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ROUNDTABLE

ADVICE OR GUIDANCE AT RETIREMENT?

– USING TECHNOLOGY TO BRIDGE THE ADVICE GAP
– A STOCHASTIC APPROACH TO ALL RETIREMENT RISKS

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MACHINE RETIREMENT PLANNING

Retirement funding is a massively complex challenge. We need decumulation solutions that are up to dealing with that complexity

John Greenwood
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DC savers receive a wide range of support and protection through the relatively straightforward accumulation phase, yet when faced with the massive complexities of transitioning to retirement most are left to make decisions on their own.

In the eight years since pension freedoms, the decumulation framework has barely changed, yet sub-optimal outcomes have been widespread. Numerous providers do not offer their clients the decumulation functionality to make truly efficient use of their pension assets, and in the trust-based world in particular, there is a dearth of mandatory guidance once the individual's accumulation journey is over.

It is said that you can lose the equivalent of a decade's worth of contributions through a single bad decision at retirement. But even after that first decumulation decision is made, there are numerous other pitfalls that can catch out the unwary retiree.

This is why advice should be the goal for all, although there are not enough advisers in the country to go round, and even if there were, the price would be prohibitive.

Providers seeking to bring genuine innovation to digital advice solutions should be applauded for their pioneering efforts, and we should remember that, as with all technical innovations, costs usually come down in due course.

The concept of best next dollar withdrawal is little understood by the UK population. We need a deeper understanding of the decisions that retirees are making, the investment behaviours they are displaying and the tax efficiencies they are missing out on as a result of their actions so we can better understand the value of advice.

Solutions that can boost understanding and facilitation of best next pound withdrawal deserve serious consideration.

The round table debate covered in this special supplement looked at whether current industry approaches to addressing the DC retirement conundrum go far enough, and whether a fundamental rethink of access to advice is needed.

What is clear is that retirement is a complex process and that smart digital solutions can do much of the heavy lifting of bringing individuals to better outcomes.

Unfortunately adoption of digital solutions in the pensions industry appears to be happening at glacial pace - let's hope we can build some momentum in the coming years.

INSIDE

REPORT

ADVICE OR GUIDANCE AT RETIREMENT?

USING TECHNOLOGY TO BRIDGE THE ADVICE GAP

Retirement is complex and fluid. As a minimum, all schemes need to offer at least some support - and better outcomes will be achieved with solutions that embrace that complexity. Emma Simon reports

There is little debate about the fact the pension industry needs to rethink its approach to retirement if it is to improve member outcomes.

It is now eight years since pension freedom rules were introduced, but the decumulation landscape has barely changed, meaning the majority of pension savers get little or no support navigating complex decisions around how to turn their accumulated wealth — via pensions, savings and property — into a retirement income.

At a recent roundtable event hosted by Corporate Adviser, delegates agreed on the scale of the problem, but there was debate about the most effective way to address this issue. At the core of the debate was the question of whether retirees should get advice or could get by and achieve a good outcome through guidance.

Mercer Workplace Savings head of proposition Stephen Coates said it was clear decumulation had not been seen by providers, regulators, or policymakers as a priority to date. He cited the fact that there isn't even industry-wide data, covering both contract- and trust-based schemes, to show exactly how people are using these pension pots post-retirement.

But he said that the partial data that is available, from the Financial Services Authority, other regulators and the Office of National Statistics, suggests there are a number of issues in how people are using their pensions in retirement, and this is likely to be a growing problem.

Cashing out

"Figures from the FCA show that when people are accessing their retirement savings, 60 per cent of them aren't buying an income with it. I think that's a problem and it puzzles me why the industry doesn't really perceive that to be a problem."

He went on to say more than half of pensions pots (55 per cent) are cashed in entirely on first access, with a spike of activity at the age of 55, rather than the normal retirement age of 65-plus. Meanwhile, 40 per cent of savers taking income from their pension are doing so at a rate that is not sustainable over the longer term.

Envizage co-founder and CEO Vinay Jayaram

Coates suggested these 'sub-optimal' outcomes are partly due to the industry's reliance on 'guidance' at retirement, rather than widening access to advice.

"If you look across the workplace pensions industry we've got products, which include flexible access drawdown and annuity, and then we combine that with education, projection tools and income drawdown calculators. There are all sorts of gradations and variations of guidance and education and as an industry we delude ourselves into believing that's enough to help people make good decisions."

