The Evolution of Drawdown

AT-RETIREMENT CHOICES IN TRUST-BASED DC SCHEMES

A Report for the Pensions and Lifetime Savings Association

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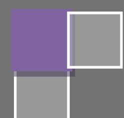

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INTRODUCTION

Since the unexpected announcement of 'freedom and choice in pensions' in 2014[1], employers, pension schemes, administrators, consultants and asset managers have worked hard to adapt to the new choices available to members. Alongside automatic enrolment and associated regulations, such as the price cap for default funds, the pension freedoms have brought about significant change to the workplace pensions landscape as well as outcomes for members.

A comprehensive review of developments and member outcomes in the contract-based workplace has been undertaken by the Financial Conduct Authority (FCA)[2]. The Work & Pensions Committee has also made a number of recommendations for Government and regulators[3] including supporting the FCA's recommendations for investment pathways into drawdown and a price cap on drawdown.

The PLSA identified the need 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 findings from this research commissioned from Jackie Wells & Associates will support and shape the policy work of the PLSA. The report documents the changes that trust-based schemes have made and are planning to make in response to the pension freedoms, described in terms of the phases of the journey towards and into retirement experienced by members of these schemes. The report also summarises a smaller study of the contract-based workplace pension sector in Appendix 1.

The authors and PLSA would like to thank the 27 organisations (and individuals) who gave up their time to input to this report and between them represent:

- 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.

A summary of the methodology applied and the organisation types and profile interviewed is included in Appendix 2 to this report.

[1] HMT, March 2014, Freedom and choice in pensions
[2] FCA, June 2018,Retirement Outcomes Review Final Report
[3] Work & Pensions Committee, April 2018, Pension freedoms Ninth Report of Session 2017–19

EXECUTIVE SUMMARY

The trust-based workplace pensions sector is undergoing a transformation, driven in part by the implementation of the pension freedoms in 2015. In particular, the provision of choices at retirement is evolving with master trusts at the forefront of new in-scheme drawdown solutions. As a result, pension scheme members are already experiencing very different outcomes in retirement to those of previous generations.

THE MEMBER JOURNEY TO AND INTO 'RETIREMENT'

Prior to the introduction of pension freedoms, the journey for the vast majority of DC scheme members was relatively simple and common to many larger schemes including those interviewed for this project. The process was designed to ensure that members' funds were invested for taking the tax-free cash and buying an annuity with the remainder at selected retirement age.

Since the pension freedoms, the choices available to members from age 55 have multiplied and schemes have started to introduce very different journeys for their members. In essence there remain four main phases to the journey but, in some cases a fifth phase is planned:

Phase 1. **The glide path:** investment strategies designed to help the member align assets with their expected choices at retirement;

Phase 2. **Getting ready:** the pre-retirement alerts and information;

Phase 3. **Decision time:** the choices available to the member at retirement and the guidance or regulated advice given at retirement to support making a decision;

Phase 4. **Early years 'retirement':** while some members cash out altogether, other members remain invested in the scheme beyond their selected retirement age and some schemes now offer or plan to offer in-scheme drawdown that facilitates the payment of a regular income; and

Phase 5. **Later years 'retirement':** A fifth phase designed to manage longevity and vulnerability risks among ageing drawdown customers is in planning phase among a small number of master trusts that are offering or plan to offer in-scheme drawdown.

PHASE 1: GLIDE PATH –DRAWDOWN AS THE DEFAULT

Most schemes report making changes to the default glide path used to determine assets held by members at their expected retirement date to respond to changes in expected members' use of funds under pensions freedoms. However, this decision is also complicated by many members now withdrawing funds well before that date and a smaller proportion withdrawing significantly later than that date.

Most schemes reported making a fundamental change in the default glide path, with the majority of schemes interviewed having changed their default glide path to a multi-asset strategy suitable for targeting income drawdown. This was characterised by some schemes as the default that created the 'least harm' for members rather than necessarily being optimal for all. There were a few exceptions where cash or annuity is targeted where schemes have taken a different view based on the expected behaviour of members or concerns over trustee liability.

As a result of these changes, the majority of members will arrive at their retirement with a different

mix of different asset classes than was the case before the pension freedoms.

PHASE 2: GETTING READY – MORE HOOKS TO ENGAGE MEMBERS

The pension freedoms have also triggered changes to the way in which members are communicated with in the lead up to retirement.

Schemes report that they are encouraging members to start thinking about their choices at retirement around the age of 50, irrespective of the length of the glide path. Among the larger schemes and master trusts interviewed, many make on-line tools and guides available to members throughout the period leading up to their retirement date designed to help them gradually familiarise themselves with and explore the choices that they will have to make at retirement, although some schemes commented that levels of member engagement with tools and guides remains disappointing.

Among some single employer schemes, the prompts about retirement are being incorporated into a broader financial well-being programme.

PHASE 3A: DECISION TIME – EXPANDING CHOICE

Expanding the choices available to members at retirement was the primary purpose of the pension freedoms. This research identifies that not only are the choices open to members changing but architecture in which those choices are made is also changing and varies by scheme type.

Prior to the pension freedoms, all of the schemes interviewed limited the choices available to members at retirement to a trivial commutation or transfer to an annuity (or drawdown for some with large enough funds). The choices being made available to members in the first year of pension freedoms were typically driven by the capabilities of a scheme's administrator. Since then, some schemes have extended their choices further.

Among the single employer trusts interviewed, most allow members to take the cash in staged payments, typically up to three payments over three years. One scheme allowed more flexibility in payments but each withdrawal must be triggered by the member. Some schemes also allow members to leave funds invested beyond retirement date but do not offer any further flexibility in withdrawals. All of the single employer schemes interviewed require members to transfer to a personal pension or master trust in order to access a flexible drawdown facility and draw a regular monthly income from their pension fund.

By contrast the master trusts interviewed are offering, developing or planning to develop flexible drawdown designed to pay a monthly income. At present, the master trust drawdown arrangements tend to set a minimum fund size of £20,000 - £30,000, although some of those in development anticipated a lower still minimum value of around £10,000.

PHASE 3B: DECISION TIME – SUPPORTING MEMBERS

We noted significant changes in the architecture designed to support member choices among the schemes interviewed. All schemes reported doing more than the statutory minimum in terms of member communication at and around retirement. Many had developed or signposted to tools designed to help with understanding trade-offs between the different choices available. Some single employer schemes felt that master trusts were better placed to fund and develop more advanced tools and website functionality for members. Others were incorporating their retirement communication into a wider programme of financial well-being.

While not a quantitative study, the findings suggest that there is a growing appetite among trustees for incorporating optional regulated advice at retirement into either the scheme itself or the employer's financial well-being offer. Where such advice is offered, it is typically offered through the advice services of one of the benefit consultancies or a large national firm of regulated advisers. It is also limited in its scope. Advice tends to be a one-off session, sometimes provided on-line and typically is restricted to matters relating to pensions and retirement.

One of the most significant changes taking place in the choice architecture of several single employer schemes is the use of signposting scheme members to either a master trust or a group personal pension that offers a drawdown facility for regular income. While some trustees remain uncertain about the risks of signposting or the appropriateness for their members, several schemes reported either having an arrangement in place or considering doing so. Some trustees are recognising that the emergence of master trusts with in-scheme drawdown presents them and their members with an attractive solution.

PHASE 4: EARLY YEARS 'RETIREMENT' – DEVELOPING 'IN SCHEME' DRAWDOWN

The design of drawdown products in trust-based schemes is in its formative years. However, innovative propositions are beginning to emerge among the master trusts. The design of in-scheme drawdown makes the move largely frictionless in terms of costs to the member and simplicity of process. Having passed through the process of risk warnings and being prompted to use Pension Wise, the member simply provides bank account details and tells the scheme how much they wish to take each month. Features such as funds specifically designed to support a regular income and manage risk and the same (or similar charges) to those in accumulation and on-line tools to check/warn about the sustainability of income are typical.

Four master trusts interviewed were in the process of developing propositions for members in retirement that featured multiple pots designed to deliver different outcomes. While none of these had been launched at the time of this research, a number plan to launch in 2019. A common feature to all is expected to be the core drawdown pot from which members take a regular income; but other pots would be designed to provide income in later late (typically via an annuity), act as a 'rainy day' fund and, in some cases, provide an inheritance for family members.

At present, schemes reported that they largely kept the pricing of decumulation at the same or very similar level to the accumulation scheme but were keeping this under review. However, all of the schemes offering or planning to offer drawdown had little experience on which to price the facility. All indicated uncertainty about future pricing, albeit that most felt confident that pricing could be kept at a figure that is close to the accumulation phase.

PHASE 5: LATER YEARS 'RETIREMENT' –SUPPORTING OLDER MEMBERS IN RETIREMENT

Trustees are increasingly concerned about how they will support older members in retirement where members can keep funds invested beyond retirement age. Trustees worry about members exhausting their funds, members being poorly equipped to manage longevity risks and about the costs and complexities of dealing with fragile and vulnerable older customers. Some schemes manage this risk by requiring members to transfer out of the scheme by age 75.

Several schemes expressed disappointment that a deferred annuity market had not evolved to support members in drawdown with longevity risk whilst also understanding the capital constraints

on insurers providing these products. Among those schemes developing the multi-pot option, an annuity pot is intended to help members put aside funds to protect against out-living their drawdown funds, providing an alternative solution to a conventional deferred annuity. These pots would remain liquid and accessible to members up to the point of purchasing an annuity around age 80 and do not ensure that there will be a viable annuity offer available at the time they need to annuitise. For members in drawdown, some longevity protection can be provided by changing the investment mix as the member ages to mirror the investments of annuities but this does not afford the same security as an annuity itself.

Several schemes also reported that their thinking on more vulnerable customers was incomplete with more work planned. Most expected to have to develop systems to identify vulnerable customers and to offer more help and advice to such members or their families.

DIFFERENT MEMBER JOURNEYS

The research suggested that trust-based schemes adopt one of five typical retirement journeys with varying degrees of support and choices offered to members, including:

1. a minimalist approach that leaves the member to determine their journey themselves;
2. employer/scheme support to access regulated advice or personalised guidance (the most common journey among single employer trusts);
3. through signposting members wishing to drawdown to negotiated terms with a master trust or group personal pension arrangement;
4. the provision of in-scheme drawdown solutions (typical of several master trusts interviewed) taking them 'to and through' retirement (in addition to other options);
5. the plans to extend these solutions to include multi-pot options.

