Achieving good retirement outcomes

An analysis of DC pension scheme members' decisions and options

November 2021

Contents

Overview

The introduction of automatic enrolment in 2012 has played a huge role in raising scheme participation, and has kick-started many more members' saving journeys. Now, nearly 10 years on, the number of those reaching retirement and relying on their defined contribution (DC) savings is growing rapidly, with over £1.25bn being paid out of DC trust-based schemes each year.

Whilst an increase in savers is positive, many members still feel lost about what to do as they approach retirement. It is clear that supporting DC retirement decisions is no longer a problem for the future. DC savers are struggling here and now, and the challenge will only be compounded as the years go on.

In an ideal world, we would all have infinite resources to fund our retirement thus reducing the importance of good decision making. Unfortunately, this is not the case. Pension savings are finite and need to be utilised wisely – making smart decisions at key points in time can make them go further.

In our **first annual survey of DC retirement outcomes** we look under the bonnet to understand what members are doing with their pension savings, and at the factors that influence their choices. We then highlight ways that trustees and employers can help ensure DC savers are achieving good outcomes.

There has never been a more important time for savers to focus on their financial wellbeing. The economic slump caused by the COVID-19 pandemic accentuates the need to save them from making potentially disastrous decisions about their future.

There are clear, and relatively easy, actions that trustees and sponsoring employers can take to support DC savers' retirement outcomes.

Sophia Singleton
Partner, Head of DC

Key findings

In this survey we analysed **18,500 DC pension scheme members** aged over 55 in trust based arrangements.

Of this population **5000 members** retired, **3,500 transferred** to alternative pension schemes and **10,000 remained** with untouched pots.

1

The retirement options available to members shape the choices they make. However, only 11% of schemes offer flexi-access drawdown.

That available options mould outcomes is an obvious, yet too often overlooked, fact. For members to get their best outcomes, it is important to offer full flexibilities which allow them to choose between purchasing an annuity, an uncrystallised funds pension lump sum (UFPLS) and flexi-access drawdown (FAD).

Lack of choice can force members into decisions which either leave them with less income at retirement; or which unintentionally incentivise them to transfer to other, more expensive arrangements offering less value for money. (See page 3).

2

Members transferring out of DC schemes tend to move into more expensive products – only 24% of DC transfers go to workplace pensions.

Self-Invested Personal Pension (SIPP) products continue to dominate the market. Very few transfers are made to low-cost receiving vehicles (such as mastertrusts or workplace pensions). This means transferring members can often face much higher costs which, in turn, risk them running out of pension savings a full 8 years earlier than would otherwise be the case. (See page 5).

3

Scams are a significant issue for DC pension schemes. 61% of transfers from DC pension schemes show at least one warning sign of scam activity.

Pension scams are prevalent for DC-to-DC transfers and not just a concern of those transferring out of DB pension schemes. In fact, DC transfers are 15% more likely to show one or more warning signs of potential scam activity. The problem will become more acute as dependency on DC funds increases. It is essential to protect members from making transfers which are not in their own best interests. (See page 6).

4

Untouched pots could cost members 10% of their potential pension income.

Leaving a DC pot invested beyond retirement age can be a sensible decision (for instance, when other benefits are being drawn). But problems arise when funds are left in vehicles making heavy allocations to inappropriate assets. Members who unknowingly deferred accessing their pension schemes by 10 years could result in a loss of over 10% of potential income. (See page 7).

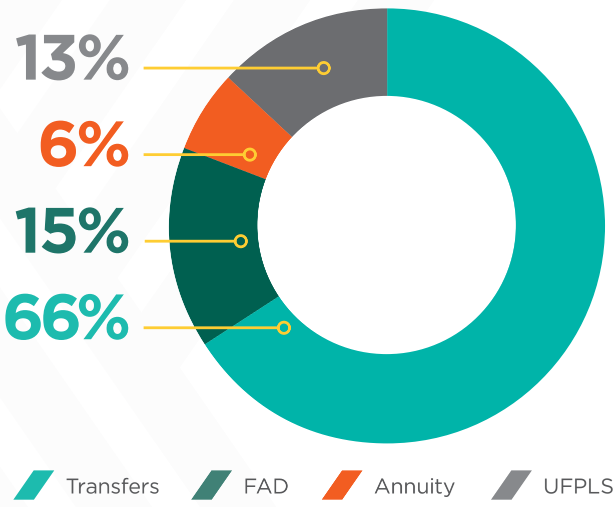
The data: what members are doing

1. The retirement options available to members shape the choices they make

The options that are available to members ultimately shape their retirement. Our research shows that when members do not have access to the full suite of flexibilities (i.e. the choice of purchasing an annuity, taking an UFPLS or accessing FAD) they either take the path of least resistance – an annuity or UFPLS – or access their benefits in a way which leads to higher charges. Further detail on the impact that a lack of choice has upon member behavior is described below:

