Information for Investment Professionals
November 2023

Pensions Watch | Issue 28:

What's been happening and what's on the horizon in the world of pensions

Chris Wagstaff, Head of Pensions and Investment Education, Columbia Threadneedle Investments, and Senior Visiting Fellow, Finance Faculty, Bayes Business School – City, University of London

With the inexorable rise of defined contribution (DC) and the progressive shift in focus by policymakers towards DC decumulation, this edition of Pensions Watch examines the PPI's recent research findings into DC decumulation policies across the globe and asks what lessons the UK can learn from the eight pension systems covered.[1] Spoiler alert – it isn't a simple copy and paste.

Decumulation decision making is difficult

Defined contribution (DC) decumulation has been described, by Nobel prize winning economist Bill Sharpe as, "the nastiest, hardest problem in finance". And for good reason. Striking a balance between meeting current and largely unknown future needs, not least given the vagaries of longevity and health longevity, is indeed a knotty problem. Moreover, given worries about future financial security, health, later life care and leaving an adequate bequest, moving from a deep-seated lifetime-of-saving mindset to a spending frame, by drawing on an exhaustible, non-replenishing pot of money, demands a fundamental psychological shift of mindset. Consequently, when given a choice of how to utilise their DC pension pots, many retirees are reluctant to draw down their pension assets – many simply withdraw the income generated – thereby compromising their retirement living standards, often dramatically so.[2] Of course, at the other end of the spectrum, there are those who operate a myopic approach to retirement spending, resulting in them outliving their retirement savings, sometimes very prematurely.[3]

So, whether outliving retirement savings or living in penury in fear of doing so, the risk of individuals sleepwalking into a sub-optimal retirement is ever-present. Quite the problem then and unquestionably a growing policy issue.[4]

The UK experience

In the UK, prior to the 2015 freedom and choice reforms, most DC savers were required to annuitise their DC pots at retirement to provide a lifetime income. This accorded with the fundamental mantra of the OECD and the Mercer CFA Global Pensions Index,[5] that the primary objective of any pension system is to ultimately

[1] See: What can the UK learn about other countries' approaches to accessing DC savings? Nick Hurman, Pensions Policy Institute. November 2023. Columbia Threadneedle Investments is one of five sponsors to have proudly sponsored and participated in the compilation of this report.

[2] The US, Australia and New Zealand all have systems that do not require retirees to annuitise their DC assets into a lifetime income. As the PPI report notes, "The evidence from these countries is that rather than drawing down their assets in retirement and relying on a State Pension underpin, more retirees are reluctant to draw down the majority of their capital. In the US, on average and across all wealth levels, most current retirees still had 80% of their pre-retirement savings after almost two decades of retirement. Although this figure is likely to be weighted to those with the most wealth, even for those in the lowest wealth group, more than half had 50% or more of their assets remaining after 17-to-18 years of retirement. In Australia, maintenance or growth of assets occurs despite policy settings designed to stimulate drawing of assets. As a result, most leave the majority of the wealth they had at retirement as a bequest. Retirees tend to consume only the income from their assets and not the assets themselves. In New Zealand, there is a tendency for retirees to treat KiwiSaver pots as a nest egg, leaving them with their provider or withdrawn and put into a savings vehicle, as they are not confident to use their accumulated assets to fund their retirement." See: PPI report p.10.

[3] In the UK, this is evidenced by full and partial cash withdrawals from DC pension pots continuing to escalate beyond pre-pandemic levels, the Treasury's income tax-take from cash withdrawals far exceeding expectations and FCA retirement income data recording a majority of withdrawals exceeding 8% of capital.

[4] One succinct way to think about decumulation is as two tightly-interlinked problems: an investment one – how should I invest my money? – and a planning one – how much should I take from my pot and what pattern of income do I want or expect in the future? In the pre-freedom and choice era, the planning decision was determined in advance and so the investment problem became relatively easy – basically it was only an accumulation problem.