Our research also reviewed briefly the response of **contract-based schemes**. We found that most offer members access to an individual or group personal pension that offers drawdown. Like in-scheme drawdown, this can be relatively frictionless for the member in terms of cost and ease of process. However, in some cases, this can result in a significant increase in charges for the member as they move from group pricing in a workplace scheme to individual pricing in a personal pension arrangement.

CONCLUSIONS

Two key themes emerge from this research, 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; and
- 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.

While this research suggests a clear direction of travel for the trust-based sector, 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.
- 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.
- 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.
- 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.

THE MEMBER JOURNEY TO AND INTO 'RETIREMENT'

The trust-based workplace pensions sector is undergoing a transformation, driven in part by the implementation of the pension freedoms in 2015. In particular, the provision of choices at retirement is evolving with master trusts at the forefront of new drawdown solutions. As a result, pension scheme members are experiencing very different outcomes in retirement to those of previous generations.

This research suggests that, among the largest DC trust-based schemes in the UK, the direction of travel is becoming clearer, albeit that some of the developments outlined remain at planning and design phases.

Other reforms shaping the trust-based sector

The changes highlighted by this research cannot be laid entirely at the door of the pension freedoms but should also be understood in the context of other regulatory, economic, social and technological forces, including:

- The introduction of automatic enrolment and associated regulations such as the default fund price cap and value for money requirements;
- A growing focus on governance and transparency that is adding to the costs of running a scheme and the responsibilities placed on trustees;
- The authorisation process for master trusts and increased governance requirements for other trust-based schemes;
- Rising costs of employment and uncertain economic conditions leading to some employers seeking cost savings in their benefit packages.
- New technological developments that allow for more interactive engagement with pension scheme members, but which come at a cost; and
- The closure and gradual winding-up of DB schemes with which many of the larger single employer DC schemes were originally associated.

Some of the changes highlighted in this report are a consequence of this combination of reforms and uncertainties that are themselves not the subject of this report.

This research suggests that many members of occupational DC pension schemes in the UK are experiencing a gradual transformation in the choices and services available to them at retirement or when they take benefits[4]. The past three and a half years since the introduction of the pension freedoms have seen:

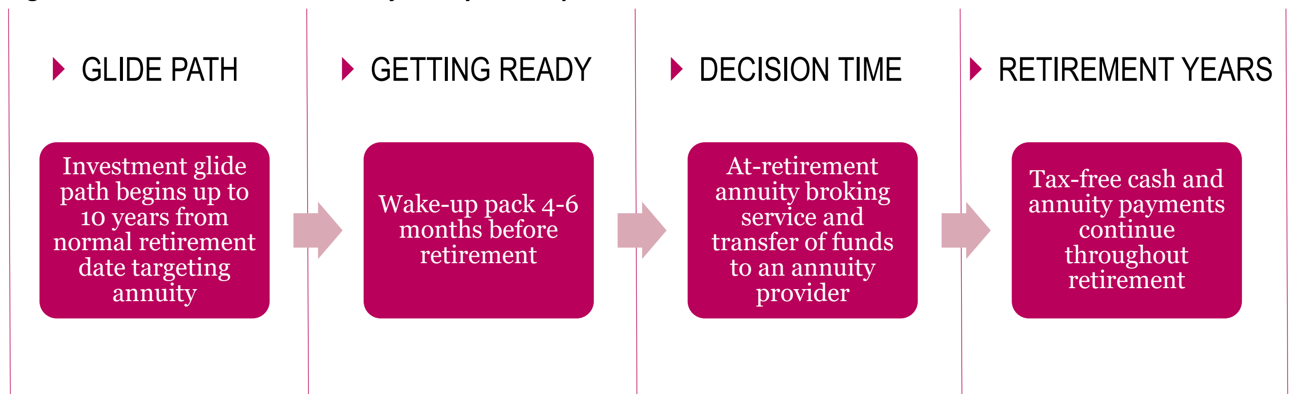
- Innovation in the design of investment strategies leading up to (and, in some cases, beyond) retirement, also known as lifestyling or the glide path;
- New services available in the lead up to retirement in terms of tools, advice and guidance;
- A new choice architecture at decision time when funds are accessed;
- The development of both in-scheme options for delivering a retirement income from invested funds as well as some new propositions from the contract-based personal pension and annuity markets; and
- Developments that will assist members in later years of retirement where willingness and/or ability to manage an income from invested funds may decline.

This transformation is gradual in nature and many of the most innovative developments are still at design and testing phase and may not be fully available to members for another year or two. However, other changes are already affecting members at all stages of their retirement journey.

THE MEMBER JOURNEY: BEFORE PENSION FREEDOMS

Prior to the introduction of pension freedoms, the journey for the vast majority of DC scheme members was relatively simple and common to the larger schemes interviewed in this project, and is summarised in Figure 1 below. The first three phases were provided by the scheme itself with the fourth typically provided through a transfer to a life assurance company.

Figure 1: Phases of the retirement journey before pension freedoms



The process typically consisted of four main phases designed to ensure that:

- The members' funds were invested appropriately for taking the tax-free cash and buying an annuity with the remainder. Most schemes operated a glide path designed to reach a point at the member's retirement age which would, broadly speaking, align the assets to 25% in cash and 75% in a bond-like investments that would provide stability of value in the lead up to retirement.

[4] We use the term retirement from this point onwards as short-hand for the point or multiple points in time when members access their funds. These points may or may not coincide with leaving employment and we recognise that the very nature of retirement is changing.

While members could choose different investment funds and create their own glide path, few did.

- The member was alerted to their forthcoming decisions in advance of normal or selected retirement date in order to prepare them for having to select an annuity. Few people took their funds before retirement due to the lack of flexibility of access.
- At their normal retirement date, members were often signposted to an annuity broking or regulated advice service in order to support decisions and arrange for the transfer of funds to a life company. Some schemes also provided access to workplace seminars for active members or could access a scheme pension.
- A life company or scheme would then provide an income for life for the member.

Schemes generally followed the regulatory requirements in terms of alerting members to their forthcoming retirement date and the decisions that they would need to make. Often employers or schemes would make access to a broker or adviser available for retiring members and would transfer funds for the purchase of an annuity.

The exceptions to this process were few and far between and were typically driven by a small number of members with large enough funds at retirement choosing to move their funds into income drawdown with a life company or other provider at retirement rather than buying an annuity. Before the pension freedoms were introduced, it was generally held to be the case that a saver would need around £100,000 in order to access drawdown and would need (and typically took) initial and on-going regulated advice on the appropriate asset mix and drawdown rate.

THE MEMBER JOURNEY: POST PENSION FREEDOMS[5]

Since the pension freedoms were implemented, the choices available to scheme members from age 55 have multiplied and schemes have started to introduce very different journeys for their members.

Some of the changes have taken some time to evolve or are still evolving. This has been due to a number of factors that are explored in later sections of this report but, based on the interviews conducted, include:

- Administration systems lacking the ability to provide drawdown solutions and requiring major investment;
- Uncertainty about how scheme members would respond to the new freedoms and data on which to build a business case for investment;
- Uncertainty about the legal and regulatory responsibilities of employers and trustees in relation to retirement solutions that could give rise to future claims for misselling and a reluctance on the part of some employers and schemes to support older, more vulnerable, pensioners within their schemes (or, in time, potentially the dependents of pensioners as drawdown funds can pass to beneficiaries);

[5] In 2014, the Conservative Government announced radical changes to the way in which members of DC pensions could access their funds from the age of 55. In its consultation 'Freedom and Choice in pensions' the Government proposed a new system that would enable all DC scheme members to take full withdrawal of their fund, subject to their marginal rate of tax, regardless of the size of their DC pension pot. They would also be able to buy an annuity, as before, or to take a regular income through flexible access drawdown, a facility that allows members to take as much or as little income or lump sums from their fund as they wish.

- Other critical developments that took priority over discretionary changes, such as changes to schemes in relation to the charge cap or new governance requirements;
- Some uncertainty about how regulation of retirement options would evolve; and
- A lack of clarity on how the individual personal pension and annuity markets and the master trust sectors would respond with choices for members of single employer trusts.

All of the schemes interviewed undertook a review of their scheme and some made changes to investment strategies and, in some cases, changed their service providers, following the changes in legislation and regulations to facilitate the pension freedoms. However, several decided to hold back on making wide-ranging changes to their schemes until some of the issues were clarified; focusing initially on the regulatory requirements and new communication material.

In essence there remain four main phases to the journey but, in some cases a fifth phases is planned:

Phase 1. **The glide path:** investment strategies designed to help the member align assets with their expected choices at retirement;

Phase 2. **Getting ready:** the pre-retirement alerts and information;

Phase 3. **Decision time:** the choices available to the member at retirement and the guidance or advice given at retirement to support making a decision;

Phase 4. **Early years 'retirement':** while some members cash out altogether, some members remain invested in the scheme beyond their selected retirement age and some schemes now offer or plan to offer in-scheme drawdown that facilitates the payment of a regular income; and

Phase 5. **Later years 'retirement':** A fifth phase designed to manage longevity and vulnerability risks among ageing drawdown customers is in planning phase among a small number of schemes that are offering or plan to offer in-scheme drawdown.

The journeys experienced by trust-based scheme members have become more diverse than before the pension freedoms. They are no longer dictated by the intended purchase of an annuity (or trivial commutation) but by employer and trustee views on how best to help members deliver a good outcome when faced with a complex choice of options.

The following chapters explore the changes that larger trust-based schemes have made to the stages of their members' retirement journeys. The findings are based on both the schemes interviewed and the discussions held with scheme advisers and administrators about broader changes in the trust-based DC sector. A later chapter explores how schemes have combined the five phases in different ways to deliver diverse member journeys.

PHASE 1: THE GLIDE PATH

One of the first changes that schemes report having made following the introduction of the pension freedoms was to the glide path used to determine the assets held by members in the default investment strategy at their retirement date[6].

One of the complications for scheme design created by the pension freedoms has been that, whereas before the freedoms most members took their money at retirement age, many are now withdrawing funds well before retirement age and a smaller proportion are withdrawing sometime after that age. One scheme reported that fewer than 20% of members were taking benefits at their selected retirement age with more than half taking benefits earlier and 15% taking them later.

