The Evolution of Drawdown

AT-RETIREMENT CHOICES
IN TRUST-BASED DC SCHEMES
2020 ADDENDUM

A Report for the
Pensions and Lifetime Savings
Association

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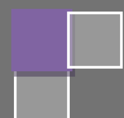

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INTRODUCTION

This report is an addendum to a report produced for the PLSA in April 2019[1]. The earlier report summarised the findings from a programme of interviews designed to understand more fully developments taking place in the at-retirement choices made available by the trust-based Defined Contribution (DC) sector; both among single employer schemes and master trusts.

The original research was conducted among 27 organisations (and individuals) who between them represented:

- around **7 million active members** of DC workplace pensions, several million deferred members and **more than £25bn of assets** under management;
- **11 master trusts** including the largest and some of the newer players in this sector;
- **11 single employer DC schemes** including some of the most mature and largest including a range of, typically **larger, private sector employers** in the UK:
  - from retail and leisure sectors to pharmaceuticals, technology and banking,
  - from those employing predominantly low and modest earners to high paid employment sectors.
- Several of the largest employee benefit consultants (EBCs), administrators and bundled platform providers, a law firm and a professional trustee company. In some cases, these organisations were also operating master trusts and providing other services to the sector, in which case the discussion was extended to include those services.

In February and March 2020, the authors of this report, Jackie Wells and Nick Hurman, re-contacted the original participants in the study with a view to understanding any changes that had taken place between the original interviews and today or any planned changes. In particular, we sought to understand any regulatory barriers that might be preventing schemes from implementing changes and any views on the potential for DWP to adopt similar changes to those being implemented by the FCA following its Retirement Outcomes Review.

As part of this update, we spoke to 16 organisations managing more than £35bn of assets. Understandably, some schemes were unable to talk to us due to the impact of Covid-19 on all organisations in the first few months of 2020. The organisations spoken to included:

- Eight master trusts, including one that did not participate in the earlier research. These included not-for-profit schemes as well as more commercial offerings.
- Five single employer schemes ranging in size and industry sector.
- Independent professional trustees, a legal firm, firms offering administration services and employee benefit consultants.

[1] Jackie Wells and Nick Hurman, The Evolution of Drawdown, April 2019, PLSA

SUMMARY OF FINDINGS

The 2020 update research found that all of the key themes identified in the 2019 report continued to hold true. We have summarised the findings from this update by following the headline findings from our original report.

Drawdown has become the most common destination for the default pre-retirement glide path, replacing the annuity destination in most schemes.

Overall, drawdown remains the default outcome of the investment glide path or target date funds for most schemes interviewed. Some schemes are reviewing their glide path default investment strategy as thinking about sustainable drawdown solutions evolves and member behaviour changes. Several schemes mentioned the difficulty in setting a target date when members often first access their money before or after their selected retirement age.

One scheme in particular has made the decision to re-target to drawdown those who had previously been on an annuity glide path except those near their target date. However, another had increased the threshold above which drawdown is targeted and below which cash is the default.

Some schemes with in-scheme drawdown report looking at whether a target date set as 'retirement' might be better replaced with one much later in life, perhaps when annuitisation is appropriate. One scheme interviewed in the original research already operated a glide path for one employer with a target date beyond normal retirement date.

There remain a small number of respondents with cash as their default or one of their segmented defaults [2]. Typically, these schemes have very low average pot sizes and/or low earners or are responding to member preferences or behaviour at retirement. One scheme with a cash default reported plans for a review of their default in 2020.

In-scheme fully flexible drawdown providing a regular income is available or in development in the majority of master trusts interviewed.

This continued to be true among the master trusts interviewed. Master trusts were described by a number of respondents as 'upping their game' when it comes to drawdown. Two schemes interviewed had launched new solutions since the original research. Others were working to ensure that members understood the benefits of the scheme's drawdown.

However, some master trusts had not been able to launch their new propositions as quickly as they had anticipated in 2018/19. This was attributed to a number of factors including master trust authorisation, a renewed focus on administration and scheme data, ESG work, a perception of regulatory barriers, or extended member testing of propositions. Many of these barriers were expected to be overcome during 2020 with some expecting new propositions expected to be launched later in the year. However, at the time of interview, the effect of COVID-19 had not been fully factored into plans.

