themselves. As a result of this ostrich effect, very few have had conversations with partners or family on what they will do if this happens to them. Left to their own devices is it unlikely that they will explicitly set money to fund these potentially expensive final years. For homeowners, there was a tacit assumption that their house will be the key financial resource for this.

“

Care is not something we have talked about. We know that it can be quite expensive, my husband's parents had to go into a home. Care costs are something we are aware of but we haven't talked about.

(Female, 55-65)

”

“

If my wife or I have to go into care, then that is what we will have our property for – we can use that to pay for the care.

(Male, 55-65)

”

Moreover, their focus is almost entirely on residential care; very few had thought about how they might pay for social care whilst still in their own home. A key solution, equity release, had a bad reputation amongst our respondents and it was typically seen as the last resort.

“

I stay away from the dreaded equity release, but when you look at what it's worth it makes you think why not downsize and live in a property that's worth £100,000 less and we could have that money to use as income and for our later years in retirement.

(Female, 55-65)

”

PENSION FREEDOMS HAVE MOVED US AWAY FROM A ONE-SIZE FITS ALL APPROACH

There can be no doubt that pension freedoms have revolutionised the way people think about their pension money and broken many of the traditional norms.

We have seen a switch from a one-size-fits-all prescriptive approach – where people accessed their pension at retirement through a combination of tax free cash and an income for life delivered through an annuity – to one which can be tailored to each person's unique set of circumstances.

In 2012, for example, the Association of British Insurers (ABI) estimated that 420,000 annuities were sold, 16 times more than income drawdown products, with a premium value of £14 billion compared to £1.2 billion for income drawdown. Today, drawdown sales are twice that of annuity sales, with 37% of drawdown sales made without advice.⁷ The vast majority, 60%, of pots entering income drawdown do so with their existing provider.

Most, but not all of our respondents were aware of the new rules; those that were welcomed the change. Even amongst this relatively small group there was a wide range of suggestions about what they might want to do with their money. Reflecting the market data, few thought they would purchase an annuity, even though most knew very little about the product and how it works.

THIS COHORT HAVE MULTIPLE SOURCES OF WEALTH FOR RETIREMENT, AND MANY ARE PROBABLY OVER-PROVISIONED

It is important to remember that savings in DC pensions for those on the cusp of retirement (i.e. those aged 55–64) are relatively low, and there is a plethora of additional sources of wealth for them to draw on. For many who are going to be accessing their defined contribution pension

savings using the new freedoms in the next few years, retirement income is likely to be a mix of defined benefit, defined contribution, the basic state pension, and state earnings related pensions (SERPS).

Moreover, over 50s in the UK have substantial property wealth, with recent estimates putting this at £2.29 trillion by mid-2015.⁸

According to the Institute of Fiscal Studies (IFS)⁹ median non-pension wealth among these individuals is £250,000 (mean non-pension wealth is £390,000). The majority of this wealth (60%) is held in owner-occupied housing, with 22% held in financial assets (current and savings accounts, ISAs, stocks and shares etc.), 11% in other property and 7% in other assets (such as business assets, land, and so on).

What happens to housing wealth in retirement will therefore be the big driver of changes in individuals' overall wealth.


On recent trends, the IFS report that over 40% of owner-occupiers at 50 would be expected to move house, and to release some funds, before they die. As a result, for many in their 50s and 60s, their defined contribution pot is not a substantial part of their wealth relative to their other pension savings and property wealth. Furthermore, many in this generation will be in the fortunate position of having excess wealth, so estate planning will be a consideration.

This certainly appears to hold true amongst our respondents, where all but two were homeowners and most had paid off their mortgage or had very little left to pay. A handful had second properties – either buy to let or holiday homes.

7. <https://www.fca.org.uk/publication/data/data-bulletin-issue-12.pdf>

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

9. The use of wealth in retirement', IFS, June 2018, <https://www.ifs.org.uk/uploads/publications/bns/BN237.pdf>



**Moving
away from
a one-size fits
all approach**

Financial plans for retirement

Although the new pension rules provide much greater flexibility to individuals, aligning well with new retirement patterns, they also mean that individuals are now faced with increasingly complex choices and more personal responsibility for managing their money throughout their retirement years.

We explored how our respondents, who are rapidly approaching retirement, were preparing to meet these new challenges and what plans they had in place to manage their finances.

WE OBSERVED A DECOUPLING OF THE DECISION TO ACCESS MONEY (AT 55) FROM RETIREMENT PLANNING

While consumers now have the freedom to access their DC pension savings at any time from age 55, there is strong evidence to suggest that many are accessing at least part of their pension as soon as they are able to. Evidence presented in the FCA's Retirement Outcome Review Consultation Paper¹⁰, published just after our fieldwork was completed, suggest that most people had moved into drawdown as a by-product of accessing their tax-free cash. The FCA also suggested that nearly three-quarters (74%) of non-advised drawdown cases in their survey were from people aged between 55 and 64 and 53% identified themselves as working either full-time or part-time.

So, whilst market data indicates that around 70% of those accessing pensions in 2016/17 were aged 55-59, many in this age cohort will not expect to fully retire into their late 60s (to coincide with state pension age), or perhaps even their early 70s. This means that there is likely to be more than ten years between their access decision and their decision to retire, during which time they are still earning an income and possibly building up more savings.

The emerging social trend of taking a bit of pension money whilst still working was certainly reflected in our discussions. Eight of our 39 respondents still in work had accessed one or more of their DC pensions, and several more were seriously thinking about it. The drivers and motivations behind their decision to take some or all of their tax-free cash today felt very different to the factors that will underpin their decision making once they no longer have a regular income source to rely on.

“ Well, obviously I am taking the 25%, because that's a no brainer. I'm not sure what I'm going to use that for yet.
(Female, 55-65)

Given this mind-set; it will be very difficult for providers to 'nudge' members to think very deeply about the consequences of early access decisions on their longer-term financial well-being. Members do not go through this process to access money from a savings account, and they question why taking money from their DC pension should be any different.

Moreover, evidence from the FCA's 'Retirement Outcome Review'¹¹ suggests that providers may run the real risk that members perceive any interventions at this stage to be unhelpful barriers which only serve to reinforce any negative perceptions of pensions they may have.

This suggests to us that the concept will not, in and of itself, be the panacea to solve early access issues. We discuss members' thoughts on what measures might be effective, and how this chimes with the FCA's views later in this report.

10. <https://www.fca.org.uk/publication/consultation/cp18-17.pdf>

11. <https://www.fca.org.uk/publication/market-studies/retirement-outcomes-review-interim-report-annex3.pdf>

THERE IS A LOT OF TREPIDATION ABOUT HOW MEMBERS WILL MANAGE FINANCIALLY WHEN THEY STOP WORK COMPLETELY

Until the decision to stop work is imminent, our respondents told us that that they will spend very little time thinking about their retirement years. Most of their thinking is 'dreaming' about the lifestyle rather than making firm plans about how they might fund it.