All of the schemes interviewed adopt an approach to investing as retirement dates approach known as a glide path. Among the schemes interviewed, the length of the glide path varied between seven and fifteen years, typically starting before age 55 when most members can first take benefits.

Before the pension freedoms, the glide path typically moved members' assets gradually from growth assets such as equities into more stable assets such as bonds. Targeting annuity purchase was the default in most schemes but with members able to choose their own funds or path.

A MOVE TO DRAWDOWN GLIDE PATHS

For the majority of schemes interviewed for this project, the pension freedoms brought about a fundamental change in the default glide path. In all cases, members are typically given the option of selecting a glide path that they feel meets what they expect their needs to be at retirement. The majority of schemes interviewed offer three distinct glide paths targeting cash, annuity or drawdown. Most also offer members the ability to select a specific mix of funds and to make their own selections throughout their accumulation phase.

The majority of schemes interviewed changed their default to a multi-asset default glide path with a mix of equities, bonds and other investments with an emphasis on volatility management in the later years of investment. Most describe this as a default that is suitable for targeting income drawdown. This was described by some schemes as the default that created the 'least harm' for members rather than being optimal for all. Several schemes undertook research or referenced external research. One scheme referred to member research that showed drawdown as the most popular choice among members. Most of the schemes interviewed report that the majority (80-95%) of members do not make an active choice of path and continue in the default arrangement.

The few exceptions to the use of a drawdown glide path include:

- One single employer trust and some master trusts (typically those with low average member funds derived from automatic enrolment at minimum contribution levels) move investments into predominantly low risk assets such as bonds and money market funds as retirement date approaches. In effect these schemes continue to target cash, reflecting member behaviour (although some recognised that the default might also be influencing member behaviour).
- One scheme had decided, following a review, to keep its default glide path targeting annuity purchase; driven in part by concerns about member outcomes and in part by concerns about trustee liability should a different default be put in place.

[6] Typically, the retirement date selected by the member or the normal retirement date for the scheme.

- One scheme allocates members to a default glide path based upon their projected fund value at retirement. For those with small funds, the default is cash whereas for those with larger projected funds, the default is a mix of assets suitable to carry across into drawdown.

Once retirement age is reached, schemes typically then leave members invested in the asset mix as it stands at the end of the glide path. One continues the glide path into drawdown with an annuity-like glide path into later life. The development of in-retirement glide paths is in the early stages of development.

For many of the new master trusts sponsored by the benefit consultancies or life companies, targeting the default at drawdown coincided with the development of their in-scheme drawdown facility.

For most of the single employer schemes interviewed, the move to a drawdown default glide path assumed initially that any member wanting drawdown would transfer out into a personal pension drawdown product. One of the emerging trends among some schemes interviewed is to align the glide path to a particular fund that can be carried across into a drawdown facility, either within the scheme or in another pension that the member can transfer into with minimal cost and out of market risk. We explore this detail further in a later section of the report.

As a result of the changes to glide paths, the majority of members in the schemes interviewed will arrive at retirement with assets that include a mix of different asset classes rather than predominantly bonds or cash that was the case before the pension freedoms. Some of those interviewed did remark that it remains early days for such strategies and they expect further advances to be made in managing volatility and growth. A few schemes reported that members were accessing their funds at a different time to that suggested by the glide path which has consequences for their risk profile.

PHASE 2: GETTING READY

The pension freedoms have also triggered changes to the way in which members are communicated with in the lead up to retirement.

MORE HOOKS DESIGNED TO ENGAGE MEMBERS DURING GLIDE PATH

Schemes report that they are encouraging members to start thinking about their choices at retirement around the age of 50, irrespective of the length of the glide path. Members are specifically communicated with at the start of the glide path to remind them of their choices and the implications of the default glide path. From there on, all schemes provide at least a generic reminder with their annual statements.

Among the larger schemes and master trusts interviewed, many make online tools and guides available to members throughout the period leading up to their retirement date designed to help them gradually familiarise themselves with and explore the choices that they will have to make. Members are signposted to these tools in their annual statement and, in some cases, through pro-active communication from the scheme or employer. Some schemes interviewed confirmed that levels of member engagement with tools and guides remains disappointing. Some single employer schemes noted that their ability to develop tools and guides was limited either by their employer’s budget for pensions or by their administrator’s capabilities. Others chose their administrator based, in part, on the tools and guides that could be made available to members.

Among some single employer schemes, the prompts about retirement are being incorporated into a broader financial well-being programme. Some large employers interviewed were in the process of putting such a programme in place. One consultancy firm suggested that, among employers implementing financial well-being programmes, this was taking priority over developing retirement solutions for pension scheme members.

One master trust is developing a more personalised approach to online communication with personalised banners appearing on the online portal that reflect the individual member’s journey and plans.

Some of the schemes pre-retirement communication continues to be driven by regulatory requirements, in particular the issue of a wake-up pack 4-6 months before retirement date. Some schemes interviewed were aware of and supported the FCA recommendations in the Retirement Outcomes Review that wake-up packs should be issued from age 50, and then at 5 year intervals until members access their benefits. These packs would include a one-page summary document to highlight key information.

PHASE 3A: DECISION TIME (CHOICES)

Expanding the choices available to members at retirement was the primary purpose of the pension freedoms. This research identifies that the choices available to members and the ease with which these can be implemented vary considerably according to the attitude of trustees and employers, the type of scheme and the profile of scheme members.

Prior to the pension freedoms, all of the schemes interviewed limited the choices available to members at retirement to a trivial commutation for those with funds small enough to take the cash and to a transfer to an annuity (or drawdown for those with access to an adviser). Most single employer schemes interviewed introduced members to an annuity broking service or provided access to a regulated financial adviser through which they could access the annuity market.

EXPANDING CHOICE

Many schemes described the choices made available to members in the first year of pension freedoms as being driven by the capabilities of a scheme's administrator. Since then, some schemes have extended their choices further.

A small number of schemes had made very little change to the choices available from the scheme itself since the early days of pension freedoms. One scheme had made no changes to the choices available from the scheme and requires members to transfer to access the tax-free cash and any other options. A number of schemes changed their scheme to allow members to cash in their pension from the scheme in a single lump sum. Administration capability or a desire not to bear the costs of providing further options appear to have been the main drivers behind this choice, alongside relatively small average pot sizes.

However, among many of the single employer schemes and master trusts interviewed, it was common for choices to be extended to include the option of taking the cash in staged payments, typically up to three payments over three years. These were paid as UFPLS[7], meaning that the member would receive 25% of each sum tax free with 75% being subject to the member's marginal rate of income tax. One scheme had offered staged drawdown payments instead of UFPLS. In each case, each payment needed to be explicitly triggered by the member and was not automated as it would be in fully flexible drawdown.

Some single employer schemes and master trusts also allowed members to leave funds invested beyond retirement date but did not offer any further flexibility in terms of withdrawals. Some require members to transfer if they wish to stay invested beyond retirement date, in part driven by a concern about dealing with ageing scheme members. Some allow members to stay until age 75 when they need to transfer their funds.

One single employer scheme had added more flexibility in the form of a type of drawdown facility where the member would take their tax-free cash first, leave the remaining funds invested and could then request up to three drawdown amounts per year. The drawdowns could not be automated and each one has to be triggered by the member.

All other single employer schemes interviewed require members to transfer to a personal pension in order to access this type of flexibility or to draw a regular monthly income from their pension fund.

[7] Uncrystallised funds pension lump sum.

Members wishing to transfer to an annuity could continue to do so, although some employers made changes to their annuity broking service or access to financial advice (see Phase 3B).

Among those schemes offering only cash from the scheme itself or a transfer to another scheme; most reported that the dominant choice among members was for cash with few taking transfers to purchase an annuity or to go into drawdown.

CONCERNS ABOUT LIABILITY AND AGEING PENSIONERS

Although the choices offered by the single employer trusts interviewed were in part shaped by the facilities on offer from their administrators, a number of other factors have inhibited the development of more in-scheme offerings, including:

- Concern among employers and trustees about the potential difficulties in handling an ageing membership base. Particular concerns were dealing with members:
  - whose funds could no longer sustain the level of income being taken;
  - who were exhibiting vulnerable characteristics including diminishing cognitive abilities.
- The belief or concern that by introducing drawdown into a scheme it could imply that the trustees have made a personal recommendation which could constitute regulated advice. An associated concern is that members who enter drawdown in the scheme seek compensation at a future date if they run out of money. The history of retrospective misselling campaigns in the UK has led to a nervousness among both employers and trustees that is limiting the development of new in-scheme choices.
- A concern that signposting members to any particular drawdown facility could also constitute regulated advice or otherwise expose the trustees or employer to risk and liability.
- A lack of apparent demand from scheme members for options other than cash or transfer, particularly among schemes with small average pot sizes (notably master trusts set up specifically to serve the new automatic enrolment market and employers with low contributions and low income membership). While schemes do not (and cannot easily) track the behaviour of members who transfer funds out of the scheme, several noted that a number of members appeared to be transferring out into personal pensions with a view to drawdown, either with the help of regulated financial advisers or through DIY-style drawdown plans.

Several individuals interviewed from schemes and advisers to schemes commented on the consequences for members of single employer trusts not offering in-scheme drawdown. Several felt that leaving members to find their own way to drawdown through regulated financial advisers to, what they saw as, relatively complex and high charge products, was a policy failure. The complex process and high costs involved, as well as out of market risks, were thought to be inappropriate. Some felt that 'doing nothing' left trustees just as exposed as 'doing something' to help members find a suitable home for their money.

As noted in Phase 3B, some single employer schemes have recently started to explore different ways in which members can be helped into drawdown through other mechanisms.

MASTER TRUSTS LEADING IN-SCHEME DRAWDOWN

The master trusts by contrast are addressing these concerns and are, in the main, offering or developing in-scheme flexible drawdown that is designed to pay a regular income in retirement.

One master trust interviewed introduced fully flexible drawdown shortly after the pension freedoms were implemented. Four others followed soon after. All of these master trusts are characterised by being sponsored by either life companies, benefit consultancies or administrators. They are also characterised by having above average member funds and by competing for transfer business from single employer trusts.

Of the remaining master trusts interviewed, four are in the process of developing in-scheme flexible drawdown and one anticipates beginning development within the next two years. NEST has expressed the desire to introduce drawdown in the form of its published Blueprint[8] but is currently inhibited from implementing by legislation.