Some master trusts also feel less urgency in launching propositions due to their relatively small average pot size, although even these schemes recognise that they the number of customers with larger pots is expected to rise quickly. Even those with small pot sizes today envisage needing a

[2] As reported in our original research, some schemes operate a segmented approach to their glide path whereby members are allocated to different default s based on the value of their funds.

drawdown solution within the next 2-5 years. NEST continues to be limited by statute in the range of options it is able to offer its members in retirement.

Master trusts with drawdown continue to focus on drawdown governance and looking at ways of avoiding members running out of money. While annuities at age 75 or 80 are considered the most appropriate solution for some schemes, with most of the members in drawdown already in their 50s or 60s, there is time to develop alternative mechanisms. At present, some drawdown solutions end at age 75 or 80 with members (or trustees) expected to purchase an annuity with remaining drawdown funds at that age.

At the time of this research, it was too early to say what impact Covid-19 would have on drawdown solutions. As well as potentially delaying some launches, the big unknowns at the time of this research were how members would react to the value of their funds dipping and how those approaching or in retirement will react to falling markets.

None of the single employer trusts provided fully flexible in-scheme drawdown, although a small number provided limited drawdown flexibility.

This continued to be true among the single employer schemes interviewed for this update with no schemes planning to implement their own drawdown. Just one single employer scheme (not interviewed) is known to have in-scheme drawdown that is designed to provide a regular income. Other schemes provide either limited drawdown or UFPLS, although some continue to require all funds to be transferred in order for members to access their money.

Rather than providing their own in-scheme drawdown, several single employer schemes are finding alternative approaches to ensuring that their members can achieve good outcomes in retirement (see section on signposting below).

Across the board, schemes are investing more into member engagement, seeking to encourage members to plan early for their retirement journey.

Improving member communication and engagement continues to be an important focus for all schemes. Work continues in ensuring that communication about decumulation and drawdown can address all levels of financial literacy.

Some respondents have chosen to implement some of the FCA's new rules on communication at age 50 and regularly thereafter, using simplified wake-up packs. One respondent reported increased member engagement since the increase in auto-enrolment contribution rates but most continued to report difficulties in engaging members over their retirement needs.

Some schemes reported focusing on how best to communicate what members can expect in terms of income from the scheme (throughout the accumulation phase and into the glide path). A few were hoping to incorporate the PLSA work on Retirement Living Standards.

The member pre- and in-retirement journey is evolving with bespoke guidance and advice services employing new technologies being developed by several schemes.

Several schemes interviewed report using guidance rather than advice but some have in place limited advice services for those retiring. Some continue to develop robo-advice services using third parties, although at least one had looked at options but had rejected current models of robo-advice as a solution due to concerns about the potentially poor outcomes that it could deliver, instead using

guidance rather than advice. Others are reported to be aligning themselves more closely with specialist advisers offering decumulation advice, sometimes offering preferential rates. However, schemes report limited use of advice services provided by schemes while several schemes expressed the view that guidance could achieve most of what members require at and during retirement. Some schemes with larger DC funds were aware that members were using their own financial advisers at retirement but evidence was anecdotal.

Some single employer trusts are beginning to signpost members to master trusts for in-scheme drawdown with the default glide path designed to reduce costs and friction at point of transfer.

In this wave of research, several respondents mentioned an increase in single employer schemes signposting to external providers of drawdown following the completion of master trust authorisation. One single employer scheme had, since the original interview, introduced a signposted solution to a personal pension with the provider of their investment platform, accompanied by advice from an EBC ahead of the transfer. Several other schemes were mentioned as aligning themselves with master trusts.

The EBC and professional trustee interviews confirmed the rapid and extensive growth in the single employer schemes signposting to master trusts for drawdown. Trustees are reported to have become comfortable with the risks of doing so, often after taking legal advice. The master trust is selected through a rigorous selection and due diligence process with the brief for the drawdown proposition driven by the ceding scheme trustees. Trustees are also putting into place regular reviews to ensure that the selected master trust remains appropriate to their member needs. Some are reported to be putting in place service level agreements with the receiving scheme as part of their on-going monitoring of the relationship.