“

I'm a bit unsure about my retirement, I haven't really thought about it. I've kind of got a plan in my head, but I haven't actually done a budget listing and I haven't worked out how I might divide my money.

(Female, 55-65)

”

This finding is aligned with data from the FCA's 'Financial Lives 2017' survey¹², which shows that almost half (45%) of those aged 55 and over who are not retired have not thought much about how they will manage financially when they come to retire.

Nevertheless, there is a deep undercurrent of apprehension and our respondents were very worried about their ability to make the right decision. There is a lot of confusion and uncertainty about how much they will have, whether they will have enough saved, and whether they can make this money last throughout their lives.

“

I find it quite frightening really and I am hoping that I have enough. I feel quite ignorant and have no real understanding and I am really just hoping it will all come to fruition.

(Female, 55-65)

”

“

I went to see Pension Wise and they told me nothing I did not already know.

(Male, 55-65)

”

Partly, these worries are driven by the media and the industry themselves. Respondents reported constantly hearing messages that people have not saved enough for their retirement, without really understanding how much they need, or whether this holds true for them.

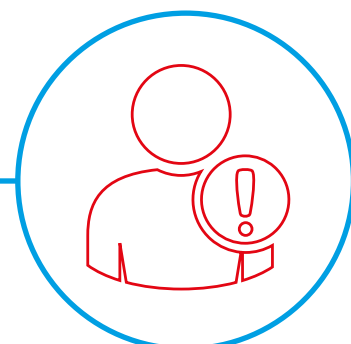
Although there is a plethora of information and guidance available to them, which many are taking full advantage of, our respondents told us that it is not really helping them to make an informed decision. They said that they feel that they are overloaded with information and so have a tendency to put off looking at it in any detail; the terminology used is not consistent across the different sources; and reading endlessly about the different options available to them does not help them make a decision about what to do with *their money*. A couple of respondents had recently been to see Pension Wise face-to-face and found this to be of limited help as, again, they felt the information was generic rather than personal to them.

“

I need help to decide what is going to be best for me, whether that's going to be drawdown or an annuity. I spoke to Pension Wise and they didn't tell me anything I didn't already know – that was just a waste of time and I was left hanging.

(Female, 55-65)

”



12. <https://www.fca.org.uk/publications/research/understanding-financial-lives-uk-adults>

A STRUCTURED PROCESS TO IDENTIFY SPENDING AND SOURCES OF INCOME IN RETIREMENT IS A REAL EYE-OPENER

The vast majority of our respondents who were more than six months away from giving up work had a very low awareness of how much money they will actually have to live off, or where this money would come from. They often said it was 'scary' to think about this, and that they preferred to ignore the question until it became absolutely necessary to think about it.



I'm scared of numbers and sometimes I just don't want to know. I think that's because it's all so vague; I don't know exactly what I will be getting, I don't know where we will be living, whether we will be paying a lot of rent?! I think that's what I can't get my head round yet and I feel like I will be working for another 20 years, so I haven't thought about it.

(Female, 55-65)



The frightening thing is that ... you're used to earning x amount of money and then you go into the unknown. I've worked since I was 15 and I think that if you have been used to that and come into something of the unknown and you're earning less money — that's the frightening part.

(Male, 55-65)



We conducted two structured exercises to help them have a better understanding of their financial position:

- A retirement budgeting exercise; asking respondents to think about their lifestyle and what they would be spending their money on in retirement and how this might change over time
- A retirement income exercise; asking respondents to formally set out their income sources in retirement and roughly say what each was worth today

AN ASSESSMENT OF HOW MUCH THEY WILL NEED FOR 'ESSENTIAL SPENDING' IS IN BROADLY LINE WITH 'THE PENSIONS AND LIFETIME SAVINGS ASSOCIATION'S (PLSA) NATIONAL INCOME TARGETS

Our respondents understood that they will need to maintain a certain level of spending throughout their life to cover everyday spending, but the vast majority told us that they have never done a formal budget plan for their spending today, let alone their future retirement years. The handful that did have a plan only focused on the next five years and had not thought about how their income needs will change over time.

Our first step to bridge this information gap was to ask our respondents to think about their lifestyle and what they would be spending their money on in retirement. Initially, there was some push-back on their perceived ability to complete this exercise. They expressed doubts that that they would be able to say what the basic cost of living will be in the future due to inflation and used this as their 'excuse' to do nothing. But by focusing on simply getting them to produce a list, without any numbers, they were quickly able to overcome this barrier and complete the exercise. Spending items were naturally clustered by the groups into 'essentials', 'rainy day/emergency money', 'holidays' and 'luxuries'.

Once this exercise had been completed, respondents were asked to say how much they thought they needed per year to cover just the basic essentials. There was broad agreement that somewhere around £1,500 to £2,000 per month was the right ballpark; so, couples with no mortgage will need £18,000 to £24,000, singles will need a bit less, renters will need a bit more. They used a variety of terms to describe this essential spending – “spending on the basics”, “everyday spending”, and “everyday essentials”.

“

That’s exactly the number I came up with when I worked it out: £25,000 a year. When you’re working you’re probably spending £35,000, but then you’ve got to think that a lot of that we won’t be doing anymore in retirement.

(Female, 55-65)

“

I would have said £24,000 – that’s a nice figure, because you can pay your bills with that. That’s enough to just about get by.

(Male, 55-65)

These figures are very much aligned with the PLSA’s thoughts on national income targets. Our respondents had no issues with the industry promoting these income targets as a new rule of thumb and, indeed, the vast majority felt that this would be very helpful in helping them anchor to a “real” number. They supported this initiative as long as it is not presented as “fixed in stone” and that there are tools and sliders for them to play about with to match their own circumstances.

“

Now you’ve explained it, I think it’s a good starting point for your own calculation.

(Male, 55-65)

”

“

Seeing that that number does trigger you to think a bit more about how that would work for you.

(Female, 55-65)

”

The exercise is a real eye-opener for some as, for the first time, they saw in black and white what their money will need to cover for the rest of their lives.

“

Makes you think, doesn’t it! I haven’t gone through this before.

(Female, 55-65)

”

“

Doing this exercise did not feel good. It made it clear that I don’t have enough. It made me realise that I would have had to start this way back to really see a significant result. So, there’s a bit of a panic now for me, all of a sudden it has brought into focus how much more I need to do if I want to be where I want to be.

(Female, 55-65)

”

MEMBERS WERE OFTEN FINANCIALLY BETTER OFF THAN THEY THOUGHT

Next, we conducted an exercise to formally set out their income sources in retirement and roughly say what each was worth today. This process was very helpful for our respondents and, again, was often described as an “eye-opener”. For many, this was the first time they had ever actually sat down and done this calculation.

“ Makes it a bit more realistic and brings it home really – what I have kept putting off has suddenly hit me.

(Male, 55-65)

“ It’s really good this, because until you actually start to write your numbers down, how can you make decisions? The numbers have to make the decisions.