All schemes interviewed anticipated member take-up of flexible drawdown increasing as pot sizes increase in the near future and more members reach retirement without adequate DB pensions. At present, the master trust drawdown arrangements tend to set a minimum fund size of £20,000 - £30,000, although some of those in development anticipated a lower still minimum value of around £10,000. The reasons given for accepting lower amounts included:

- The ability to use drawdown from this relatively small pot to fund an income between leaving work and the start of the individual's state pension; and
- The ability to top up state pension, albeit by a small amount in order to ensure bills could be paid.

Among those master trusts already offering drawdown, numbers of customers using the facility remain low but some are beginning to see increased take-up.

[8] https://www.nestpensions.org.uk/schemeweb/NestWeb/includes/public/news/NEST-launches-its-retirement-blueprint-in-response-to-pension-freedoms.html

PHASE 3B: DECISION TIME (SUPPORT)

Not only are the choices open to members changing but the architecture in which those choices are made is changing and varies by scheme type.

CHOICE ARCHITECTURE CHANGING

The signposting of scheme members to master trusts or personal pensions for drawdown is just one example of how the architecture designed to support member choices is changing. The components of the choice architecture made available by schemes include:

- Scheme-specific information provided via an employer or scheme website throughout a member's pension journey and/or scheme specific brochures or other forms of non-electronic communication;
- A scheme-specific telephone helpline providing information and/or guidance;
- Regulation-driven information at specific points such as the annual statement and the wake-up letter or pack;
- Signposting to Pension Wise and the Money Advice Service at regular points of the member's journey;
- The provision of workplace or individual regulated advice for some or all of the members of the scheme as they approach retirement, typically provided, and sometimes paid for, by the employer;
- Signposting to a regulated advice service that is paid for by the member;
- The provision of guidance tailored to the scheme and providing examples of member decision making, sometimes in the form of workplace seminars but increasingly web-based; and
- Signposting to a specific master trust or personal pension that can deliver drawdown facilities.

ELECTRONIC AND OTHER COMMUNICATION

All of the schemes interviewed reported doing more than the statutory minimum in terms of member communication at and around retirement and had scheme-branded websites, often incorporating information and tools provided by their administrator. Many had developed or signposted members to tools that could help with understanding trade-offs between the different choices available to them. Several schemes noted the importance of member engagement around retirement, some stressing that trustees could no longer determine good member outcomes without some engagement from the member.

Some schemes noted that master trusts were better placed to fund and develop more advanced tools and website functionality for members than single employer trusts. Several single employer schemes noted that pension information and communication was beginning to form a sub-set of the employer's approach to financial well-being. The master trusts themselves reported that smaller employers were much less concerned about retirement and pension issues and relied on the master trust to provide information and tools.

The use of electronic communication had become the norm in all schemes with members required to be pro-active in searching out information and guidance. However, several schemes noted that some members could not access information in this way and would continue to need access to

phone based information. Some master trusts specifically provided access to a telephone guidance service.

BESPOKE GUIDANCE

Several schemes interviewed noted the importance of providing members with a simple guided journey through the accumulation phase and into retirement. Too much choice was felt to be off-putting for most members and that guidance could be used to narrow down the options for individuals.

Some schemes felt strongly that trustees had an important role in guiding decisions or even taking on the decision for the member. These schemes supported the idea of an investment pathway as proposed by the FCA and some went further and suggested that trustees ought to be able to direct members to an option. Others felt equally strongly that members should make their own decisions and that trustees should avoid guiding at-retirement decisions.

The research revealed a mixed picture in the provision of either bespoke guidance or individual (regulated) advice by the employer or scheme:

- Some left it to members of the scheme to find their own financial adviser;
- Some had previously provided access to retirement advice or an annuity broking or regulated advice service but had withdrawn the service, due in part to a perception of poor value or concerns about trustee liability even where the advice is whole of market;
- Some who had previously provided an annuity broking service had extended this to provide regulated advice on all options available at retirement, often through the same provider; and
- Some had introduced access since the pension freedoms or reported the intention to introduce regulated advice in the near future.

ACCESS TO REGULATED ADVICE

While not a quantitative study, the findings suggest that there is a growing appetite among trustees for incorporating optional regulated advice at retirement into either the scheme itself or the employer's financial well-being offer. In all cases, regulated advice was seen as a way of supporting members in making complex decisions about the use of their DC pension. Some saw it as a way of giving members access to the open market in drawdown and annuities, while others used advisers with their own drawdown solutions.

Where such advice is offered, it is typically through the advice services of one of the benefit consultancies or a large national firm of regulated advisers. It is also limited in its scope. Advice tends to be a one-off session, sometimes provided online and typically is restricted to matters relating to pensions and retirement.

The way in which advice is paid for varied considerably. Some employers funded a single advice session for employees using the employer-arranged tax exemption of up to £500 per employee[9]. Where advice was facilitated by the employer, fees payable by members were negotiated with the adviser firm. In some cases, schemes were facilitating the use of the pension advice allowance which

[9] https://www.gov.uk/government/publications/employer-arranged-pensions-advice-exemption/employer-arranged-pensions-advice-exemption

allows up to three payments of £500 from the individual's pension pot to be used for regulated advice[10].

Access to advice was not only made available to members of single employer schemes. One master trust offered access to an advice service while another expressed an interest in adding an advice facility for members reaching retirement or in drawdown. Some schemes offering members access to regulated advice report low take-up of the facility, particularly where the member has to pay.

TRANSFER OR SIGNPOSTING TO MASTER TRUST OR PERSONAL PENSION

Among single employer trusts, a recent development and one which was mentioned by several of the schemes interviewed, is the ability to help members find a way into a master trust for retirement. This is being achieved in two ways:

- Some schemes (not those interviewed) are reported to be transferring all deferred members into a master trust on a bulk basis; typically once a year. Transfers of this kind have become easier to achieve following the removal of the requirement for an actuarial certificate for DC transfers. Nevertheless, the process does require the trustees to undertake due diligence on the scheme into which they are transferring members and to ensure that benefits are equivalent. In spite of the simplification, one scheme that had previously transferred all deferred members had stopped this and now retains deferred members in the scheme.
- A number of schemes interviewed have started to signpost members to a drawdown facility available from a specific master trust or group personal pension. The numbers of schemes actively doing this are reported to be small but growing and several single employer trusts interviewed expressed an interest in signposting to a drawdown arrangement. Some noted their intention to begin due diligence on schemes for drawdown as part of their regular review of administration or bundled service provider.

In many of the cases identified in this research, the signposting to a master trust or personal pension was taking place where the company operating drawdown facility was in the same group of companies providing another service to the scheme: sometimes administration or investment management; sometimes fully bundled services; sometimes benefit consultancy or DC pension advice. In all cases, trustees had undertaken due diligence on both the drawdown 'product' and the provider of the facility (the master trust or a pension provider) and had employed independent consultants to assist. They also recognise the need to review their decisions on a regular basis.

While some schemes were happy to signpost to personal pensions, some schemes expressed a strong preference for signposting to an arrangement with trustee governance.

Some trustees recognise that the emergence of master trusts with in-scheme drawdown presents them and their members with an attractive solution for those who want to access their funds in this way and reduces the risk of having older members in the scheme. In some cases, schemes describe the decision being driven partly by the needs of senior management with significant DC funds at retirement. Others see it as way of reducing the need for members to shop around and to be exposed to, what are perceived to be, complex and expensive individual drawdown options and financial adviser fees.

While some members continue to move funds to individual drawdown plans even when a master trust arrangement is in place, the master trust solution is seen by some to afford a number of benefits, including:

[10] https://www.gov.uk/government/news/savers-to-be-able-to-access-1500-tax-free-for-pension-advice

- Lower charges than many individual drawdown arrangements;
- Strong, professional trustee governance;
- A simplified approach to drawdown when compared to many of those offered by personal pension providers;
- Simple and cost-effective investment strategies that do not require members to select and manage funds on an on-going basis and therefore reduce the need to pay adviser fees;
- The ability to align pre-retirement funds to post-retirement funds in drawdown, thereby reducing some of the costs of transfer;
- The ability to co-brand the on-line tools available from the master trust;
- Re-registration of funds where such an alignment is put in place, further reducing friction in the transfer; and
- Strong financial backing of the larger master trusts, and a high probability of such schemes gaining authorisation.

Schemes signposting to a master trust or personal pension for drawdown are particularly concerned about ensuring that their communication makes it clear that the choice is for the member to make and that it is not a default option. One scheme reported that trustees would feel more comfortable if members had sought regulated advice before moving into drawdown but accepted that this could not be forced. To date, very few members have taken this route as arrangements that are in place are relatively new. It is therefore too soon to understand the experience of members transferring in this way.

Some schemes remain uncertain about the appropriateness of signposting to drawdown and continue to be concerned about the prospect of being held to give regulated advice or future claims against the trustees. Some felt that the government or regulator could do more to reassure trustees or create a safe harbour for trustees wanting to signpost. It was felt that this could help improve member outcomes.

For benefit consultancies with their own master trust, the selection of drawdown provider or the wider transfer of single employer schemes to master trusts has presented the potential for conflict of interest. Some have addressed this with Chinese walls between the master trust and consultancy services to DC schemes and some have addressed it by withdrawing from provider selection support for their clients.

Those schemes signposting to personal pensions or master trusts generally reported that it was too soon to understand take-up and member behaviour.

PHASE 4: EARLY YEARS 'RETIREMENT'

The design of drawdown products in trust-based schemes is in its formative years. Schemes have limited experience on which to base the design or pricing. However, innovative propositions are beginning to emerge among the master trusts.

IN-SCHEME DRAWDOWN AVAILABLE FROM SOME MASTER TRUSTS

Moving into drawdown has to be selected by the member but the design of in-scheme drawdown makes the move largely frictionless in terms of costs to the member and simplicity of process. Having passed through the process of risk warnings and being prompted to use Pension Wise, the member simply provides bank account details and tells the scheme how much they wish to take each month.