In selecting a master trust to signpost to, schemes were prioritising getting the right partner over putting an arrangement in quickly. Schemes are reported to be looking for good communications, tools and guidance, strong administration as well as investment solutions that help members avoid running out of money. They are also interested in value for money and the ease of transfer to drawdown with some mirroring the ceding scheme's own documentation to make the transfer simple, pain free and quick and with no fees for transferring. They also want a good choice of funds and a good drawdown 'default' fund. Some trustees are working with the master trust to design new drawdown investment solutions and are looking at how members can be protected in later life (although it is early days yet for solutions on this).

There are several drivers behind these moves. Several single employer schemes interviewed report being reluctant to deal with members in later life and nervous about members running out of money. Moreover, they often feel that master trusts can do a better job on the communication front, have the funds to invest in new tools and guidance for those in retirement and can provide a low-cost solution.

In communicating with their members about the signposting, the ceding schemes are ensuring that they present the signposted scheme as just one of many options available to the member but also are highlighting the benefits of the negotiated deal.

Some respondents, largely those master trusts not currently in a position to attract such arrangements, felt that this development would require more regulation to ensure that schemes ensure good outcomes for members.

The design of new income drawdown concepts is being led by several of the master trusts, including the development of multi-pot solutions that seek to address issues of later life.

A small number of master trusts interviewed reported launching new drawdown facilities. However, the launch of some solutions has been delayed, for reasons mentioned above. Multi-pot solutions continue to be in development whereas other schemes report a preference for a more streamlined approach to the different phases of retirement.

The economics of scheme drawdown are not yet clear but drawdown facilities on offer at present tend to mirror the default accumulation charges (which, in large master trusts are typically lower than the price cap).

The pricing of drawdown in master trusts varies scheme by scheme but is generally reported to be in line with pricing during the accumulation phase for that scheme. While this research did not explore drawdown charges in detail, schemes typically report using a single annual management charge in drawdown.

While schemes report a slow but steady increase in the numbers using drawdown, it remains the case that data on member behaviour are limited, in particular data on how members respond in much later life and how often they will engage with the scheme. The Covid-19 crisis is expected to provide some data on how members respond in volatile markets.

Work on supporting older members in drawdown is incomplete with further work on vulnerable customers anticipated.

Schemes are exploring ways in which they can build best practice for members by learning from financial services organisations that have dealt with older customers for longer and who have had to build systems to comply with FCA regulation on vulnerable customers.

One employer described it as ‘front and centre of our thinking’ and important in their work with the master trust in designing drawdown and later life issues. Several anticipate that they have much yet to learn and expect to continue to develop new systems and processes.

Both the trust- and contract-based sectors are developing and anticipate developing new technology-based solutions that can deliver simpler and lower cost routes to drawdown and annuities.

Technology is expected to continue to afford efficiencies in the delivery of drawdown but it will rely in part on members being more engaged and relies on members being able to continue to use new technologies well into later life as physical and cognitive limitations kick in.

FCA retirement outcomes and DWP regulations

As part of the update, PLSA was interested in whether and how schemes were viewing to the FCA’s new rules on investment pathways for contract-based workplace pensions[3].

Respondents had mixed views on the implementation of the FCA’s investment pathways for the trust-based sector. While many agreed with the principles behind the pathways and, indeed, some schemes are designing their drawdown by adopting a similar approach, they are cautious about limiting trustee discretion in the design of investment solutions. The FCA’s approach is seen by many to be too

[3] FCA 2019, Retirement Outcomes Review

interventionist for the trust-based sector. It was felt that allowing trustees more flexibility than the FCA rules might achieve better outcomes, in particular flexibility in relation to shaping the member journey and outcomes as well as investment solutions. Trustees feel keenly their responsibility to design their scheme for the needs of their specific members and to ensure that defaults are designed to leave members in safe place. One respondent suggested that it would be helpful to see how the FCA rules work in practice before the DWP implements anything further for schemes. Most supported the idea of pathways but not the detail of the FCA rules.

Those using administration or investment platforms of life companies or fund managers are expecting that their providers will offer them the same pathway options as they are developing for their contract-based schemes, although it will be for the trustees of the scheme to determine whether and how they are applied. Others expect to mirror at least some of the FCA rules but are keen to ensure that they do not add friction to their retirement processes or prevent anything that trustees might want to implement for their scheme.

Some respondents expressed concern that in developing anything for the trust-based sector, the DWP should recognise that, unlike the contract-based sector, there is no product purchase involved when members move seamlessly from accumulation to decumulation within the same scheme.