(Male, 55-65)

Once again, there will be some behavioural barriers to overcome for members to be comfortable to do this on their own as, until the numbers go down on paper, they can ignore the situation (the ostrich effect) or ‘fool’ themselves that their plans are possible and that everything will somehow work out for them (optimism bias).

That said, many of our respondents were surprised to see the full extent of resources available to them, and the extent to which the state pension will cover much of their basic living expenses. It was common for our respondents, or their partners, to have a DB pension. During the course of our discussions, they often remembered other savings, particularly other pensions, which they had simply forgotten about.

“ Based on a very quick calculation, because I have never thought of this before, I would say that the state pension could just about cover your day to day expenditure, your everyday living – depends on where you are with your house – and then the rest is on top of that, for the ‘extras’.

(Male, 55-65)

Looking at real numbers, some of our respondents started to think a little differently about using their housing wealth. They warmed to the idea that some of this wealth could be used to support their lifestyle in retirement or to fall back on if they run out of money, rather than mentally assigning it solely as an inheritance.

“ When you look at the numbers you realise that here I am with only this and here are the kids with all of that money from the house – it’s a bit of an eye opener that. We could downsize and use some of that money for us now.

(Female, 55-65)



RESPONDENTS SOMETIMES STRUGGLED TO COMPLETE THE INCOME EXERCISE DUE TO KEY INFORMATION GAPS AND POOR MATHS SKILLS

Our respondents had a very low level of awareness of how much the state pension would be worth and were pleasantly surprised when told by the moderator (or by others in the group) that it would be roughly £8,000 a year for singles, and perhaps £16,000 for couples. Some were pleased to find out that they would get the state pension even though they had opted out of the state earnings related pension scheme (SERPS). They very much welcomed being told how they could find out about their state pension entitlement.

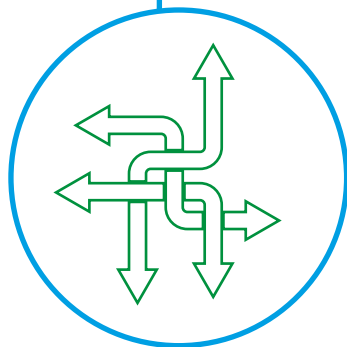
Communicating these simple, basic facts would significantly help members to have a better understanding of their financial position.

Our respondents typically had very low awareness of how much DB income they would receive, especially where this was an old frozen pension, or their partner's pension. They were often unsure what had happened to frozen DB and DC pensions and some thought they had been 'lost'.

“ I also have a final salary pension, but I'm not sure what that is. I know it was quite late in that scheme and they stopped it, but I don't know any facts and figures.
(Male, 55-65)

“ I think I have a pension from my previous workplace. I think they stopped sending me things, so I thought it had just gone away.
(Female, 55-65)

They were very interested in hearing about the Pension Tracing Service and the forthcoming Pension Dashboard.



What did members think of the concept?

Our respondents were shown the visual description of the concept (see Figure 1 page 11). The moderator gave a brief description of the four pots and brought the concept to life by talking through a couple of illustrative examples of how DC money could potentially be split.

RESPONDENTS WERE HAPPY TO HEAR ABOUT AN ALTERNATIVE APPROACH

Initial reactions to the concept were very positive. Respondents felt this to be a simple approach, which focuses entirely on their needs and lifestyle in retirement and does not require them to have any prior knowledge. They felt that this was a solution that is personal to them, which provided “reassurance”, “security” and “took away the worry” of the decision-making process.

“

This to me is plain and simple, straightforward, black and white and easy to understand.

(Female, 55-65)

”

Our respondents felt somewhat relieved that a provider had recognised that people are struggling to understand the options currently open to them and were looking to do something different. They said that this was a fresh approach which would appeal to a lot of people. Unprompted, some started to ask about the possibility

of consolidating all their DC pensions to take advantage of this new idea.

“

It’s very reassuring that you have something in the pipeline that is concrete and set up for you rather than putting your finger up in the air and saying “right, this is what’s going to happen”. I would feel a little more comfortable to say I’m going to be alright and not going to have any problems.

(Male, 55-65)

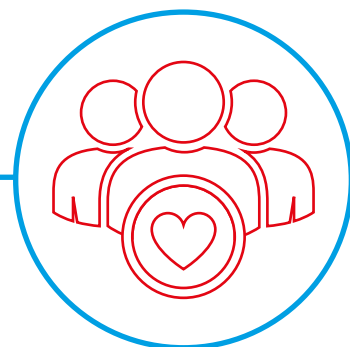
”

“

It’s taking a lot of the uncertainty out of it. To me this is a simple idea that is easy for anybody to understand.

(Female, 55-65)

”



“

You're being informed about the choices in a much more coherent way and then you can make an informed choice, instead of just being presented with a load of choices where you don't know what's going to be best for you. Whereas if you are shown the things that work for a particular lifestyle then that is so much better.

(Female, 55-65)

”

“

In your mind you think that you have to take drawdown or an annuity, that's the way it comes across, not like here where it is a mixture, and having a mixture is like having your cake and eating it. You've got your income for life, but you can also take money out in lump sums for whatever you want. I think this is brilliant!

(Female, 55-65)

”

“

I could imagine a lot of companies doing this. You can see the future here, because it's all so complicated to manage it, and there are going to be more and more people like me with multiple pensions who are going to think "I just want it all in one pot".

(Male, 55-65)

”

“

A very good concept, sounds modern. I think it would appeal to a lot of people. It's less scary because it's adjustable and that's a big plus that you're not fixed and can move things about.

(Female, 55-65)

”

Interesting, the things they did not say about the concept are just as telling as the things they did say. In discussions with over 1,000 DC decision makers since the introduction of pension freedoms, Ignition House has observed that there are a number of negative phrases that are used time and time again. However, in this research **not one** respondent mentioned the word 'minefield', nor did they mention any use of jargon, nor did they say that there was too much information to take in.

When we asked respondents to re-visit their feelings about making plans for retirement, all felt more positive, and we often observed some significant mindset shifts. Making decisions about their money on their own now felt much less daunting.

THE CONCEPT IS A SIMPLE, CUSTOMISED SOLUTION, NOT A DEFAULT

Our respondents very much understood that they would be making a decision on what to do with their DC pension money, and that this decision would be unique to them.

“The more personal it is to you the better, because that is what’s lacking with the other stuff. It’s one size fits all and “you can do all these things, but we’re not going to tell you how they will affect you”. And yes, you can go to an IFA, but they cost money and most people, if they’re like me, don’t want to pay for something like that if they don’t have to. So, anything that is personalised is brilliant.
(Female, 55-65)

A minority felt that the concept was almost too simple to be true. They were astonished to think that their life could fit neatly into four boxes and tried, without success, to find exceptions.