[5] See: OECD (2022) Recommendations of the council for the good design of defined contribution pension plans. Also see: Mercer (2022), Mercer CFA Institute Global Pension Index, accessed at https://www.mercer.com/assets/global/en/shared-assets/global/attachments/pdf-2022-mercer-cfa-global-pension-index-report.pdf

generate a secure and sustainable income stream in retirement.[6] However, post-freedom and choice, despite the ever-greater dependence on DC provision in retirement, the multitude of largely unquantifiable investment, economic and demographic risks which need to be managed and the difficult choices that need to be made, the decision-making process continues to be largely unsupported by the provision of accessible frames of reference, guidance and low-cost advice. This, coupled with the almost total absence of financial education, especially from an early age, means that even the simplest of calculations or concepts are largely unfathomable to most people.

Consequently, most people simply don't know what's feasible and realistic at and in retirement.[7] Moreover, this enormous decision-making burden, which weighs heavily on the shoulders of a largely ill-equipped, disengaged and rapidly ageing population, with a deeply entrenched preservation mindset, comes at a stage in peoples' lives when financial literacy and cognitive ability often starts to decline. Couple all of this with retirement increasingly being phased, rather than a one-off event with a well-defined destination point, that demands a solution which offers both security and flexibility, and you definitely have "the nastiest, hardest problem in finance" to grapple with and ultimately resolve. The question, of course, is how.

Addressing the decumulation challenge

Given these challenges, the PPI recently published its findings into the decumulation experience of eight DC pension systems, comprising those in the US, Canada, Australia, New Zealand, the Netherlands, Denmark, Singapore and Chile, to see what policy measures applied to the management and drawing down of DC pension assets might improve UK retirement outcomes. These range from guided choices, to setting minimum drawdown rates, to partial and full compulsion to annuitise DC pension pots.[8] Of course, applying lessons from one country to another isn't a simple copy and paste, given the UK's and these comparator countries' unique features, not least the role and quantum of the state pension, how the second and third pillars are expected to interact with this first pillar, all against often very different societal and demographic backdrops and tax and social security frameworks.[9]

What can the UK learn from the decumulation experiences of other DC pension systems?

Despite these often stark differences, lessons can certainly be learnt by the UK from what has and hasn't worked elsewhere. Listed below are the key takeaways from the PPI report, how the UK is currently positioned on each of these points and how it could be positioned if better DC outcomes are to become the norm.

1. The inherent flexibility of DC offers ample opportunity for policy to accommodate the ever-increasing phasing of retirements and individuals' ever-changing needs and circumstances in retirement. However, no one pension system has yet fully squared the DC decumulation circle by adequately addressing the multiple risks and changed circumstances individuals must navigate throughout their retirement.

   Not having fully developed policy in this area, the UK is in the enviable position of being able to do so based on the experiences of its peers.

2. Having a minimum pension income underpin, courtesy of a simple, trusted, index-linked state pension, results in higher gross replacement rates and provides an element of longevity insurance. However, in some countries, rather than being universally applied, the state pension is means tested, as in Australia, whereas in others, e.g. Canada, it is both universally applied and means tested, or completely absent, as in Singapore.[10]

   Although applied universally in the UK, the full new state pension, despite the unique triple lock, fares poorly against most of its international peers in gross replacement rate terms, so cannot be relied upon to provide anything other than a minimum standard of living in retirement. If the state pension isn't to form the mainstay of UK retirement outcomes, as some predict it will, then a more prescriptive policy on decumulation must be formulated.

3. Minimum drawdown provisions, which prima facie strive to move retirees from a preservation to a consumption mindset unintentionally create *de facto* defaults, or anchors.[11 12] However, to be effective, these provisions must be designed around a consensus of what a good outcome looks like and

[6] Dispensing with compulsory annuitisation post-freedom and choice has resulted in the UK being continually marked down in the Mercer CFA Global Pensions Index's annual assessment of global pension systems.