Delegates attending the event agreed that the regulatory distinction between advice and guidance was not helping. Face-to-face regulated advice remains an

expensive service only viable for the wealthiest pension savers. This has led to a proliferation of 'guidance' options — aimed at the majority of workplace pension savers. But while providers, trustees and schemes might want to help savers — many are all too aware of the dangers of straying into advice.

Envizage co-founder and CEO Vinay Jayaram pointed out that the current taxonomy used by the FCA bears no resemblance to how consumers and pensions savers understand these terms. "It turns out that what most people consider to be advice isn't what the FCA consider to be advice."

He said this reflects the industry's focus on products. "What the FCA considers to be advice is a series of compliance steps that need to be followed before a financial product can be sold to a consumer." As a result he said the guidance and information that is often available to people at retirement tends to be more narrowly focused on specific pension products, rather than taking a more holistic look at their total wealth and spending needs in retirement. "If we are working off the wrong framework then it is difficult to deliver better outcomes," he said.

Guiding principle

But consultants attending the debate pointed out that guidance can take a more holistic approach. WTW director of financial planning Helen Perrin said: "A guidance service can look at all assets and give guidance on that basis. It doesn't have to be focused on just pension savings. You can ask somebody to complete a fact-find about themselves that takes into account all aspects of their financial situation and then offers guidance on their retirement options on this basis."

However, Perrin pointed out the key difference is that guidance won't produce a personalised recommendation, telling people exactly which product to buy. This can be a significant barrier when it comes to getting individuals to actually take the steps needed to fulfil the decisions they had come to.

She added: "You would have recourse to the Ombudsman, whether it's guidance or regulated advice, if you've been told something that's inaccurate or misleading."

Scottish Widows senior corporate pensions specialist Robert Cochran said many people are reluctant to "press the red button" — despite guidance on what might be a suitable course of action. "They might say I think this is what I need to do, but they are hesitant to make these big decisions without someone to help them do it."

This can be one of the shortcoming of guidance services. But as he pointed out this can also be a problem with some 'robo' advice services — that might give a tailored recommendation, but still rely on the customer to action this themselves.

Those attending the debate agreed that any guidance or advised solution needs to address these psychological barriers, as well as number-crunching the financial details, be it the size of savings pots, expected longevity and projected investment returns to determine what a sustainable income stream might look like.

Behaviour matters

EBC Collective partner Charlie Goodman said: "Rather than worrying about the end income, we need to go further back and ▶

Scottish Widows senior corporate pensions specialist Robert Cochran

make sure we are taking account of people's mindset, their behaviour and their biases."
Part of the problem is auto-enrolment's success is largely built on inertia, he said, with people not having to make active decisions about their pension savings.
As a result the choices that need to be made around retirement can be "overwhelming".

"We need to be engaging people at a far earlier stage," he said. If not, there is the danger that people have already made the decision to take cash from their pension at 55, and education or guidance at this point can be ineffective.

Cochran agreed it is important to understand the psychological factors behind retirees' decision-making processes — or non-decision-making processes. He pointed out that people now primarily see their pension as a cash pot, rather than a potential income stream. He said this also applies to defined benefit pension pensions as well as DC savings.

People see the cash as something that belongs to them he said, and even a relatively small sum in the bank can make them feel more secure and considerably richer.

They may intend to convert this to an income at some point, he said, but this does not necessarily always happen.

Jayaram said not enough research has been done around why so many people choose to cash in their pensions. "My hypothesis is the industry is about income because the industry has the tools and products to deliver an income. People are about cash because they've lost trust to a certain extent in the industry and in the politicians."

Cochran added that another psychological barrier can be people's reluctance to make a 'forever' decision that is not reversible at a later stage. It is for this reason that Cochran said investment pathways, which represent a guidance approach to decumulation, appear to be popular with pension savers, from what he had gleaned from the client calls he had listened in on. People genuinely seem to like them he said.

"It is easier to engage people. If you ask them what they plan to do with their pension over the next five years they can answer that." Asking them to draw up a plan for the next 20 to 30 years is more daunting, and not surprisingly many simply put off making a decision.

These investment pathways highlight two other problems with the current retirement system.

The first is the fact that retirement shouldn't be a "once and done" issue. All the consultants attending the event highlighted the need for regular financial reviews during retirement, with amendments being made as personal and wider economic circumstances change.

The other issue raised by attendees was the regulatory gap between contract- and trust-based pensions. Only FCA-regulated pension schemes are currently required to offer default investment pathways at retirement, although the majority of master trusts offered by life insurers now have similar pathway options too.