“Normally, when you see something from a financial provider it’s diagrams here and flow charts there and graphs and all the rest of it. And having four groups like this is the other extreme. It doesn’t look like there is enough, which was my first impression, but having gone through it, it probably is! It feels too simple to be true, you expect a whole list and they managed to make it into four, and life doesn’t seem to feel that simple.
(Male, 55-65)

UNPROMPTED, RESPONDENTS ARE ALREADY PUTTING SOME OF THEIR MONEY INTO DIFFERENT POTS, SO THEY ARE EASILY ABLE TO UNDERSTAND THE CONCEPT

Our respondents already talked about the money they had for everyday living expenses, having money put away for emergencies and using their house to pay for (residential) care or inheritance, so they were quickly able to understand, in very broad terms, how this concept would work with their money.

“I’ve got short-term and long-term savings; the short-term savings are for things like holidays or emergencies that come up and the long-term ones are like an insurance policy for when I do retire so that I can fall back on those.
(Male, 55-65)

“With this pension and my other money, I am having three pots; one is for maintenance on the house, one for my basic, everyday living expenses and the last third is going to be just sitting there in case I need care.
(Female, 55-65)

“We’ve got £2k or £3k that we set aside each year into a savings account, which I suppose you could say would be for holidays and rainy days. So, we are already doing it like that.
(Male, 55-65)

To further test their comprehension, we gave a couple of different combinations of the four pots and asked them to say why people might choose that particular combination for their DC pension money. All were able to give a good account of why this might be.

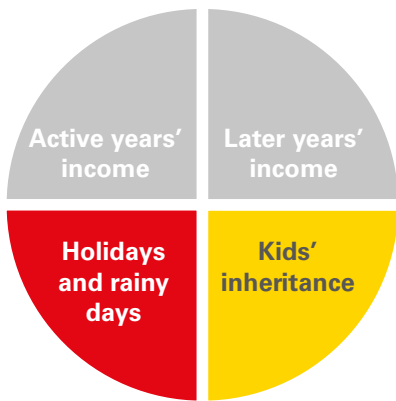


Respondents are already putting some of their money into different pots

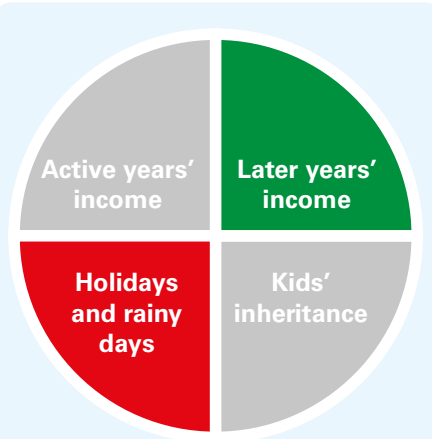
Figure 6: Results of the comprehension test

Who is this?

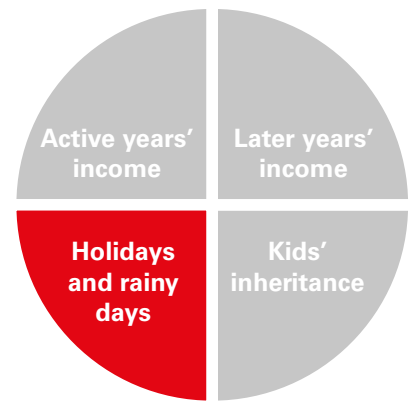
What types of people would split their DC money like this?



- Wealthy
- Already have a good pension income
- Lots of savings and/or property and other assets
- Not yet retired, still working
- Family/couple with children



- A potential medical condition/ care requirement
- Good pension
- Comfortable with other pension income (for now)
- No children
- Single



- State pension/other pension income and other investments
- Partner has good income
- Rich, no money worries
- No 'bank' savings
- Not yet fully retired
- Poor health diagnosis
- No children

“ I think they might be in a good situation, maybe they have a well-earning partner or money already. They must have other money apart from this pension.
(Female, 55-65) ”

“ They’ve got some money to keep them going in early retirement. But they’re going to run out pretty soon, so they have weighted this toward the back-end. Perhaps they’re going to take a part-time job or they’ve got some savings they’re going to use in the early days and they have ring-fenced the pension for when they run out.
(Female, 55-65) ”

“ A person who has got money and isn’t worried about things and just going to enjoy themselves with this pension pot and spend everything they’ve got. Selfish attitude, selfish but lovely – if you can do it, great!
(Male, 55-65) ”

RESPONDENTS UNDERSTOOD FROM THE STIMULUS THAT THE POTS WOULD HAVE DIFFERENT RISK PROFILES

When shown the simple, one-page stimulus which explained how LGIM would manage their money for them (see Figure 3 page 13) the vast majority were able to pick up that there was a difference between the two sides of the circle.

On the left ('Active years' income' and 'Holidays and rainy days') they picked up that the money was in cash. On the right ('Later years' income' and 'Kids' inheritance') they were drawn to the words 'investment' and 'higher risk'. Some were quite worried about this, and the moderator pointed out that they would have a long time to recover from any investment falls before feeling comfortable with this situation.

This will need to form a key part of any communication strategy.

THE STORY-BASED STIMULUS HELPED RESPONDENTS UNDERSTAND THAT THEY ALREADY HAVE AN UNDERPINNING OF INCOME FOR LIFE

Respondents were shown two personalised examples of how the concept could work in practice. The moderator talked through the thinking behind the allocation to the four pots, outlining whether or not the individual in the case study would be able to cover their basic living expenses through state pension and any DB entitlement.

This approach resonated well, and they could see these 'people like us' types of stories featuring as videos or narratives on provider's websites.

“ I could see these things helping. On the website, like this or as videos, where you can find the one that's a bit like you. It makes it a bit more real, doesn't it!?”
(Female, 65-55)

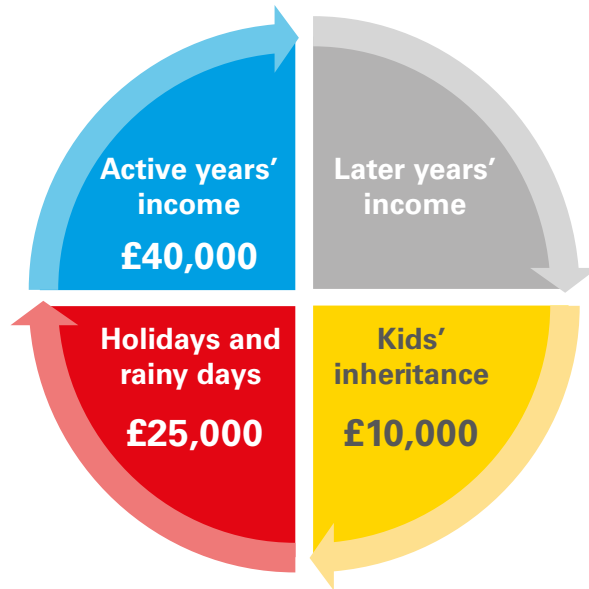


Figure 7: Personalised examples of the concept shown to respondents

Jane – £75,000 of LGIM pension savings at 65

Jane’s husband has a local government pension

- Jane’s partner has a local government final salary pension. This, plus their state pensions, means they will receive £20,000 a year.
- Jane wants to top up their income by £4,000 a year for 10 years so they can make the most of their early years of retirement. She uses £40,000 of her LGIM pension for this.
- Jane plans to spend £25,000 of her LGIM pension money in the next 2 years on some home improvements and a new car.