When schemes **offer full flexibilities**

Retirement decisions made by members who are in schemes with access to full pension flexibilities



15%

Of members take their benefits via FAD[1] which is proving more popular than choosing an UFPLS[2].

The possible reasons for this are explained overleaf.

66%

Of members transfer out.

The additional flexibilities reduce the number of members choosing to transfer.

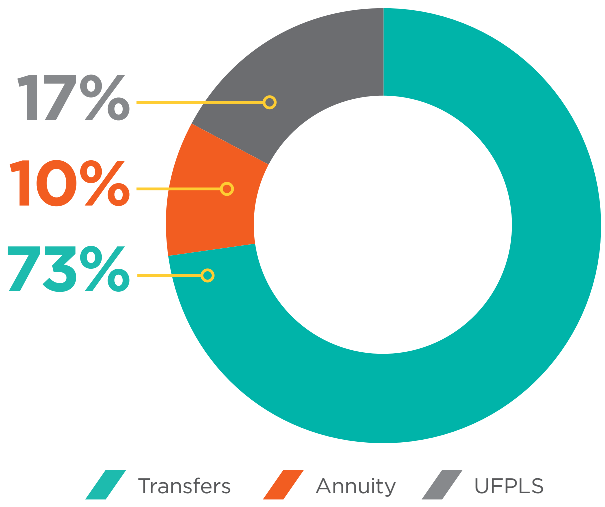
6%

Of members purchase an annuity.

More members are looking for alternatives to purchasing an annuity. Illustrative of the declining popularity of annuities when people have more attractive alternative options.

Where schemes **do not offer full flexibilities**

Retirement decisions made by members who are in schemes with access to partial pension flexibilities



17%

Of members chose an UFPLS[2] with the accompanying risk of higher tax bills.

This is 30% higher than for members of schemes where more flexibilities are offered.

73%

Of members take transfers.

This is 11% higher than for members of schemes where more flexibilities are offered.

10%

Of members purchase an annuity.

This is 66% higher than for members of schemes where more flexibilities are offered

[1] Flexi-access drawdown (FAD)
[2] Uncrystallised funds pension lump sum (UFPLS)

Source: XPS Pensions Group

1. The retirement options available to members shape the choices they make. (Continued)

Members need good advice in order to make good decisions. For instance, a basic rate taxpayer accessing UFPLS could see their benefit being taxed at 40%, or even 45%. It could also result in losing entitlement to means-tested benefits. The amount of tax paid can be reduced, and means-tested benefits safeguarded, if members access benefits via a series of cash payments.

This is why it is so important to allow members the freedom to choose to ensure they are making a decision that suits their circumstances.

Hannah Rowden
Pensions Consultant

XPS Analysis

The Financial Conduct Authority's (FCA's) 2018 report on 'Retirement Outcomes' found that most members want flexible access to their benefits. The report also found that many end up receiving significantly less income as a result of tax charges, poor returns on investment and loss of state benefits.

Our analysis indicates that when a scheme does not offer full flexibilities, more members opt to take the path of least resistance – an annuity or UFPLS – which for many results in poorer outcomes. An UFPLS can be taken from age 55 (rising to 57 from 2028) with 25% of its value tax-free. Members with this option can withdraw their entire pension on retirement. But doing so can also increase the amount they pay in tax, impact their entitlement to state benefits and reduce the amount they are allowed to contribute to other money purchase pensions, because taking a lump sum via UFPLS counts against the money purchase annual allowance.

It is therefore important that schemes provide DC members with access to income drawdown either within their scheme or, more typically, by providing access to a low cost receiving vehicle, such as a mastertrust.