Single-trust concerns

Buck benefits consulting leader Mark Pemberthy agreed there are differences between the two regulatory jurisdictions, particularly when it comes to taking benefits at retirement. This doesn't just cover default pathways, but the functionality of schemes in terms of flexible drawdown options, as well as the advice, guidance and information available.

"I think it's important to differentiate between master trusts and single-employer trusts," he said. "Many larger master trusts are now mirroring the kind of capabilities available within contract-based arrangements. But this is not the case for most single-employer trusts."

Barnett Waddingham partner Andy Parker agreed this is an issue — and one he would like to see policymakers tackle head on. Trustees of these schemes typically see their remit and responsibility around accumulation, not helping members make the right decisions when it comes to retirement income, which is exacerbating this problem, he said.

"Policymakers and regulators need to just get on with it, and say get your own trust into a master trust or GPP. Don't give them an option. Don't do it by stealth. Just get on with it."

Contending with complexity

Coates said that many of these issues could be addressed by more people getting advice on their retirement options. "It's not necessarily that advice conceptually is a better concept than the guidance," he said. "But I think at the moment that's the best mechanism we have for helping people navigate what is essentially a very complicated decision."

Guidance has sought to simplify retirement issues, but he does not think this is helping consumers in the long run. "Time and time again you hear people say we need to make it simpler. But the problem is I'm not sure you can make it simpler. It's a bit like shouting at a brain surgeon saying

you've got to make the brain simpler. When you are trying to help people make better retirement decisions you need to contend with the complexity."

Regulated advice, Coates said can deal with these complexities — but the cost of delivering it has been prohibitively expensive for those with more modest savings. Technology has been seen as a key way to reduce the cost of delivering this advice, and it is to this end that Mercer has launched its new Destination Retirement service.

Coates positions this as a "third way" which aims to "democratise the advice process to broaden its reach" by removing much of the upfront cost.

This is a regulated advice service, although users also have a 'self-service' guidance option, and options to model income scenarios well ahead of any retirement decisions. Coates said this isn't just streamlining the advice process by moving the fact-finding process online. "The advice itself is produced algorithmically."

Helen Perrin WTW director of financial planning and Mark Pemberthy of Buck

Mercer Workplace Savings head of proposition Stephen Coates

EBC Collective partner Charlie Goodman

Coates hopes this new service will address many of the issues raised by consultants during this debate. It is designed to help people meet their spending requirements in retirement – rather than be specifically focused on product recommendations, be it an annuity or drawdown.

"Part of the point of this product is the customer doesn't need to make any decisions about drawdown or annuities or longevity risk. You have to tell it what you want, in terms of spending, and it calculates the best way of generating this."

This service will ask about individual's and their household's wider wealth, including savings, Isas, bank accounts and pensions, and from next year there are plans to include property wealth.

Stochastic advice

Coates said the algorithm models a sustainable income, and will review this on a regular basis. It will also suggest the most tax-efficient way to sequence these income withdrawals, from Isas, general investment accounts, pensions and cash savings.

"If you have all these types of savings there are 24 different ways you can sequence these products, or 48 for couples who each have these accounts.

"Every time you run the tool it will go through 80 million calculations to come up with the different scenarios with the one at the top being the most tax efficient. The difference that you can pay in tax between the most and least efficient sequencing can be as much as 25 per cent over a lifetime."

Although, it has only be available for a year Coates said that take-up has been encouraging and significantly more than the number using the telephone-based restricted advice service that was previously offered.

Coates said there are some advantages with a digital service, with some people preferring to disclose financial information to a non-judgemental machine. However some consultants pointed out that there were still limitations with these digital services not least when it comes to engagement.

Parker said: "I am still struggling a bit with the idea that people have to tell it 'what they want'. I think that this is the heart of the problem: a lot of people really don't know what they want at all."

Parker said he would like the starting point to be a default option that tries to improve member outcomes, particularly for those who are least likely to engage with their pensions. An advice programme that bombards them with questions at retirement may not necessarily address this issue he said.

However, Coates said that it is very much about how these questions are framed. "If you ask people what their attitude to risk is, whether they want an annuity, or how much they want to invest for long term care, then you are not going to get very far because most people don't know the answers to these questions. "But if you ask them what their Netflix bill is, how much they might spend on a car when they retire, or how many holidays they would like to take a year then people can answer these questions. This can be a good starting point to making better decisions around retirement."