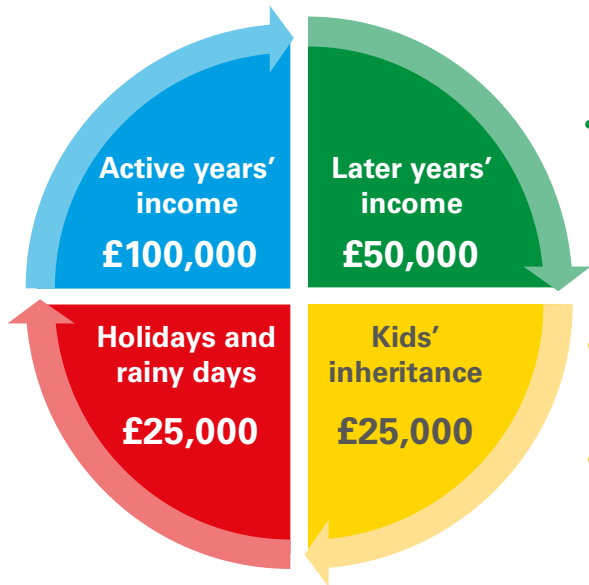


- Jane and her husband are happy that their state pensions and his final salary pension will be enough to live off in their later years.
- They plan to use their house to pay for any care costs, and might consider equity release.
- Jane has set aside £10,000 from her LGIM pension money, which she is hoping to pass on to her children.
- The money is invested, and is It is expected to be worth £18,000 when she reaches 80.

Peter – £200,000 of LGIM pension savings at 65

Peter is single, with two kids and has no other pension savings, except for the state pension.

- Peter can take an annual income of £8,400 from age 65 to 80 from his LGIM pension. Peter will get his full state pension at 67.
- This could provide Peter with an extra £5,500 per year for five years, which he plans to use on holidays and emergency funds.



- £50,000 could provide Peter with an annual income of £6,000 from aged 80 onwards.
- This pot will be left to grow, but Peter can add to it or take from it at any time.
- It is expected to grow to be worth £45,000 when he is 80.

The figures were shown to members for illustrative purposes only and are based on LGIM funds’ growth assumptions

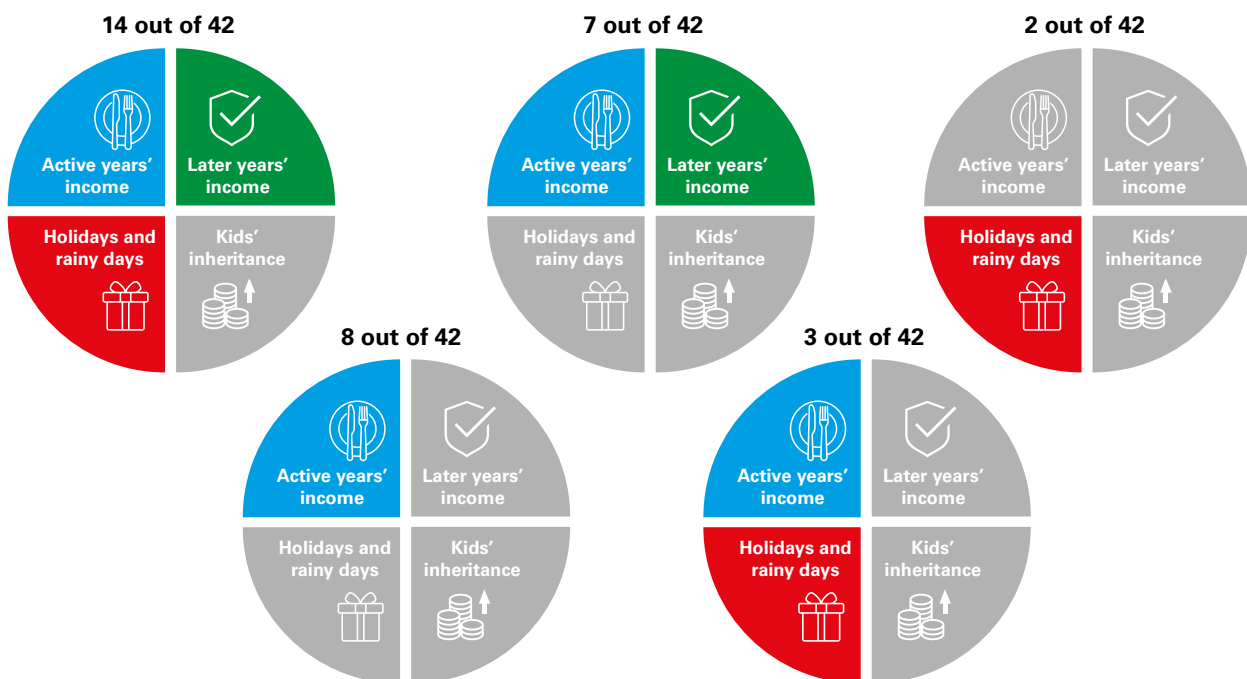
MORE STRUCTURED CHOICE ARCHITECTURE MEANS RESPONDENTS ARE NOT OPTING TO PUT ALL OF THEIR DC MONEY IN CASH

The FCA's consultation paper (CP18/17)¹³ raised a number of concerns that current decision makers may be making poor choices by choosing an investment strategy that is unsuitable for their needs, including their risk tolerance and what they intend to do with their pot in the future. They point to the fact that, overall, 33% of current non-advised drawdown consumers are holding cash only. Furthermore, the FCA estimated that over half of these drawdown consumers are likely to be losing out on retirement income by holding cash. It highlighted that someone who wants to drawdown their pot over a 20-year period could increase their expected annual income by 37% by investing in a mix of assets rather than just cash.

The exercise to identify sources of income in retirement clearly demonstrated that our respondents also have a high propensity to hold cash-based savings. Very few held investments or equity investment savings accounts (ISAs); most said that this was because they did not want to take a risk with their money. Given their current preferences it is likely that they, too, would want put their DC money into low, or no-risk cash options.

However, a simple task; to ask respondents to think about the potential different uses for their money – appears to have had a fundamental impact on their thinking. Very few said that they would put all of their DC pension money in the low risk 'rainy days and holidays'; most would put some into 'later years' income'.