Among those master trusts currently operating drawdown designed to provide a regular income, the key features of the facility include:

- A minimum remaining fund of £20,000-£30,000 at the point of starting drawdown. One master trust noted that this level remains too high for many who may need drawdown of smaller amounts or need to use drawdown to fill the gap between retirement and state pension age;
- Monthly income appears to be the norm, although one scheme did expect to explore providing other frequencies in time;
- One or more investment funds designed specifically to support a regular income and to manage volatility, inflation risk and, to some extent, longevity risk. While not technically a default fund, members can typically select the fund in the later years of accumulation and continue with it into drawdown, making it default-like. Several schemes reported that they expected investment funds for drawdown to become more sophisticated, perhaps adopting some of the techniques used in DB schemes such as cashflow investing. Some see the possibility of more personalised target drawdown funds being designed;
- A choice of funds for those who wish to self-select;
- The same charges (or similar) to those charged in the accumulation phase (for the same funds), although some schemes report applying a one-off charge for entering drawdown phase (or UFPLS) and some charge per withdrawal; and
- Online tools that allow members to check the sustainability of their income and/or push messages that warn about sustainability of income.

MULTI-POT PROPOSITIONS IN DEVELOPMENT

Four of the master trusts interviewed were in the process of developing propositions for members in retirement that featured multiple pots designed to deliver different outcomes. While none of these had been launched at the time of this research, a number plan to launch in 2019. A common feature to all is expected to be the core drawdown pot from which members take a regular income. This pot will be invested in a fund of the members choosing but will include a default-like fund designed specifically for drawdown.

Other common features include:

- A pot designed to provide an income in later life, typically through the purchase of an annuity

(see next section of this report) that will replace the drawdown income at a later age;

- A pot invested in cash-like assets designed to provide funds for rainy day needs such as home repairs, new white goods or a holiday; and
- In some cases, a pot invested for growth designed to provide an inheritance for family members.

It is expected that members will be guided as to how best to split their fund at retirement, although one scheme felt that trustees should go further and suggest an appropriate split. Members will not have to use all pots but it is expected that members will need to at least use drawdown and a later life pot and that members will be expected to annuitise at some point. Members will be able to move funds between pots and all pots will be capable of being transferred at any point or used to purchase an annuity.

THE UNCERTAIN ECONOMICS OF DRAWDOWN

All of the schemes offering or planning to offer drawdown had little experience on which to price the facility. All also indicated uncertainty about future pricing, albeit that most felt confident that pricing could be kept at a figure that is close to the accumulation phase. Uncertainties arise from:

- Uncertainties over the future scale of drawdown funds and the number of members entering drawdown;
- Unknown member behaviour. If members become more active and engaged, this could increase costs as could more frequent changes to the way in which funds are managed and income taken;
- New investment strategies or product design which could increase costs;
- Uncertainties about how regulation will evolve and whether it will introduce new costs; and
- In some cases, uncertainties about the cost of new systems required to support drawdown.

Some felt that there were aspects of drawdown that could give rise to higher costs than the accumulation phase, for example:

- The added complexities and costs involved in the management of funds in order to manage volatility and liquidity;
- The need for more active engagement with members as their funds reduce and/or members have the time to contact the scheme more regularly;
- The lack of scale in decumulation funds – one scheme reported that the decumulation fund was costing them 50% more than their default accumulation fund; or
- Regulation imposes new requirements on schemes with drawdown

At present, schemes reported that they largely kept the pricing of decumulation at the same or very similar level to the accumulation scheme but were keeping this under review.

Views on a price cap for drawdown were mixed. While a small number supported such a move, several schemes, both those offering drawdown, and those signposting, expressed some uncertainty about a price cap for drawdown. In part this reflected the uncertainty that schemes have about the economics of providing drawdown and the needs and behaviour of scheme members in drawdown. A price cap might also be more complex to apply to the emerging multi-pot solutions.

PHASE 5: LATER YEARS 'RETIREMENT'

Trustees are increasingly concerned about supporting older members in retirement where members can keep funds invested beyond retirement age. The risks to members and trustees are just some of the issues holding back new retirement propositions. Trustees worry about members exhausting their funds and looking to place some of the blame on trustees or employers, members being poorly equipped to manage longevity risks and about the costs and complexities of dealing with fragile and vulnerable older customers. Some schemes manage this risk by requiring members to transfer out of the scheme by age 75.

One of the biggest concerns among schemes expressed in this research was the difficulties that members now face in managing their retirement finances in the face of uncertain lifespans and investment returns. In the design of its blueprint for a retirement income strategy[11], NEST proposed that members should protect themselves from longevity risk by putting aside a regular amount each month to purchase a deferred annuity when members reached their mid-80s.

Several schemes expressed disappointment that a deferred annuity market had not evolved to support members in drawdown with longevity risk. However, all understood the constraints that insurers have in meeting their Solvency II capital requirements and the high capital costs of deferred annuities. One scheme expressed the view that the Government should have some responsibility for shaping the development of the longevity protection offered to members in drawdown.

Among those schemes developing the multi-pot option, the annuity pot is intended to help members put aside funds to protect against out-living their drawdown funds. These pots would remain liquid and accessible to members up to the point of purchasing an annuity around age 80. The funds are intended to be invested in assets that broadly match annuity prices but members remain vulnerable to changes in the annuity market and annuity prices. The schemes developing these options do not guarantee future income or that there will be an annuity market at the point that members reach the age at which they need to annuitise. Some schemes anticipate that other solutions such as Collective DC schemes may be available in 10-15 years' time when the first members reach the age of annuitisation.

For members in drawdown, some longevity protection can be provided by changing the investment mix as the member ages, to mirror the investments of annuities, but this does not afford the same security as an annuity itself.

As members in drawdown age, so the requirement for schemes to address the needs of more vulnerable customers increases; whether due to physical or cognitive impairment. Several schemes reported that their thinking on more vulnerable customers was incomplete with more work planned. Most expected to have to develop systems to identify vulnerable customers and to offer more help and advice to such members or their families.

One scheme reported that there are lessons to be learned from other lines of business such as equity release in how best to deal with vulnerable older customers. One scheme floated the idea of a personal trustee for older customers and another discussed incorporating power of attorney into the design of drawdown. Ultimately some anticipate developments around artificial intelligence to help more vulnerable customers in ways that are difficult to imagine today.

[11] https://www.nestpensions.org.uk/schemeweb/NestWeb/includes/public/news/NEST-launches-its-retirement-blueprint-in-response-to-pension-freedoms.html

DIFFERENT MEMBER JOURNEYS

Among the single employer and master trust schemes interviewed for this project, five broad approaches to facilitate or support members through the process of understanding and taking their benefits were identified. The five types of member journey described below might be considered to be on a spectrum ranging from minimal support for members to a more holistic approach where members are offered support and solutions that can provide a retirement income.

While there were some minor differences between schemes interviewed, most can be characterised as one of the following:

FIGURE 2: FIVE TYPICAL RETIREMENT JOURNEYS (TRUST BASED SCHEMES)

1. Member determined journey

These journeys typically begin in much the same way as for members of other schemes with decisions made about glide paths some years before retirement age. Among a small number of single employer schemes interviewed, pension freedoms had led to less help being made available to members by the employer or scheme than before. Whereas most schemes reported providing access to an annuity broking or regulated advice service, often paid for by the employer, some had withdrawn this service altogether afterwards.

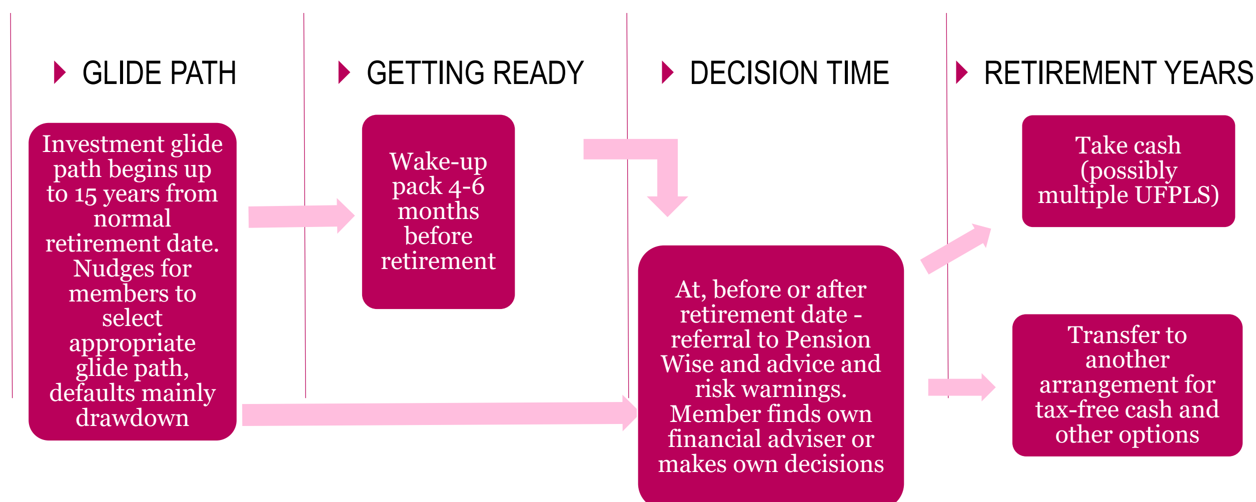
The members to whom this journey type applies include some automatic enrolment master trusts and both higher income and lower income single employer trusts.

These schemes require members to find their own adviser or to affect their own transfer without advice, although all schemes refer members to Pension Wise[12]. In-scheme options are typically limited to taking the fund in full, in a single or very small number of payments. For any other outcome the member must transfer to an individual product in order to access the tax-free cash while leaving the rest invested or to access drawdown or an annuity.

Members of these schemes only have access to individual products and charges if they wish to move into drawdown. Some may find their way to drawdown through regulated advice while others may choose the non-advised route.