Platform blues

For the past 10 years there has been talk of 'robo-advisers' reshaping the financial landscape – but to date few have caught on. Coates said part of the reason was the technical-challenges launching a platform like this.

"If you look at the workplace platforms out there the vast majority just don't have the APIs and the digital capability to offer an automated programme of this complexity. There are very few people who can build these sophisticated digital products." He said HUB used the Embark platform to build the 'Destination Retirement' product as this was the only platform that was able to handle the digitisation of this product.

But he said he expects others to follow suit, and this platform may have a range of other competitors in future. "I think if we can push the industry to modernise their products, and if this is supported by the right legislation we will be able to build a more flexible architecture that can support more automation. "This has the potential to really transform the advice landscape which in time I would hope will help deliver better retirement outcomes for many workplace pension savers." ■

ADVICE OR GUIDANCE AT RETIREMENT?

A STOCHASTIC APPROACH TO ALL RETIREMENT RISKS

Multiple risks persist right through retirement. So how can a once-and-done at-retirement solution meet an individual's complex needs? **John Greenwood** reports

Funding retirement is an infinitely complex challenge riddled with uncertainty, yet the pensions industry offers cumbersome, static solutions that do not meet the fluid needs of individuals. That was one of the conclusions of a round table held by Corporate Adviser in London last month.

Speaking at the event Vinay Jayaram, co-founder and CEO of Envizage, the analytics software provider, said: "The industry models uncertainty from one single source - equity price volatility, interest rates, inflation, capital. But that household has to deal with uncertainty from a number of other sources. Longevity, the flip side of which is mortality, disability, long term care, health conditions, taxation and government policy.

Multiple risks

"All of these are every bit as probabilistic as what happens to capital markets estimates," he said. "The problem that we're actually trying to solve for consumers is how can we help consumers make sure that they have enough money to pay their bills over their lifetime without running out of money, and without ignoring the stochasticity associated with the other aspects of their lives."

Delegates agreed that delivering good outcomes required an approach that puts the problem of how they want to live their retirement as the starting point, not how they may fit into pre-existing products sitting in existing silos. The challenge is to ensure providers and advisers are looking after the member, not the pension pot.

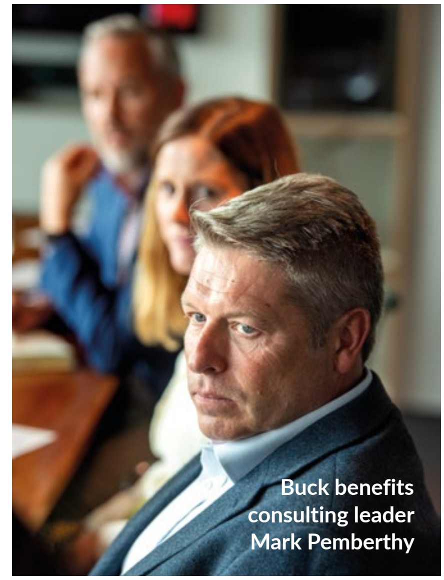
Part of the challenge however, said Charlie Goodman, a partner at EBC Collective, is that people don't necessarily know how they want to live their retirement.

"We're presenting people with a question that's ultimately challenging - something they are fearful of and don't actually want to engage with. And that's because a lot of people fundamentally don't know what makes them happy," he said.

Income question

Robert Cochran, senior corporate pensions specialist, Scottish Widows, pointed out