Figure 8: Breakdown of how respondents would allocate their DC pension money



The remaining eight respondents picked the following money split combinations:

- Active years income and kids' inheritance
- Active years income, later years income and kids' inheritance
- Later years income
- Active years income, later years income, kids' inheritance and holidays and rainy days
- Kids' inheritance and holidays and rainy days
- Three respondents did not know how to split their pot

This exercise was completed with 42 out of the 45 respondents interviewed

13. www.fca.org.uk/publication/market-studies/ms16-1-3.pdf

We think, in part, that this apparent contradiction between the desire for safe investments and how participants now think they will split their DC pension can be explained by Daniel Kahneman’s System 1 and System 2 thinking¹⁴. When people make ‘top-of-mind’ decisions, they are basing this on their System 1 thinking, the brain’s fast, automatic, intuitive approach. They fall back on their natural inclination to look for ‘safe’ options, regardless of whether this is the right thing to do for

their particular circumstances. By asking our respondents to slow their thinking down and conduct some exercises, they used their System 2 thinking, the mind’s slower, analytical mode, where reason dominates; hence we saw a very different set of results.

Of course, in reality, the challenge will be to get people to conduct these exercises for themselves rather than in the controlled environment of a research session.

Figure 9: System 1 and System 2 thinking



OUR RESPONDENTS WERE ALL IN DEFAULT FUNDS, AND WERE GENERALLY HAPPY FOR “THE EXPERTS” TO MANAGE THEIR MONEY IN RETIREMENT

None of our respondents could recall ever making any investment choices for the money in their DC pension pots. They said that they would be worried about taking this task on now, as making a mistake when they will shortly need the money to live off of would be disastrous.

“ The fact that LGIM are going to invest your money is great, because you don’t want to have that responsibility and would rather have someone else who is a professional and knows about it.
(Female, 55-65) ”

14. Kahneman, D. (2011). *Thinking, fast and slow*. New York: Farrar, Straus and Giroux.

The vast majority felt that managing investments was the key role that their DC pension provider had had up until now, and they were very keen to see this responsibility continue in the future.

“ That is what they do, the pension company does that anyway unless you tell them otherwise. That’s what their whole purpose is, to manage our money. They’re the experts, and I am not.
 (Female, 55-65) ”

“ I think it’s nice to know that there are professionals out there that are going to help you manage your funds.
 (Male, 55-65) ”

This sentiment chimes with how current drawdown holders seem to feel. FCA figures cited in CP18/17 indicate that just 37% of those in drawdown (including the more sophisticated self-invested personal pension population) currently say they know exactly where their money is invested. In contrast, 34% have a broad idea and 28% are not sure.

RESPONDENTS FELT THE PROPOSITION WAS A DIY VERSION OF WHAT THEY MIGHT GET FROM A FINANCIAL ADVISER

Unprompted, some respondents suggested that the concept was doing the work of a independent financial adviser for them, but without the “hefty fees”. Most of our respondents did not want to pay for ongoing advice, especially when they heard from others in the focus group, or from the moderator, how much it would cost.

Knowing that a reputable company had set up a solution to “do it all for them” - in much the same way that a IFA would - was very much welcomed in principle.

“ It’s like an IFA, isn’t it! You tell us what you want from your money and then we will guide you around what is best for you.
 (Female, 55-65) ”

“ They’re being a bit like an IFA. Because they are saying we’ll take all your pot, you tell us what you want to do with it and we’ll divide it accordingly. It’s quite a clever idea. It’s like tailoring your pot to meet your requirements.
 (Male, 55-65) ”

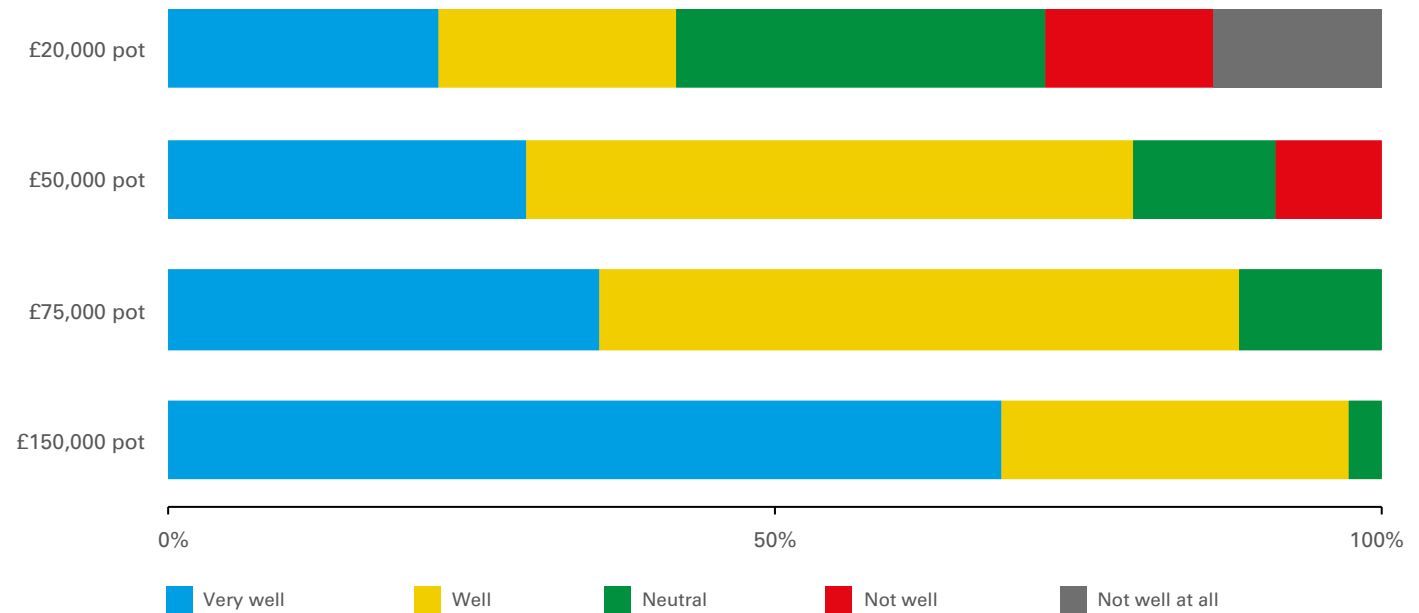
We explored whether they would see this as ‘advice’. Our respondents were aware that this was a decision they would have to make and described it as “their choice”.

MOST THOUGHT THIS WOULD WORK FOR MEMBERS WITH POTS OF MORE THAN £50,000, BUT SOME FELT IT WAS FLEXIBLE ENOUGH TO COVER ALL CIRCUMSTANCES

Respondents were asked to think about how well the approach fits with different pot sizes. The results are shown qualitatively in Figure 10 below.

Figure 10: Respondents' assessment of the suitability of the concept by pot size

Assume that you had a DC pension pot at retirement of the following amounts. How well does concept fit with the way you want to manage your money now?



The general consensus was the larger the pot, the better the fit. The tipping point seemed to be around £50,000; many respondents felt that anything significantly less than £50,000 would not be enough to justify splitting their money across several different pots. At £20,000, the money is either being used for holidays or rainy days or to live off for a few years.