[7] 77% of UK DC savers do not know how much money they need in retirement to support their desired lifestyle. See: https://www.retirementlivingstandards.org.uk/details

[8] Guided choices are provided by Australia and New Zealand. Minimum drawdown rates at certain ages are set in the US, Canada and Australia. Threshold-based partial compulsion to annuitise is mandated in Chile and Singapore and full compulsion to annuitise, via a default conventional annuity or variable lifetime income, is mandatory in the Netherlands. See: PPI report pp.11-12.

[9] For instance, contrast the Netherlands with Singapore. The former provides a high level of social security and support, adopts a social partnership model (comprising policymakers, employers, unions and members) in setting pensions policy and governing workplace pensions, and requires DC pension pots to be annuitised into a lifetime income. By contrast, Singapore in adopting an economic system which values low taxes to maximise rewards for enterprise, doesn't have a universal state benefits system and supports choice of access beyond the provision of a basic level of pension income from an individual's pension assets. See: PPI report p.12.

[10] As the PPI report notes, "In Singapore, pensions savings are part of a wider workplace funded social security system." See: PPI report p.12.

[11] As the PPI report states, "From age 73, US retirees are required to take a Required Minimum Distribution (RMD) from their pots each year designed to extinguish the assets [over] their remaining expected life span. In Canada, if retirees do not take a cash withdrawal or purchase an annuity, their pension fund will be moved into a retirement income fund. Funds are required to be drawn down from age 71 at or above a minimum rate. [Uniquely,] for funds accumulated via a workplace scheme, there are also limits on the maximum rate that funds can be withdrawn. In Australia, minimum drawdown rates apply as soon as benefits are taken. These start a 4% up to age 64 and rise to 14% for those aged 95 or over. In Chile, the saver has the option to choose different pension products only when sufficient funds have been accumulated to purchase an [indexed] annuity that would generate an income equal to or above a defined threshold. If this threshold is not passed, then the fund will be placed by default into a programmed withdrawal. Fewer than 40% of savers are typically able to pass this threshold. In Singapore, those with a retirement fund less than a Basic Requirement Sum threshold are required to take a level annuity. Those with more can choose to have a higher level of annuity or to withdraw cash in excess of the threshold as and when required. Both of these mechanisms are designed to generate a required minimum income in systems which have limited or no state pension support." See: PPI report p.11 and p.16.

[12] As the PPI report notes, "A further strategy to incentivise [US] retirees to drawdown is the favourable treatment of the Qualified Longevity Annuity Contract (QLAC) created in 2014. This is a deferred fixed annuity that can be purchased via a DC pension withdrawal up to a maximum of US$200,000. Payments can be deferred until as late as age 85 and can be made on a single life or joint life basis. Inflation protection is offered by some providers at additional cost. A refund death benefit option is also available, returning any unused premium to beneficiaries." See: PPI report p.16.

shouldn't be implemented principally and explicitly to recoup income tax deferred in the tax-incentivised savings phase. To do so simply compounds retiree resentment around the loss of control of their savings.[13] Minimum drawdown provisions, as implemented, also largely fail to address the inclination by many to save and not spend these compulsory withdrawals. This growing policy challenge is where good guidance and/or well-constructed defaults come into play. More on each of these shortly.

While UK policy doesn't currently provide for a minimum drawdown rate, this warrants serious consideration, notwithstanding the policy shortcomings identified in the report. After all, while acknowledging that retirement spending in many countries historically tends to fall in real terms, especially in later retirement,[14] in the UK the demographic bulge of aspirational "sandwich generation" second wave baby boomers (now in their late-50s to early-60s) and early Generation Xers (now in their late-40s to mid-50s)[15] will likely be the first whose financial commitments and real spending could well increase, not decrease, throughout retirement.[16] A policy which fails to overcome this preservation mindset will not serve this capacious generation of retirees well.