In addition, the road to retirement can be a daunting and confusing experience for members. It is essential to map out a 10 or 15 year journey to help members make the right choices at retirement through access to advice and guidance which covers budgeting, choosing appropriate investment options, targeting the right retirement age, and deciding how and when to access benefits.

2. Members who transfer out of a DC scheme tend to move to more expensive products

66%

Of members making a decision about pension savings decided to transfer out.

Members said they transferred out of DC pension arrangements to gain flexible access to benefits, alternative investment options and better guidance and tools i.e retirement modellers and tax planners.

38%

Of members who went through a pension scam identification interview, explained that the reason they transferred their DC benefits was because their scheme did not offer full flexibilities.

Offering access to a low-cost receiving vehicle, such as a mastertrust, can better suit member needs.

21%

Of members who went through a pension scam identification interview, explained that they transferred because their current scheme did not offer the investment options they wanted.

The member journey can be enhanced by using data-driven insights to understand the types of funds that members need and want.

XPS Analysis

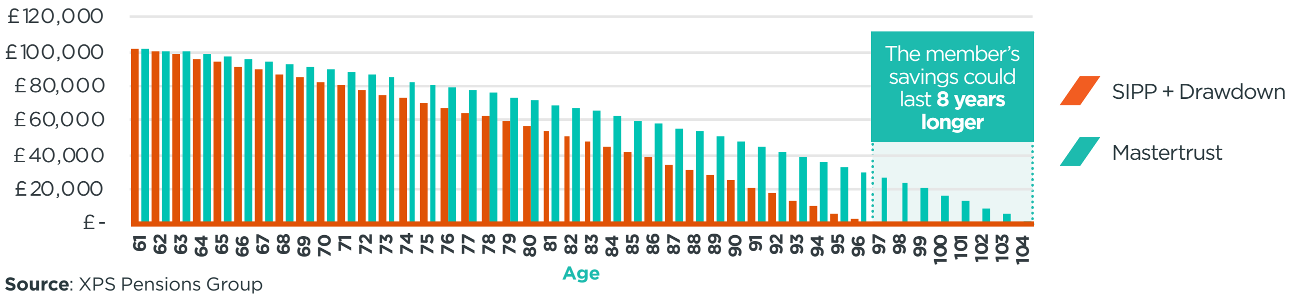
Our data shows that many members are choosing to transfer their benefits – 76% of all transfers that took place in the year to 31 March 2021 were made to SIPPs, with an average transfer value of £102K. The remaining 24% were transferred into personal pension and occupational schemes. This is clear evidence of a shift towards member consolidating their pension pots before retirement, triggered in part by growing awareness of the amounts held in DC schemes.

However, transferring to an alternative scheme, including a SIPP, can be a positive step, but in many cases members are unintentionally entering high cost solutions – the FCA's 2018 'Retirement Outcomes' states that DC members often incur ongoing administration fees (which can be up to 1.6% p.a.). Charges within a workplace scheme, such as a mastertrust, or in a low cost SIPP are generally much lower and often less than 0.75% p.a.

The default charge cap has provided much needed consumer protection during the savings phase. However, our data shows that charges still pose a significant risk in the drawdown phase – this can have a serious impact on a member's expected lifestyle in retirement if not properly understood.

The chart below demonstrates the potential impact on a member's fund if they transfer their DC pot to either a SIPP or to a low-cost receiving vehicle, such as a mastertrust or low cost SIPP. In both scenarios, the member has transferred at age 61 with £102,000 worth of accrued retirement benefits and takes an income of £4,000 p.a. We have assumed the same level of investment return in both cases. The member who transfers to a low-cost receiving vehicle was able to make their DC savings last an additional 8 years due to lower charges. Some members may of course choose to pay additional charges to gain access to SIPP specific features and investment flexibility.

How income can last longer if an appropriate low cost recieving vehicle is in place



Source: XPS Pensions Group

This highlights the importance of offering access to income drawdown via a low-cost receiving vehicle such as a mastertrust.

3. Scams are a significant issue for DC pension schemes

61%

Of transfers from DC pension schemes show at least one warning sign of scam activity.

A scam flag denotes risk of harm to a scheme member. This means there is evidence of disreputable advisers, excessive charges and promises which seem too good to be true. Scam flags were up 79% over a five-year period.