“ Works well for the others, but I’m not sure about the £20,000 pot... the concept still works, but you would then just put it all into one pot, probably wouldn’t make sense to spread it out. (Male, 55-65) ”

“ I think that would work well with the £50,000 pot and very well with the larger ones. The more you have in your pension the more flexible you are with your money. (Male, 55-65) ”

Making it work in practice

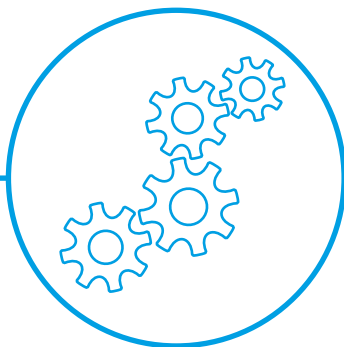
Whilst, in principle, the respondents we spoke to were extremely positive about the concept, we wanted to explore whether there would be any hurdles to adopting this kind of approach in practice.

FLEXIBILITY WILL BE KEY

Respondents were told that they could move the money around without penalty any time they wanted, and as many times as they wanted. All valued this flexibility for a number of reasons:

- They are unsure how their retirement years will pan out, and may need to shift money around as and when their circumstances change
- They are worried about making a mistake, and don't want to be locked in to making a one-time only decision
- They may or may not need residential care¹⁵
- They are worried that the goalposts might shift – the state pension age or entitlement might change, the NHS may not cover all their needs, or social care delivered by local councils might be further reduced

This has implications for the investment proposition, and also for the timing of any deferred annuity purchase to provide a guaranteed income for life.



PLANNING TOOL OR PROPOSITION?

When asked how they would describe the concept to a friend, our respondents often failed to mention the investment strategy, re-counting the proposition simply as a way to plan their finances.

“It's a product that is trying to help people understand what they can do with their money in advance of their retirement date so that they can plan.
(Male, 55-65)”

“It's like your own personal financial plan that's bespoke to your needs and requirements to live through your retirement.
(Male, 55-65)”

“It's a new way of planning your retirement money. It's jargon-free, it's friendly, and it's easy to manoeuvre, set it up and change it when and if you want to.
(Male, 55-65)”

“I would say that it made things plain and simple and easy to decide about your pension without paying money to someone to make it understandable. I could cope with that and manage financially with that.
(Female, 55-65)”

15. The Laing and Buisson survey 2016 suggests that approximately 416,000 people live in care homes, which is 4% of the population aged 65 years and over, rising to 16% of those aged 85 or more.

A SMALL MINORITY WERE UNCOMFORTABLE WITH THE “WE WILL DO IT FOR YOU” INVESTMENT STRATEGY

Our respondents highlighted a number of concerns which, although by no means universal, will need to be addressed:

- **They want to have ‘control’ of their money:** on probing, they have not made any decision on their investments in accumulation, so this is more of a general feeling about the loss of control than a real desire to manage it themselves
- **A minority have been conditioned to think they need to know what is high, medium and low risk:** on probing, they have no idea what this means in practice for their money, and are likely to hold all their money in low risk funds

WHAT’S ‘IN IT’ FOR LGIM?

We know from previous research that many people in this age cohort mistrust pensions and pension providers, due to a legacy of broken promises, bad news stories and shifting goalposts.¹⁶ It was, therefore, not surprising to hear some respondents question LGIM’s motivations for the concept.

On probing, they think that ‘what’s in it’ for LGIM is that LGIM want to hold onto their pension money. That said, it transpired through discussion that they generally have no issues with this ambition, as long as LGIM are honest and charge them “fairly”.

They would be more worried if this type of proposition was offered by a company that they had not heard of, as it might be a scam. But LGIM is a big, household name, a strong brand and for many, has been their DC pension provider for many years, and so they are happy to take the proposition at face value.

UNDERSTANDING CAPACITY FOR LOSS, NOT ATTITUDE TO RISK, WILL BE CRITICAL

Most of our respondents had multiple sources of income for their retirement and savings they could call on in an emergency, but not all were so fortunate. Even amongst the 45 people we spoke to, a small number of people will be reliant on the state pension and their DC pension to cover their everyday spending. For these people it will be absolutely critical for them to understand whether they could bear any investment loss at all, and for how long. If even a small, short-term loss will tip them over the edge, then they will need to be directed outside of the concept to think about whether a guaranteed income for life is, perhaps, the best thing for them.

When probed, the majority felt that they could sustain falls of 5-10% in any income generated by their DC pension over a couple of years. Beyond this, they would question the value of the concept and whether the investment strategy was working for them. They would be likely to move into cash. To date, the stock markets have been kind to our new cohort of drawdown investors, so we have not seen any behavioural responses to sustained falls in fund values in action.

MEMBERS WHO WANT TO VALIDATE THEIR THINKING BEFORE COMMITTING WILL NOT FEEL COMFORTABLE TO “CLICK THE BUTTON” WITHOUT SOME FORM OF VALIDATION

Respondents often struggled when it came to actually assigning their DC pension pot across the four pots. Sometimes this was because they found the maths difficult; sometimes this was because they had incomplete information on their own circumstances; sometimes it was just a lack of confidence.



16. www.justgroupplc.co.uk/~media/Files/JJ/JRMS-IR/news-doc/Rebuilding%20Trust%20in%20Long-Term%20Savings.pdf

Respondents often said that they will need some reassurance that they have understood the exercises correctly. When explicitly asked what this would be, respondents said that they would want to talk through what they have done and have the facility to ask questions. It was hard for our respondents to envisage exactly what support they might need. And, when questioned, most reverted to face to face as this is what they know and are most comfortable with. The challenge will be to develop solutions that fill this gap in a cost-effective manner.

Respondents would also like the 'system' to have built-in ways to identify any strange results or anomalies, and to give them warnings for them to check their thinking again.

“

It would be good if a warning came up. You know, a box or something to tell you if you're making a mistake.

(Female, 55-65)

”

MEMBERS MAY OVER-ENGAGE TO START WITH AS THEY GET USED TO RETIREMENT

Our respondents happily admitted that they did not pay much attention to their pensions for much of the accumulation years, but as retirement draws ever nearer and the money becomes more “real” they are now checking the value of their pots on a more regular basis.

They told us that their engagement is likely to peak when work has just stopped and there is no longer a steady flow of earnings coming into the household. When they are in this situation, our respondents said they would want to check in at least every six months to see how their money is doing, and some would look daily.

This seems to tie in well with actual experiences. Our newly retired respondents reported feeling very apprehensive when this happened, and it took many months for them to adjust to seeing their overall savings fall as they accessed money to live off. In line with academic studies in this area, they said that they tended to cut back on spending and to be very careful with their money until they got used to how things would be.

“

The most difficult thing for me has been adjusting from a saving mentality of putting money away for the future to now watching that pot diminish. And being relaxed about that being OK is difficult. For the first few months I didn't go out and spend anything and then I realised that that's alright and that I now have more money in my pocket than I ever had. And because I was using it all the time, I looked at it like my bank statements, monitoring it all the time. And once you get used to it, you end up keeping it in your head and not looking all the time.