For the scheme and member, the journey can be summarised as:

FIGURE 3: MEMBER DETERMINED JOURNEY AFTER PENSION FREEDOMS

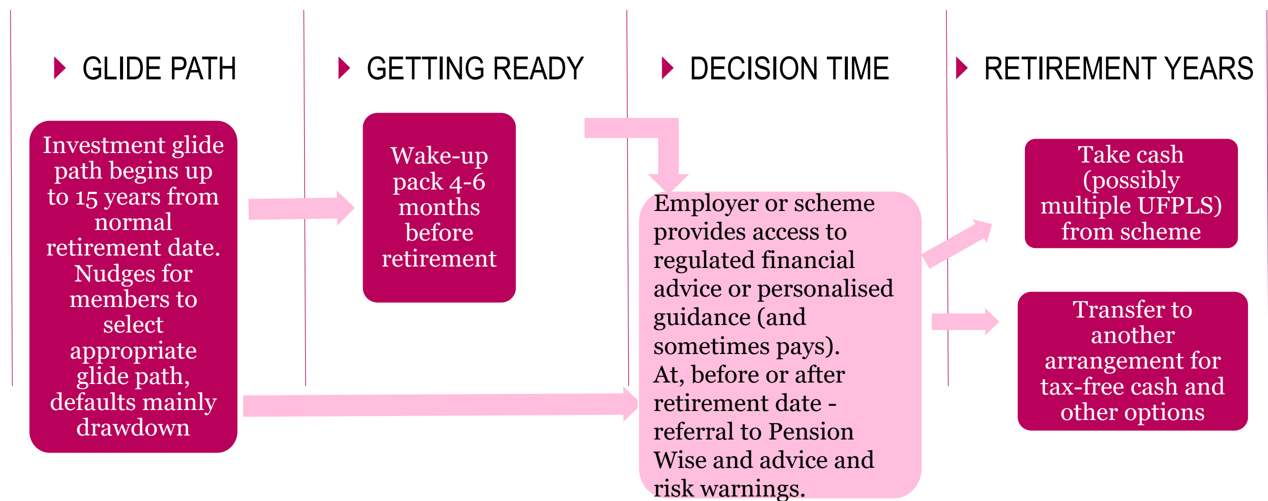


[12] Pension Wise is the guidance service established by the Government following the introduction of the pension freedoms.

2. Employer / scheme supported journey

A small number of schemes (single employers and one master trust) provide access to regulated advice or personalised guidance. In some cases the employer pays for that advice or guidance or the scheme facilitates a one-off payment for advice under the employer-arranged pension advice exemption[13]. Otherwise, the journey tended to be much the same and once again, the member wanting drawdown had access only to the individual market for drawdown and might use the advice services supplied by the scheme or their own adviser. Some might choose the non-advised route to drawdown or other solutions.

Figure 4: Employer / scheme supported journey



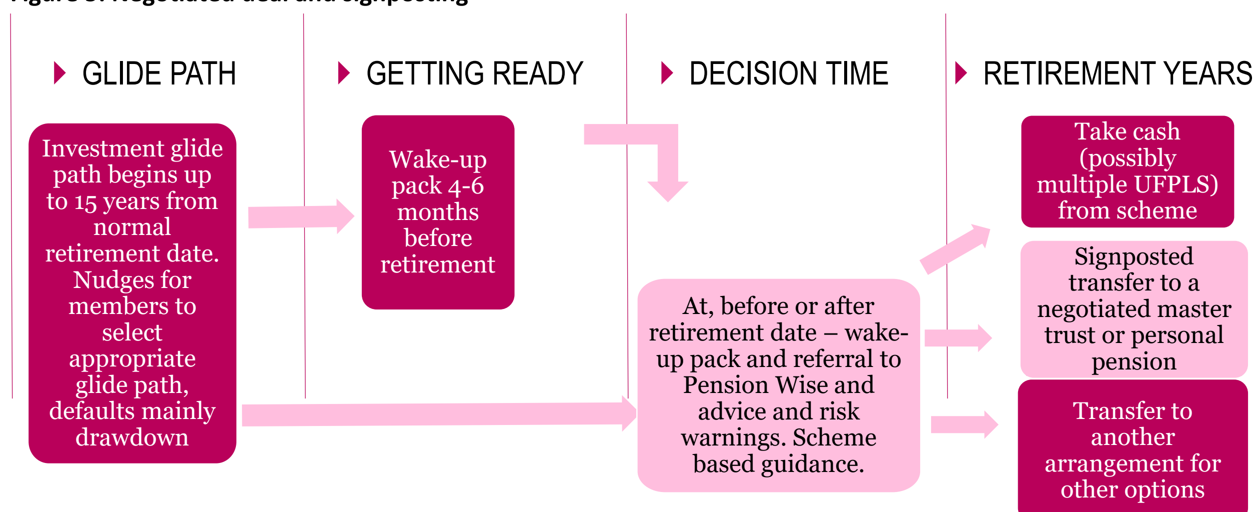
[13] https://www.gov.uk/government/publications/employer-arranged-pensions-advice-exemption/employer-arranged-pensions-advice-exemption

3. Negotiated deal and signposting

In a marked shift from the more traditional journey that requires members wishing to do drawdown to transfer to an individual personal pension, a number of schemes have begun to negotiate terms to signpost members to either a master trust with drawdown or a group personal pension arrangement. This may be offered with or without the advice services offered in the previous journey.

This showed signs of becoming the most common journey among the single employer schemes interviewed, whether high or low income members. Several had either introduced this recently or were in the process of negotiating such an arrangement. Others were considering it as an option in their next review of the scheme. Members following this route can experience a smoother and lower cost transfer from accumulation to drawdown with charges that typically mirror group pension charges rather than individual personal pension rates. One master trust also followed this journey at present but was in the process of moving to a 'to and through' solution.

Figure 5: Negotiated deal and signposting



4. 'To and through' solution for drawdown

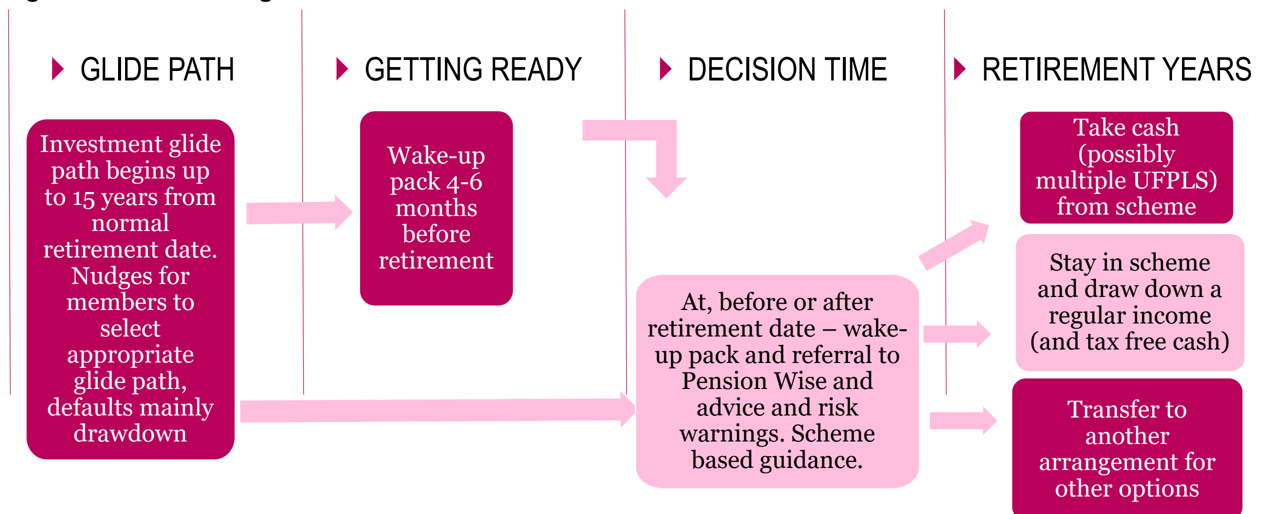
Most single employer schemes interviewed had rejected putting drawdown into their own scheme. By contrast, most of the master trusts interviewed had:

- Already implemented in-scheme drawdown (five);
- Were in the process of designing and testing either this solution or the multi-pot solution that follows (four); or
- Expected to begin design and testing in the next year or so (two).

The 'to and through' solution presents members of master trusts with the opportunity to leave their money invested in the scheme and to take a regular income from their funds. Members also have the opportunity to transfer to other arrangements should they wish. In some cases, regulated advice is being considered as an addition to this journey, either at or in retirement.

Frictional costs (for example advice fees and out of market costs) at the point of retirement are minimised and institutional pricing is maintained for members. Assets can also be gradually transferred during the glide path to a retirement income fund (or funds) that will be used in drawdown. Some continue the glide path into retirement to the age at which members expect or are required to purchase an annuity.

Figure 6: 'To and through' solutions for drawdown



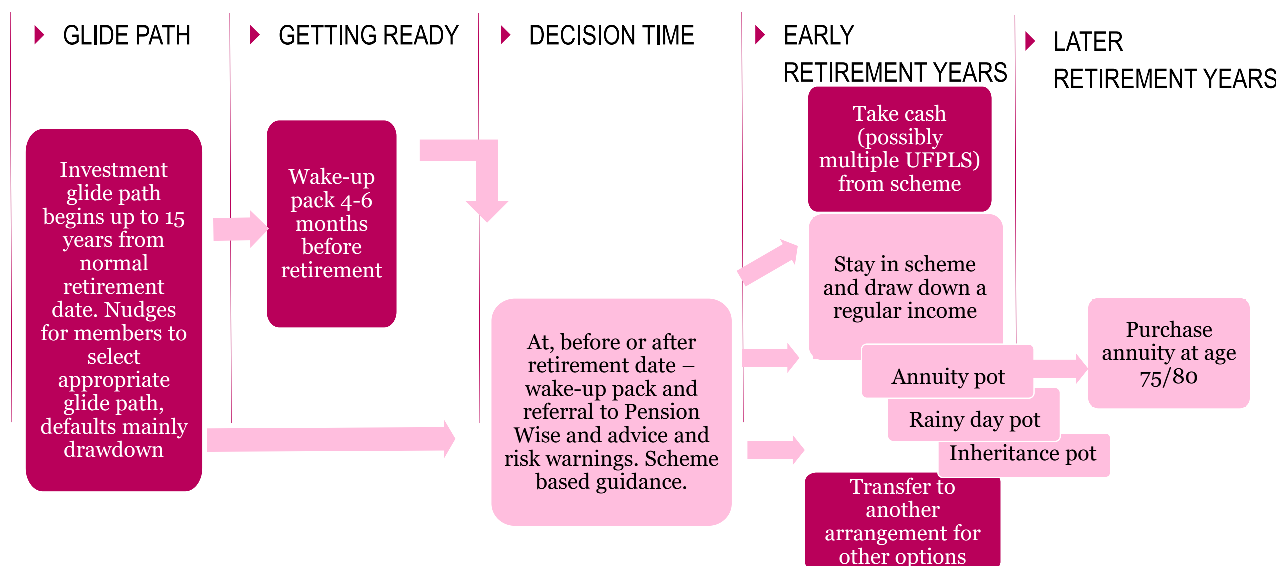
5. 'To and through' multi-pot option

The multi-pot option is an extension of the 'to and through' solution which, rather than placing all of the funds into drawdown, gives the member the opportunity to allocate their funds for other requirements such as:

- The purchase of an annuity at a date in the future;
- Rainy day funds; and
- Funds set aside for inheritance.