Mercer Workplace Savings head of proposition Stephen Coates


Buck benefits consulting leader Mark Pemberthy

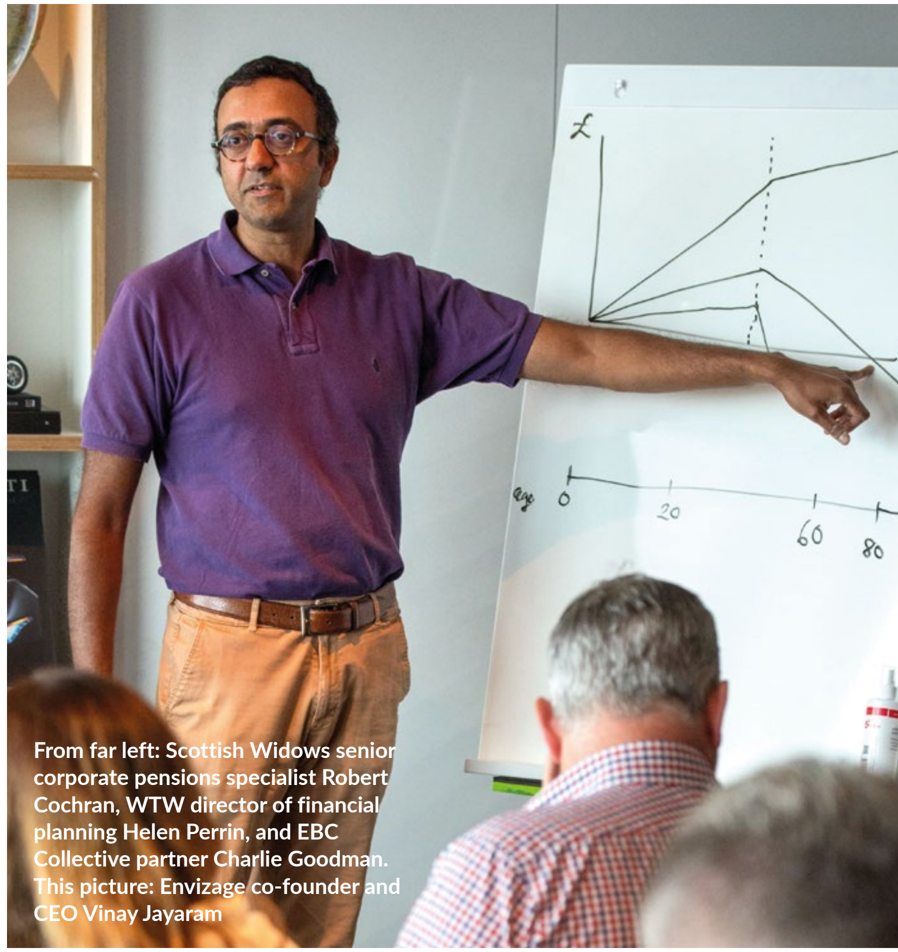
how few customers he came across actually considered their pension pot as something to generate a retirement income - even their defined benefit pensions.

Cochran said: "I go to lots of employer events, speak to employees, and even the DB money they view as a cash equivalent transfer value, they don't view it as an income. And that's a reality. The industry and the people that they are they are serving are disconnected. We are all about income, income, income. They're all about cash, cash, cash."

Goodman saw the need for solution along the lines of the whole of life planning approach promoted by George Kinder, which focuses on helping the individual to understand their life goals before setting out a financial plan that can best support them.

He said: "People actually don't trust DB any any better. People still think about Maxwell and everything else that happened. There is a psychological dimension here that betrays my work at the Institute for Financial Wellbeing. It's people's mindsets, people's behaviours, people's biases that we actually need to be looking at rather than

Andy Parker, partner, Barnett Waddingham



From far left: Scottish Widows senior corporate pensions specialist Robert Cochran, WTW director of financial planning Helen Perrin, and EBC Collective partner Charlie Goodman. This picture: Envizage co-founder and CEO Vinay Jayaram

worrying about the end and worrying about the income."

Illustrating journeys

Mark Pemberthy, benefits consulting leader, Buck said: "One of the challenges is how do you build those journeys, those stories, so that people actually understand the issues they are facing. People are facing all the risk issues Vinay mentioned, but if you ask them, they won't list any of them. These are all things that we see them challenged by. But whether they're using their money in a responsible way, in the way that we classify it, is hard to say. They may be taking too much in terms of sustainable withdrawals. Their money may be going straight into a deposit account and sitting there and not being used effectively. We don't really have a picture of this."

Default position

This, suggested delegates, meant that the bedrock of good outcomes needed to be a default solution - which could be advice or guidance - that addressed all of these factors whether or not the individual engaged with their broader whole life planning objectives.

Andy Parker, partner, Barnett Waddingham said: "I have this concern that people are defaulted into a pension scheme, defaulted into a contribution rate, defaulted on investment and defaulted as to retirement age, and then they have to make a lot of big decisions. I like the starting point to be let's have a default. It doesn't have to be solution. It can be a default process for those people who really don't know what they're doing."

Stephen Coates, head of proposition, Mercer Workplace Savings emphasised the need to step outside of the pension silo and ensure that the entirety of an individual's assets were taken into account.

People have multiple pensions through their lifetime, but also have retirement savings across a range of other assets - so he questioned whether any default solution attached to a single product could ever give an optimal outcome to the user.

Coates added that around 55 per cent of the financial products held by users of Mercer's Destination Retirement tool are not pensions.