A number of those interviewed expressed the wish for the DWP/TPR to offer a clearer position on things like signposting members to drawdown. However, this view was not held universally by those interviewed with many preferring not to see any further regulation in this space.

CONCLUSIONS

In the original report, two principal themes emerge from this research, both of which are supported by this update, namely that:

- The support and choices available to members of larger occupational DC schemes at retirement are changing with signs of an increase in access to regulated advice and to low-cost and simplified flexible access drawdown. In time the latter development could result in more scheme members staying in the trust-based environment rather than transferring to individual personal pensions or annuities;

  The update research confirmed this conclusion with signs that the speed of change may be accelerating the trust-based sector.

- The workplace pension sector itself is undergoing considerable change as the pension freedoms and other regulatory changes bed down with schemes consolidating and the master trusts leading innovation in the design of in-retirement options in the trust-based part of the market. For some employers, the changes taking place within their businesses and sectors and in pension policy, in particular the introduction pension freedoms, have acted and continue to act as a catalyst to review how they provide pensions for their workforce. Further structural changes to the sector may occur as a result.

  The update also supported the view expressed in the original research that some employers are finding that running their own scheme is becoming too costly and are moving members into a master trust. One of the single employer schemes interviewed is in the process of closing and moving all members to a co-branded master trust solution. While this decision has not been made simply because of the decumulation issues, this is one of the drivers. The main drivers have been the rising regulatory burden and cost of running own scheme. Employers such as these recognise their inability to deliver a DC scheme as efficiently as a master trust and to provide the range of outcomes for members in accumulation and retirement. In selecting a scheme, one of the features they report as seeking is a seamless journey for the member from accumulation to drawdown. Ceasing to run their own scheme is described by several respondents to allow the employer to focus on communication to employees / members and to reallocate funds used for scheme governance and administration to other employee benefits.

In our original report, we suggested that there remain a number of areas where the sector has issues to resolve and further developments on the horizon, including:

- Regulatory risk: the perception that trustees are at risk if they signpost to a particular retirement solution is holding back some schemes from signposting to a drawdown solution. Several respondents to this research indicated a desire for greater regulatory certainty in this area.

  In this update, we found indications that some trustees have become comfortable with the ability to signpost and a sense from them that no further regulatory intervention is required. As noted above, some felt that further clarity and regulation of the process and decumulation issues in general would be helpful, and in particular guidance on good practice. For example in signposting, and, to a limited extent, regulation of the drawdown pathways and defaults . Some also called for standard industry nomenclature and processes involved in helping members move into retirement and drawdown.

- Further scheme innovation: both the trust- and contract-based sectors are developing and

anticipate developing new solutions that can deliver simpler and lower cost routes to drawdown and annuities. New solutions beyond those outlined in this report can be expected as member behaviour evolves the shape of the sector changes, average fund sizes at retirement grow and the number of retirees with DC funds increases.

Some respondents felt that no further regulation was required to facilitate the development of new drawdown solutions; indeed, a period of regulatory calm would help to ensure that solutions reach members. However, some trustees were calling for greater clarity; feeling that the regulations did not facilitate their desired approach to drawdown.

- Guidance and advice services: whether or not schemes offer in-scheme drawdown, the provision of bespoke guidance and regulated advice to members at the point of retirement (or taking their benefits) is evolving with new technologies and new providers of advice to pension scheme members.

  The emphasis among many respondents is on the development of guidance and helping members towards a solution. Some were mirroring the principles, but not the detail, of the FCA's investment pathways to help members choose an investment solution. Some continue to offer limited advice or access to wider advice services.

- Vulnerable scheme members: many schemes interviewed recognised that they needed to do more work on how best to support members, particularly those in drawdown, as they age and become more vulnerable or unable to deal with on-line technologies. Some pointed to developments in technology itself, particularly artificial intelligence, as offering opportunities to help such members.

  We found some schemes were progressing discussions with their administrators or platform providers to learn lessons from other financial sectors. Others have started to consider whether to develop a 'trusted helper' approach where member in drawdown appoints someone else, perhaps a family member or knowledgeable friend , to formally help them make decisions and someone that the scheme recognises as the helper. However, schemes are also alert to the potential for financial abuse, for example family members or friends encouraging scheme members to withdraw their pensions for their own benefit, and are exploring ways of dealing with this.