21%

Of DC transfers cases were red flagged due to concerns over IFAs.

This represented a 320% increase over a five-year period. The members in this category had concerns raised regarding the IFA who was giving advice (e.g. they were not registered).

30%

Of cases where potential scams identified were as a result of members having a poor understanding of the charges they would have to pay.

Members were unable to provide a clear sense of the charges they would pay to their IFA; that would be charged on their transferred funds; or the charges were deemed too high. Such cases rose 76% over a five-year period.

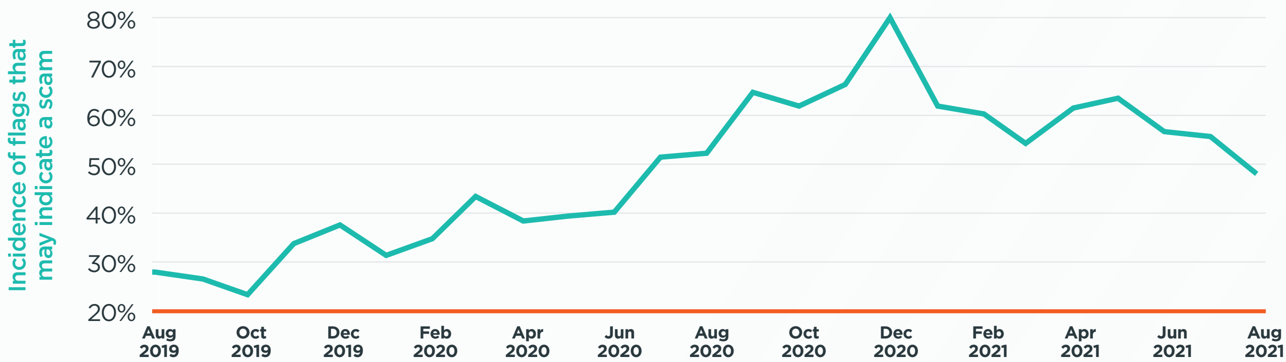
Helen Cavanagh
Client Lead,
XPS Member
Engagement Hub

> We welcome the new transfer regulations which provide greater powers to combat pension scams, and analysis by our **Scam Protection Service** clearly shows that it is crucial that trustees carry out robust transfer due diligence to protect their members from potentially life-changing outcomes.

XPS Analysis

Pensions are targets for scams or inappropriate and high-risk investments. Our data shows that 2020-2021 has seen a marked increase in scammers taking advantage of the financial turmoul arising from the covid-19 pandemic as represented below.

XPS Pension Scam Flag Index



Source: XPS Member Engagement Hub

Members are often attracted to products promising high returns without realising the risks that such transfers can pose. Potential gains can be eroded by high investment fees and costs for ongoing advice. In the worst case a pension pot can be lost altogether. This issue is incredibly important for DC savers as a DC-to-DC transfer are more likely to be flagged as potentially at risk of scam activity.

Therefore, robust due diligence, such as that provided by our **Scam Protection Service**, is needed to protect members suffering potentially life-changing harms.

4. Untouched pots often stagnate or fall in value

70 years

Average age of a members who have not accessed their DC pot.

Such members are often stuck in inappropriate investment strategies that could erode their savings.

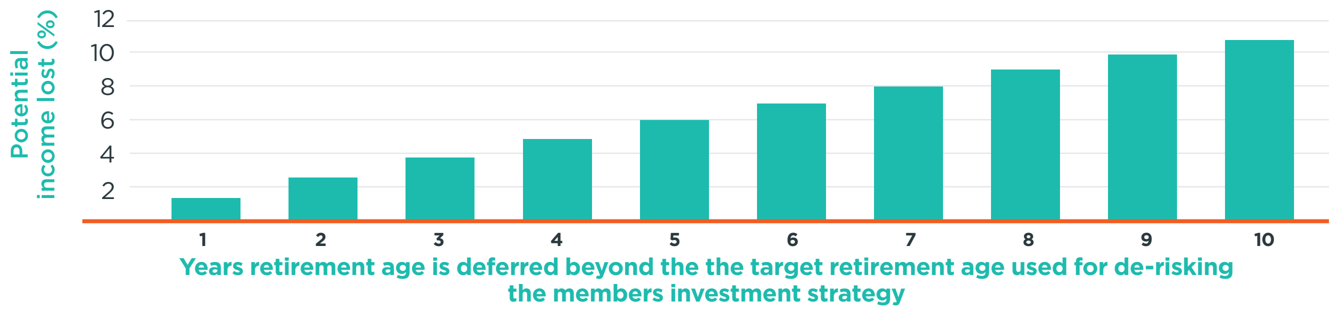
£34k

Size of the average untouched pot.