(Male, 55-65)

”

In practice, what this means is that newly retired members are likely to over-engage with their pension, at least during this bedding-in process. It will be important to be prepared for this, and to deal with any increased activity when markets are falling. Some within the pensions industry are currently proposing the idea of a 'gap year' for retirees, where they are able to settle into their new lifestyle. This would certainly chime well with those we spoke to who have been in this position.

NUDGES TO ENGAGE WILL BE NEEDED FOR THOSE FURTHER AWAY FROM RETIREMENT

However, when respondents are some years away from full retirement, the picture is somewhat different. Here, they said they would be unlikely to want to complete any detailed sources of income and spending exercises. Tracking numbers down will be an excuse to avoid and procrastinate, and they will be more likely to question the validity and accuracy of the results.

Respondents were therefore very receptive to the idea of a simplified retirement quiz as a light-touch alternative. They could see how this could work for anyone, especially those who just wanted to “play”.

“

Perhaps they could put something on their website, perhaps like a questionnaire asking people what they are thinking at the moment about their pensions and based on the answers given they could show it like they have done with the four pots here.

(Female, 55-65)

”

“

That’s a brilliant idea because people love quizzes. That will get people interested and they will be able to relate to that easily.

(Female, 55-65)

”

A number of engagement initiatives; such as linking in with the ‘Mid-life MOT’ at 50 and combining the concept with financial wellness initiatives through the workplace also resonated well with our respondents. It is easy to see how the process we went through in our discussions with respondents could also be linked to the FCA’s proposal to begin issuing wake up packs at 50 and then every five years until retirement.



Conclusions

Evidence from over 1,000 detailed discussions Ignition House has held with pension savers since 'Freedom and choice in pensions' was announced by the UK government, strongly suggests that people are struggling to decide how best to use their money to deliver the best outcome in retirement. Most are unwilling to buy an annuity, evidenced by the fall in lifetime annuity sales since the new freedoms were announced. Pension savers themselves recognise that their decisions are becoming much more complex. They are aware there is a plethora of options now available to them, but they are often confused by these choices and are unsure exactly what they would do.

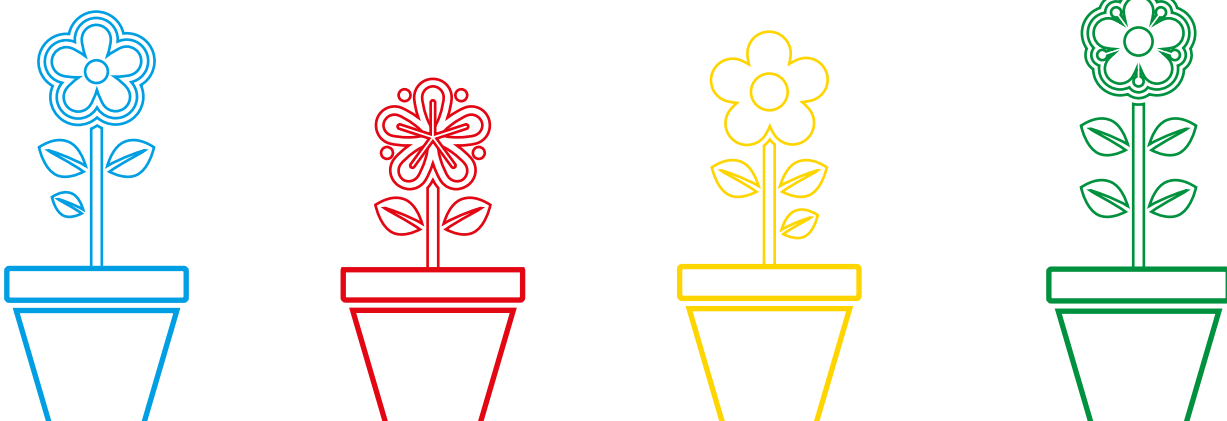
Many pension savers are now choosing some form of drawdown, even those who stumble into drawdown simply because they want to access their tax-free cash. This means that members should be making some very important choices, but all the evidence suggests that they are simply opting for the 'path of least resistance'. Behavioural biases mean that this is not going to change any time soon, so it is vital for providers to have a well-thought through solution for those who just want someone to 'do it for me'.

This is particularly true of investment choices. We have consistently found that the people we speak to are not confident enough to make decisions about equity-based investments. They usually have very low levels of awareness (and interest) in what their pension is currently invested in. They are predominately putting their non-pension savings into cash ISAs and deposit-based savings as they are unwilling to bear any capital loss. Few are aware how their investment choices could impact on their future income.

Furthermore, the choice architecture around the information and guidance currently given to consumers is firmly centred on what they can do with their DC money alone. We know that this generation has a myriad of household income sources, including DB and housing wealth, so to focus on DC money in isolation and at the individual, rather than the household level, fundamentally seems to be the wrong approach.

All of which strongly suggests that current products do not easily translate into a solution to meet consumers' needs under the new freedoms — particularly for those with smaller pots and those who may not find it cost-effective to access advice.

This research, with ordinary members approaching their retirement years, demonstrates that there could be significant consumer appetite for a blended solution of the nature tested here. Recognising behavioural biases and working with them, rather than disrupting them, is a powerful tool, and the intuitive nature of the concept is perhaps its greatest strength.



The four pots for retirement concept is a tailored solution based on each individual's circumstances and desires, rather than a default, one size fits all, solution. At face value, this seems to fit well with the types of innovation the FCA is driving towards in its recent consultation paper.

Although the concept ticks a lot of boxes with members, in practice there will be a number of challenges.

The proposition seems to fit more naturally with those who are making retirement income decisions rather than the decision to access a lump sum, so it may be that this will not be the solution for those simply accessing tax free cash at 55. That's said, the FCA's proposals to start wake up packs at 50, and that "before proceeding with an application to access or transfer a consumer's pension savings, firms must ensure that the consumer has either received appropriate pensions guidance or opted-out of receiving it" look like they could have the potential to be a game-changer for early engagement, but we will need to wait and see how these initiatives develop.

Without such interventions, it will not be easy to get members to proactively conduct detailed income and spending exercises of the nature tested in this research until they are very close to retirement. Even then, there may be many gaps in their knowledge. Industry innovations such as Pension Dashboard, national income

targets and external factors such as open banking will all help but will take some time to come to fruition. In the meantime, basic messages about the state pension, directing participants to the Pension Tracing Service and 'lighter touch' solutions, such as the retirement quiz, will certainly help.

We are very mindful that the concept works as an online solution, but what about those members who cannot or do not want to work in this way?

Although members said that this was a decision they would make for themselves, and they therefore did not see the concept as 'advice', we did not fully explore whether the choice architecture is driving them one way or another. Further work will be needed to see whether this is truly guidance.

That said, the very positive member reactions we observed in this research mean that the concept is an idea that certainly merits further exploration. It is hoped that the evidence presented here will act as a catalyst for future development, particularly when it comes to designing solutions for those with more modest pot sizes. It is likely that there could be many variants on the approach we have tested, but this research hopefully provides a foundation for the industry to build on.

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