For the member, the journey is very much like that described in the 'to and through' journey but involves an additional decision about how to divide up their fund within the scheme at the point of moving into drawdown and a further action to buy an annuity at a future age.

Figure 7: 'To and through' multi-pot option



CONCLUSIONS

Two key themes emerge from this research, namely that

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

ACCESS TO LOWER COST DRAWDOWN

Many schemes have redesigned default strategies up to retirement to target drawdown, whether or not they have in-scheme drawdown or signpost to a drawdown facility. This positions those who wish to take a regular income in retirement from their accumulated fund, something that a number of other research studies has suggested is the desire of many[14].

There remains the question of what should happen, if anything, to those members who are already on a glide path to annuities or cash but who may be better suited to a drawdown glide path. These members are more likely than younger members to reach retirement with assets that are not well suited to drawdown but are more aligned to an annuity purchase or taking cash (in one or several lump sums).

Members of master trusts that provide in-scheme drawdown and single employer trusts that signpost to such master trusts have, in addition to all other options available to them on the open market, access to a low cost and simple transition to drawdown. The same is true of members of contract-based workplace arrangements where the provider has in-scheme drawdown or facilitates a simple transfer to another low cost group pension arrangement. On the plus side, such offers can be cheaper than individual drawdown contracts and can reduce the costs of shopping around and transfer. However, members may be less inclined to shop around or to switch if the drawdown offer does not meet their needs or delivers poor value.

Members of all other trust- and contract based schemes do not have access to such arrangements and, should they wish to enter drawdown, must rely on individual drawdown products and either the use of a regulated adviser or their own research and selection. While this may work well for many, it introduces complexity and additional costs to the process of converting an accumulated fund into a regular income.

While in-scheme drawdown is currently being delivered at the same or a similar cost to the accumulation phase of workplace pensions (in many cases well below the charge cap of 0.75%) it is less certain how sustainable these charges will be. As schemes gain experience of member behaviour but also greater scale, the charges for in-scheme drawdown could rise or fall. Developments in regulation could also affect charges.

[14] Other studies indicating drawdown to be the preferred choice of pension scheme members include the PLSA's Understanding Retirement series and NEST: The Future of Retirement

The innovations in multi-pot drawdown solutions are also potentially providing members with greater security of income in later life. They also reduce the complexity and risks for employers and trustees associated with dealing with ageing and vulnerable members of the scheme. However, it is unclear how the annuity market or other solutions such as collective DC will evolve in the intervening years to deliver a guaranteed income to scheme members in later life. It is also unclear how members will behave in relation to the multi-pot propositions and whether the later life secure income will in fact be delivered or whether members will be tempted to access the annuity pot before it is converted into an annuity.

NEW GUIDANCE AND ADVICE SERVICES

The picture regarding the provision of guidance and advice at retirement by employers or trust-based schemes appears mixed. However, several schemes interviewed in this project indicated that they are either providing or considering providing bespoke guidance or regulated advice at-retirement. This suggests scope for an increase in the number of members being able to access low cost and focused regulated advice. Many of the guidance and advice services mentioned as already being in use were being delivered or developed by the larger benefit consultants.

The development of new advice services for members of trust-based schemes is, like many other aspects of this research, at an early stage and its scope, coverage and take-up are not entirely clear.

FEWER, LARGER TRUST-BASED SCHEMES

While not quantitative in nature, interviews with schemes, benefit consultants and administrators all confirmed that some very large employers are moving away from running their own scheme towards using a co-branded section of a master trust. The trend is driven in part by the scale of regulatory change and in part by the need to offer a wider choice of at-retirement options for members. What is less clear is how rapidly and extensively the consolidation will progress and what the consequences will be for retirement choices.

While some employers continue to want control over their own scheme, the benefits of using a master trust were clear to many of the single employer schemes interviewed for this project, who considered they brought benefits such as lower governance, systems and administration costs, stronger governance and access for employees to use advanced planning tools as well as a wider range of retirement options.

While some members may find themselves paying more under a master trust than a single employer scheme, there can be a number of benefits for members, as outlined above.

Several single employer trusts stated that they were either in the process of a review that included this as an option or anticipated such a review in the near future. None of the single employer trusts interviewed completely rejected this as a possible outcome for their scheme, although a small number were still strongly attached to the idea of running and controlling their own scheme while it remained viable for them to do so.

Every respondent to the survey was alert to this particular change taking place and several noted that some very large DC schemes were in the process of transferring their members and assets to master trust. One benefit consultant noted that they had been taken by surprise at how quickly and how extensively DC schemes were closing and moving their members to master trusts.

While, for the time being, there remain many large single employer trusts, this research suggests that it is the master trusts that are driving forward the choices available to members and the

retirement journeys of millions of trust-based pension scheme members.

FURTHER CHANGES TO COME

While this research suggests a clear direction of travel for the trust-based sector, 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.
- 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.
- 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 AI, as offering opportunities to help such members.
- 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.

APPENDIX ONE: THE CONTRACT-BASED WORKPLACE SECTOR

Desk research and informal telephone conversations with contract-based (life assurance) providers supplemented interviews with trust-based schemes in order to provide a more complete picture of what is happening in the workplace pensions sector.

THE RESPONSE OF THE CONTRACT-BASED SECTOR

The contract-based sector has traditionally provided services to smaller and medium-sized employers on a bundled basis. By opting for a contract-based arrangement, the employer has already made the choice to outsource management and governance of pension provision to an insurance provider, and more recently oversight from an Independent Governance Committee (IGC).

This part of the workplace pension sector has also been undergoing change. Competition for small and medium-sized employer schemes has come in the form of NEST, NOW and The People's Pension. Providers have also faced cost pressures resulting from price caps, systems changes and increased regulation. As a result, the contract-based sector has undergone considerable consolidation. There are now thought to be around a half-dozen number of large active providers of contract-based arrangements.

Large insurers initially responded to opportunities under pension reforms by adapting existing systems, but those still active in the market have since invested in new or enhanced systems to win business for new large schemes being created or re-tendered. Whilst they have had some success in this market, they have also found that some large employers have felt a stronger affinity for the trust-based pensions' model. Almost all of those still active in the market have responded by adding a master trust offering alongside their contract-based schemes and using, wherever possible, the same systems, fund platforms and customer journeys.

In this way, large insurers are an important influence in the development of the master trust market as they compete for larger schemes with capabilities developed in the contract-based market.

THE PROVISION OF DRAWDOWN

Most insurers offer members access to a personal pension that offers drawdown. Like in-scheme drawdown, this can be relatively frictionless for the member in terms of cost and ease of process. However, in some cases, this can result in a significant increase in member charges as they move from group pension pricing in a workplace scheme to individual pricing in a personal pension.

However, several insurers actively competing in the market for new schemes have responded to the trend toward offering 'to and through' solutions on their platforms to be competitive in the market and retain assets under management.

Desk research suggests that several large insurers market in-house (as opposed to in-scheme) drawdown to members of their workplace pensions; both contract and master trust members. The way in which this is delivered varies. One provider facilitates drawdown within their workplace pension arrangements so that members do not switch to a personal pension. However, while most will provide UFPLS in-scheme, to access regular drawdown they provide a near frictionless transition through a transfer of funds into another product, typically a group personal pension.

Approaches to charges in drawdown also vary. One provider promises to provide the better of their

institutional or individual pension charge; some continue to offer, typically lower, institutional charges whilst others offer funds at the same rates as to their individual personal pension customers. As individual contract charges are typically tiered, so that those with larger funds receive discounted rates, the greatest increase in the rate of charge is felt by those with smaller pots.

Other providers, particularly those no longer active in the group pensions market (and also for schemes not administered on current system platforms), have not added drawdown to their workplace systems and so offered variants of the employer/scheme supported journey by transferring into an individual drawdown product. Some offer online journeys for this process with guidance and regulated advice available, usually through regulated advisers employed by the provider or through a partnered organisation.

GLIDE PATHS

Contract-based providers, in addition to a suite of default funds for accumulation, have also introduced a range of glide path funds to manage the transition from accumulation to decumulation. With the advent of freedom and choice, providers and their IGCs have been reviewing their default glide paths – both the providers own default and those actively chosen by employers. This has resulted in a gradual move to adopting a default glide path that targets drawdown.

The FCA's Retirement Outcomes Review highlights concerns that some of those in contract-based schemes are being inappropriately defaulted into cash-based investments at drawdown. It is likely that the end-point of glide paths will receive further scrutiny both directly from the regulator and indirectly via regulatory enquiries of firms and their IGCs. It is also possible that firms will be asked to review those already defaulted into annuity targeting glide paths and assess whether these should be changed to arrive at a different end point. Some providers have already taken action to 'rebalance' funds of those previously targeting annuities to increase their equity exposure in line with those in a drawdown glide path.

MEMBER COMMUNICATION AND SUPPORT

Contract-based providers active in the market have added online access to their accounts and suites of tools and guidance for members to explore their access options and plan their choices. Signposting to these facilities can be from annual statements and from employer communications or intranet systems.

Historically, contract-based pre-retirement communication to members has more regulatory prescription than trust-based schemes. A series of reviews and rule book changes by the FSA and FCA responded to risks of poor outcomes for members accepting the annuity offer from their incumbent pension provider through inertia. The principal focus of these interventions was to prescribe content of the so-called 'wake up' packs sent to members prior to their nominated retirement date to better inform members of the options available to them and action required to secure their benefits. Wake up packs have been further adapted to respond to pension freedoms, setting out choices available and signposting to Pension Wise.

CHOICE ARCHITECTURE

Contract-based providers display a similar range of options to those offered in trust-based schemes.