He said: "We can't wave this away and say 'we've got four different asset allocation buckets and isn't that great?'.

"That's not going to work if you're just looking at say, one £25,000 pot. What about all the rest of their assets? That's that's our plea. Look at everything. I don't care whether it's advice or done in some other way, but that's the only way you're going to get a better outcome for people."

He also pointed out that while it might make sense for someone to cash out a small pot of, say, £10,000 at 55, if they had six or seven of those pots and could see them all in one place, they might take a more measured approach and give their retirement planning some deeper thought.

Jayaram agreed that solving the decumulation conundrum involved going beyond single products and required a holistic view of the individual. He said: "Helping people understand the most cost-effective way to withdraw their money from the different products they have is important. In the US that's a huge industry, helping people understand the next best dollar withdrawal. Because you can actually make your money last quite a bit longer by doing this." ■

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Q&A

EMBRACING THE COMPLEXITY OF RETIREMENT

» **Stephen Coates** head of proposition, Mercer Workplace Savings

Last July, the Mercer Master Trust, in partnership with retirement specialists, HUB Financial Solutions, launched Destination Retirement, a digital advice engine that helps people manage the complexity of establishing a long-term retirement income. It provides advice, initially and throughout the term of the customer's retirement, and keeps costs at a level that the average person can afford. There is no initial fee.

To our knowledge, we are the first to introduce full-fat, digital retirement advice to the workplace pension market. And we are proud that we have done so.

So how has it landed and what have we learned? Well, the number of sign-ups outstrips that of our previous retirement advice services by many hundreds of times. Clearly there is an appetite, and going through the process online, with access to support via phone, email, screen-share and webchat, appears not to phase people as some had predicted. Furthermore, the data we're gathering on people's situations, their wishes, their aspirations, and their financial position has been revealing. Here are some of our early findings.

Pension planning is not just about pensions

- 55 per cent of pots being modelled are non-pension products
- Around one third of the assets being modelled are non-pension assets

Maybe we've got more money than we think we have

- The median combined household income being recorded is £66,000
- The median asset value per case being modelled is £460,000
- The average household property equity is £479,000

How much income do people have secured already?

- The median state pension per household is £19K per annum
- The median defined benefit/final salary income per household is £15,000 per annum
- People also record other sources of income ranging from employment, to dividends, to annuity and rental income, the median of which is £9,600

How much income do people think they will need?

- Average household expenses are £34,000 with basic groceries and clothes accounting for the biggest item, and regular holidays coming in a fairly distant second
- On average people think they will need to cover one-off expenses amounting to £84,000. Clearing mortgage debt is the biggest one-off expense with provision for an emergency fund as the second priority

How much top-up defined contribution funds, and other funds, will you need to save to meet the PLSA Retirement Living Standards?*

- Taking into account the state pension, for a couple to meet the moderate PLSA retirement living standard of £34,000 per annum, they would have need to have accumulated £348,000 between them
- To meet the comfortable standard of £54,500 per annum, that figure rises to £980,000

So what does all this add up to?

- When you add everything together, income is covering average household expenses. But we're still a way off fully replacing employed household incomes
- Final salary income is still propping the system up. Without it, DC is going to really struggle to do the job of bridging the gap between state pension and basic household expenses
- Even allowing for the sample group who are early adopters, and likely to be more affluent than the eventual target market for this product, the aggregated value of assets modelled is surprisingly high at £460,000. Viewing things together, taking the holistic, household approach, presents a more hopeful and optimistic prospect than viewing pensions in isolation
- For future retirees with little or no DB benefits, the ability to orchestrate a complex interplay of different assets and incomes, whilst balancing considerations of tax, product, investment volatility and returns, sequencing risk, longevity expectations and a host of other variables, will be essential. It can be done, but it's very hard to figure out and easy to mess-up. More people will need the help of clever maths and algorithms to help them do this successfully
- If you aspire to the PLSA comfortable living standard of £54,500 per annum, you're going to need to be able to put your hands on just short of £1m, whether that's pension or some other source of wealth. One to think about! ■

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Sources: All data gathered in September 2023 from Destination Retirement across a sample size of 1,145 users. *Source: HUB Financial Solutions modelled data based on assumptions used in their Destination Retirement digital advice engine. January 2023. Parameters used: • same DOB for single and joint cases (01/01/1960) • full entitlement of state pension only as a source of income (applied for both lives for joint life cases) • male gender for single and male and female genders for joint life • total retirement savings of £490,000 corporate adviser

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