4 So to guidance. Placing simple, accessible, trusted, timely, well signposted and behaviourally robust[17] guidance – think rules of thumb, on-line expenditure calculators and drawdown modellers – at the centre of decumulation policy and delivering this in a consistent way,[18] to support individual decision making, can lead to desired behaviours, such as overcoming the reluctance to draw down pension assets sustainably to support a realistic standard of living in retirement. However, once again, if guidance is to materially improve outcomes through regular engagement, the imperative must be to first define what a good outcome looks like and – given life's twists and turns – to ensure the guidance is regularly revisited. Otherwise, an optimal retirement path is unlikely to be followed.

Guidance in the UK principally comprises two relatively well signposted free-to-access information sources in Pension Wise and the Pensions and Lifetime Savings Association's (PLSA) Retirement Living Standards (RLS). Pension Wise, the free-to-access telephone and face-to-face- based generic pensions guidance service for those aged 50+ has, by approaching an ultimately complex decision via logical and well framed questioning within a series of simple steps, helped many achieve better retirement outcomes.[19]

However, one-off generic guidance from Pension Wise, typically at the point of retirement, is unlikely to be sufficient, given that peoples' circumstances and spending patterns change throughout retirement, sometimes markedly so. Therefore, as noted above, this aspect of guidance should be applied repeatedly to ensure an optimal path is continually followed. Meanwhile, the PLSA's RLS, via simple, accessible and relatable single number anchors, helpfully illustrate what life in retirement might look like for both a single retiree and a couple, either living in or outside of London, at three different levels of spending: minimum, moderate and comfortable.[20] Anchoring those who are metaphorically all at sea to a single relatable expenditure number is incredibly powerful. Moreover, later in 2026 this guidance will be supplemented by the long-anticipated launch of the pensions dashboard, which will allow individuals to view all of their pensions information, including the state pension, together in one secure place.[21]

However, much more could be done – along the comprehensive lines of Australia's Retirement Income Covenant and the New Zealand Actuaries Retirement Income Interest Group's (RIIG) Rules of Thumb[22] – in helping those at and in retirement to gauge what is reasonable and realistic.[23] Indeed, in the latter case, the idea is to help retirees to choose withdrawal rates in an informed manner, based on their retirement needs and preferences. That said, many commentators have suggested that no amount of guidance can substitute for advice.[24]

[13] As in the US. See: PPI report p.2 and p.16.

[14] As the PPI report states, "In the US, when adjusted for inflation, spending from age 65 to advanced old age declines for single and couple households at annual rates of about 1.7% and 2.4% respectively. Spending declined for all initial wealth quartiles, with some small variations, suggesting that the decline is not related to economic position. In Australia, successive waves of the Household Expenditure Survey show that for a given cohort, real spending falls once households are aged over 70." See: PPI report p.10.

[15] Those born in the UK between 1963 and 1971 currently number more than 900,000 for each of these nine years, while those born from 1972-1976 currently number more than 800,000 for each of these five years. See: Mid-year population estimates, UK. ONS data as at June 2021. Also see: Overview of the UK population, 2020. ONS, 25 February 2022. The ONS estimates that in mid-2020, 22% of the UK's 67.1 million population was populated by those at or over State Pension age (SPa). By mid-2041 this percentage is projected to rise to 26% of a population totalling 70.5 million, as the numbers reaching SPa outstrip the growth in net migration and the birth rate and longevity continues to improve.

[16] The sandwich generation is the first generation to be simultaneously caring for ageing parents while helping out financially dependent adult children (hence sandwich) and be faced with the rapidly declining economics of social care. The sandwich generation stands in contrast to "the make do and mend and never let anything go to waste generation", who were either born or who grew up during WW2 and whose real spending in retirement typically declines over time.

[17] For instance, using positive words, or priming, encourages more positive behaviour. As John Paul Sartre once said, "Words are loaded pistols." The use of single relatable numbers is also particularly powerful in anchoring behaviour. Additionally, socialising good behaviours is key. After all, as social animals, our decisions are rarely made in a detached manner. Instead, we act on the information, opinions and actions of others, especially those we perceive as experts, and like to have our own actions and opinions validated by others. However, ultimately, good guidance must be easily accessible, as even the smallest number of unnecessary steps or additional effort required by the prospective DC decumulator can derail the whole process.