Large providers still actively seeking business in the market are broadly in-step with the master trusts in offering UFLPS or Flexible Access Drawdown. Only one major provider facilitates in-scheme drawdown within their workplace group personal pensions. With others the process typically

involves a change of product 'wrapper' to a group personal pension product achieved without a need to change funds (with associated out-of-market risk) and usually with continued access to the same pricing if funds remain in the default used prior to access. However, some increase their charges when the member begins to take a regular income.

Providers no longer active in workplace pensions require members to transfer their funds to purchase an individual drawdown and/or an annuity.

Providers have put in place guidance and regulated advice services to assist members in navigating options and purchasing of in-house drawdown products or transferring to another provider. Most providers, certainly all those 'active', have well-developed in-house drawdown solutions and many have been in this market for 15-20 years.

IMPACT OF THE FCA RETIREMENT OUTCOMES REVIEW

Ideas about guiding non-advised clients in this market and the question of whether defaults or 'pathways', as suggested by the FCA, have a place is still being assessed by providers and will evolve as FCA regulation becomes clearer in 2019. However, contract-based providers are marketing some propositions that aim to address some of these issues. Four examples are:

- Standard Life has defined a suite of risk-based funds aligned to access strategies elicited from customers through questions in an online process – for example to take funds over five years, draw a regular income or hold funds to purchase an annuity at a future point (e.g. age 75);
- Scottish Widows has created a range of four funds, each with different levels of equity, and which will reduce equity exposure during periods of equity market volatility;
- Royal London has a created a suite of nine retirement funds that fit with a matrix of risk appetite and expected period of drawdown; and
- Legal & General has introduced in-scheme drawdown for members of their contract-based plans which does not require a transfer to a different individual personal pension and can make use of the same multi-asset retirement income fund as that used by L&G's master trust.

Other providers have stated that they are waiting to see how the Retirement Outcome Review consultation on 'pathways' concludes but there appears a good measure of support for the FCA's proposals in this regard.

APPENDIX TWO: THE INTERVIEWS AND DISCUSSION GUIDES

INTERVIEWS

In total, 27 interviews were held to support the findings of this report. The interviews were all held with senior individuals responsible for the pension scheme or the services offered to pension schemes. Interviews typically lasted 45-60 minutes. 15 interviews were conducted by phone with the remainder face-to-face. Interviews were conducted between November 2018 and January 2019.

Master trusts

We interviewed seven master trusts and four other organisations offering administration or consultancy services as well as operating a master trust. The 11 schemes have the following profile:

Number of members	Added together, the master trusts interviewed report in the region of 15 million customers. However, there will be some duplication of membership across the schemes. The largest three schemes interviewed each report in excess of 1 million members.
Assets under management	The master trusts interviewed report combined assets under management in excess of £22bn.
Average per member 'pot' size	Average pot sizes varied considerably across the master trusts interviewed depending upon the maturity of the scheme, average contribution rates and the incidence of other schemes transferring in members and assets. Four trusts report average pot sizes for their customers at or below £1,000 while the remainder have averages typically in excess of £5,000. All trusts reported a significant distribution of pot sizes, including a small number at or close to the lifetime allowance.
Number of employers	The master trusts interviewed report almost 1 million employers signed up to their schemes.

Single employer trusts

We interviewed 11 single employer trusts with the following profile:

Total number of members	In aggregate the schemes represented 100,000 members. The smallest scheme had just over 1,000 members and the largest 40,000.
Assets under management	Schemes interviewed reported aggregate assets in excess of £3bn. The smallest scheme had just over £50m in assets and the largest £1.1bn.
Average per member 'pot' size	Average pot sizes were considerably larger than most of the master trusts with averages ranging from £2,500 to £70,000
Industries	Schemes were selected to represent a range of different industries and workforces. Five interviews were with companies operating in relatively low paid sectors such as leisure, catering and retail with six interviews in more highly paid sectors such as financial services, consultancy, oil and chemicals, and technology.

Others

Fiver other organisations were interviewed offering only legal, trustee, administration and/or benefit consultancy services to DC pension schemes. In addition, six organisations were interviewed that also offered a mix of benefit consultancy, administration, investment consulting and asset management services to trust based schemes.

Organisations interviewed included (plus 11 single employer trusts that we have not named):

AON	JLT Employee Benefits	The People's Pension
Aquila / Equiniti	Lane, Clark & Peacock	Smart Pensions
Capita	Legal & General	SEI
Capital Cranfield	Mercer	Willis Towers Watson
Ensign	NEST	
Eversheds	NOW Pensions	

DISCUSSION GUIDES

The interviews were qualitative in nature, semi-structured and were allowed to be relatively free-flowing. Discussion guides were developed and adapted for each of the different categories of interviewee. As with qualitative research of this type and given the time available for interviews, not all topics were covered in the same depth with every interviewee. In general, discussions with schemes followed the following format:

At-retirement journeys / options

- What options did you offer your DC scheme members before the pension freedoms? Probe on whether employer offered annuity broking service / individual advice to members / workplace seminars.
- Has pension freedoms changed the employer's attitude to pension provision? In what way? Has the pension freedoms changed trustee attitudes? In what way? Is the employer thinking aligned with that of the trustees? Have there been any areas of disagreement?
- What changes have employer and scheme made to information, guidance and advice available to members? Why were particular decisions made? Does the employer or scheme supplement Pension Wise guidance in any way? If so, how?
- What interventions does the scheme make as members approach age 55 – what information are they provided with and when?
- Does the scheme ask members to select a particular investment route based on their expected needs – e.g. gilts for annuity, cash investment for cash, mixed assets for drawdown)? At what age are they expected to make this decision? Are they reminded regularly of the decision they have made? What happens if they want to change route / are they prompted to consider changing route? If members take the tax-free cash, what type of fund is their remaining money invested in?
- Since the pension freedoms came in, what changes have you made to the options available to members? Investment defaults / options as members approach age 55 – use of target date funds, lifestyling, asset mix based on member's anticipated decumulation preference, use of cash in the pre-retirement asset mix. How were decisions made about changes? Why were particular changes made or rejected? Were certain options rejected and if so why? What costs were incurred in making the changes?
- What options are currently offered? Do members have to transfer out of the scheme to access the freedoms? Probe on how members can access benefits from the scheme itself or by transferring:
    - Do members have to transfer to get tax free cash? Can they take tax-free cash and leave their remaining funds invested? If so, what fund is used for remaining cash? Is it the same as the default fund at accumulation or specially designed fund for these members?

What happens if members don't actively choose to move fund?

- Single or multiple UFPLS offered by scheme itself? – how many lump sums, how frequently permitted, min amount?
- Annuity broking service offered by employer?
- Access to flexible drawdown through scheme? If so, how structured – how flexible is the amount and frequency of income that can be drawn down. If not, is a drawdown broking or advice service available to members?
- Other?
- Are these options available to all members of the scheme or only some (if some, which members). Do deferred members have access to the same options and services as active members? Can employers select the options that members are shown at age 55? If so, are other options available if members ask for them? Are all options available to members who transfer in from other schemes? If not, why not?

Has the employer or scheme considered facilitating access to other schemes or transferring members to other schemes in order to provide a wider choice of options? If not, why not? Could doing so provide members with better outcomes? What are the concerns about transferring members or signposting them to others?

Have the trustees considered defaulting members into particular outcomes – such as a default into drawdown? Has this been implemented? If trustees have not considered, why? What risks, if any are there for schemes defaulting members? Given that trustees can default into accumulation funds, is it similarly appropriate for trustees to default members into decumulation funds or must members make a choice?

What factors have shaped your decisions on the options you have made available – both things that have supported change and those that have acted as a barrier to change? What is the relative importance of (discussion will be unprompted to begin with):

- Member profile, in particular pot size and numbers approaching retirement – does member profile suggest particular options are appropriate and some inappropriate;
- Member needs and preferences and how these are monitored – has there been any research among members on what they think their needs are;
- Employer attitudes – did employers encourage or reject any changes that the trustees wanted to make? Has there been any tension between trustees and employer over changes?
- Administration capability – is this a facilitator or barrier;
- Potential cost of scheme re-design – are there particular features that are expensive to introduce (e.g. regular income drawdown)? Probe on how cost of change is funded – by employer, by administrator and recovered through charges? Any idea of cost of

introducing drawdown?

- Advice from EBCs and others;
- Concerns from trustees about risk of advice / signposting / recourse from members – does regulation or regulatory guidance do enough to support trustees in decision making on decumulation / is regulation clear enough about what trustees should and should not do;
- Concerns from employers about potential liability if changes made to the scheme or members signposted;
- Concerns from trustees or employers about the use of defaults at retirement / default investment funds in retirement;
- Attitude of scheme sponsor to retirement decisions – ranging from 'not our job' to more paternalistic approach;
- Regulatory uncertainty – anything in particular?

Member at-retirement behaviour

Typical age at which pot is first accessed / relationship with normal retirement age.

Can you describe the typical behaviour of members as they get to 55? Do they start to enquire about options or are they generally inert? What triggers them to ask about accessing their pension?

Describe the route that members typically use to reach decisions from first enquiry to fulfilment of decumulation options. What role does the scheme play at each stage? Do members tend to use Pension Wise? Do they tend to have advisers? Are members generally confused / clear about the options available to them?

Within your scheme:

- How many and what type of members are seeking to access their funds at age 55 and later ages?
- What options do they tend to prefer – tax-free cash, taking full encashment, annuity, drawdown (where known), transfer to another scheme?
- Member appetite for taking a mix of benefits.
- What does scheme feel shapes member preferences – any research conducted and available?

Has experience changed since early days of pension freedoms? Does scheme anticipate further changes ahead as scheme matures?

Looking ahead

Are there any changes you anticipate making to the scheme over the next few years – in particular decumulation options? If so, why and what will prompt these? Are there any particular barriers to adding these options? Are there any options that the trustees or employer would like to add but

can’t or won’t and if so why?

What does the future hold for individual employer schemes? Is there a size threshold below which schemes are unsustainable? Are there changes would help schemes become more sustainable?

And lastly, what does the future hold for single employer schemes and for Master Trusts? What are the next steps for schemes without flexible drawdown options? Are there opportunities for MTs to work with single employer schemes to help retirees?

Are you aware of the FCA Retirement Outcomes Review proposals? Is the FCA right to require contract-based providers to provide investment pathways for members moving into drawdown? Is it right to move members away from cash to a more balanced portfolio? Is it right to impose a charge cap on drawdown?