Such members could be missing out on significant investment returns. Trustees should work to help make members aware of the options they have.

As demonstrated in the chart below, a member can lose over 10% of potential income if they defer retirement by 10 years beyond their target retirement age without actively making a decision to update their investment approach.

Impact of deferring retirement age beyond the the target retirement age used for de-risking the members investment strategy*



* Assumes an average pension pot of £37,500 at age 65; and that the member does not make changes to the expected retirement date used for de-risking their investment strategy. Figures are shown in today's prices and assume inflation at 2.5% p.a.

Source: XPS Pensions Group

With so many members staying invested beyond retirement, ensuring their investments remain appropriate is becoming increasingly important.

Alan Greenlees
Head of DC Investment

XPS Analysis

A large proportion of DC members are keeping monies invested beyond their Normal Retirement Age (NRA) in potentially inappropriate funds. The average age of these members is 70. TPR's 2021 survey found that 96% of DC scheme members were investing in their prescribed default fund without reviewing the future of their investments.

Default funds are designed for members to take their pension at an expected retirement age; with the level of risk that members are exposed to being reflective of both their age and term to retirement. In most cases these funds are not designed for retaining savings beyond that date. That in turn risks investments becoming mismatched to member's needs. Most people invested in a default lifestyle arrangement will see their funds derisking too much, too soon, leading to a lower level of expected income.

TPR has found that only 42% of schemes are reviewing default investment strategies in the light of individual member data (Source: Defined Contribution trust-based pension schemes research, 2020 survey, TPR, May 2021). Trustees and employers need to take time to ensure that each member's investments are in the right default fund and that members are aware of their options and the impact that their investments have beyond normal retirement age.

Our recommendations for DC pension schemes to improve member outcomes

1

Offer full flexi-access drawdown

Providing access to flexi-access drawdown – either within a scheme, or via a low-cost receiving vehicle – will offer members better value, and help protect them from making uninformed choices.

Providing access to a low-cost receiving vehicle (such as a mastertrust) provides members with an option which will have already undergone extensive due diligence by the trustees and sponsoring employer.

2

Create a personalised savings journey for members approaching retirement

The road to retirement can be a daunting and confusing experience for members. It is essential to map out a 10 or 15 year journey to help members make the right choices at retirement through access to advice and guidance which covers budgeting, choosing appropriate investment options, targeting the right retirement age, and deciding how and when to access benefits.

3

Protect DC members from pension scams

We welcome the increasing DWP and regulatory initiatives, but analysis by our **Scam Protection Service** shows that public sector action alone will not solve the problem. Robust due diligence is needed to protect members suffering potentially life-changing harms.

4

Review investment strategies for those beyond their normal retirement age

Trustees and employers must seek to ensure members have the right default fund if they chose to stay invested after retirement. Regular engagement is needed to help members understand how their assets are invested and the impact of misaligned strategies.

Appendix: Further data on DC pension scheme members at retirement

62.5	Average age that a member accesses their pension benefits
£49.5m	Total DC benefits taken
£84,500	Average DC pot transferred to an alternative vehicle
£30,400	Average DC pot used to purchase an annuity
£18,000	Average amount taken as an uncrystallised funds pension lump sum
11%	Percentage of trust-based DC schemes offering access to flexi-access drawdown (either within the scheme or via a low-cost receiving vehicle)

About us

XPS Pensions Group is the largest pure pensions consultancy in the UK, specialising in actuarial, investment consulting and administration. The XPS Pensions Group business combines expertise, insight and technology to address the needs of more than 1,500 pension schemes and their sponsoring employers on both an ongoing and project basis. We undertake pensions administration for over 948,000 members and provide advisory services to schemes of all sizes, including 47 with over £1bn of assets each.

We also provide pension advisory and administration services to over 200 defined contribution schemes, with over one million members and combined assets in excess of £15bn.

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