[18] As the PPI report notes, "In Australia, the Retirement Income Covenant requires superannuation funds to develop a strategy for members who are retired or approaching retirement to help them optimise their retirement income. Funds have the discretion to determine the type of assistance that they provide to their members across a wide spectrum of information, education, assistance, guidance, advice and implementation [though they are required to balance three broad objectives: maximise expected income; manage income risk (longevity, inflation, investment and other) and provide flexible access to funds]. This could result in tailored retirement products, financial tools and education and personalised retirement planning and advice. In New Zealand, the Retirement Commission is focusing on promoting a [direct-to-consumer rules of thumb] framework with supporting on-line drawdown calculators to support individual decision making and reduce the possibility for financial decision-making errors. They are also recommending that all KiwiSaver providers contact their members at milestones approaching retirement to provide them with access to this information and guidance regarding their options." See: PPI report p.11, pp.22-23 and pp.24-25. Additionally, the report notes the positive impact on decision making of those "large and mature DC schemes in Canada that have experience of delivering DC decumulation solutions to members [in providing] tools and calculators to assist members in assessing: their risk tolerance and best match asset mixes; the optimal withdrawal rate (consistent with their investment choices and expected remaining lifespan); the potential benefits of combining variable benefits with annuity purchase (either immediate or deferred); and their DC decumulation choices in the wider context of their state and other private pensions and savings and spouse's assets and entitlements." See: PPI report p.18.

[19] Although, in April 2022, UK policymakers rejected calls for automatically enrolled Pension Wise appointments, DC schemes and providers can, and increasingly do, voluntarily offer to book members a Pension Wise appointment before they have made a final decision on accessing benefits. Additionally, since 1 June 2022, workplace DC schemes have been required to include a link to the Pension Wise booking tool in response to member applications to receive "flexible benefits". However, this "stronger nudge" may not be enough to make receiving pensions guidance immediately prior to accessing DC benefits, the norm.

[20] To make the three high level expenditures relatable, each of the standards, which are based on independent research from the Centre for Research in Social Policy (CRSP) at Loughborough University and derived from working with focus groups, drill down into what could typically be spent annually on household bills, home maintenance, food and drink, transport, holidays and leisure, clothing, personal items, presents and charitable donations. However, rent, mortgage, health and social care costs, which are specific to each individual, are excluded. The RLS are further humanised via eight personas, each at various stages of their working lives.

[21] Although the pensions dashboard's functionality and the presentation of information has yet to be finalised, just as a motorist's SatNav converts speed, distance and known roadblocks into a single ETA, the pensions dashboard needs to convey to the pension saver what their probable end game looks like, in a simple, single, easily comprehended estimated retirement income number.

[22] See: footnote 18.

[23] Having moved from one end of the choice architecture spectrum – the paternalistic requirement to annuitise DC pension pots pre-2015 – to the other – by introducing libertarian freedom and choice from 2015 – was, for most people, a step too far. Instead, a libertarian- paternalism solution which simplifies and guides choices is perhaps a better way forward for most people.

[24] Although in recent years the automated advice market has made advances in the provision of low-cost advice to those at and in retirement, it is still at an embryonic stage. Therefore, the question of how to provide simple and affordable advice to those of a certain age, not least to those who are not tech-savvy, still needs to be answered.

5 There is a strong case for segmenting retirement income policy between low earners, those on a middle income and high earners.[25] In the UK, as the full state pension provides a high replacement rate for those on a below median working life income, any accumulated pension savings are best employed as a capital buffer for contingencies and to meet large one-off expenditures. At the other extreme, those with a high working life income are the least likely to require high replacement rates in retirement and be the most likely to seek regulated advice in exercising freedom and choice.

However, those with a middle working life income will likely be the cohort to most rely on their DC pension pots to supplement the state pension if replacement rates, hence retirement living standards, are not to be unduly compromised. Therefore, it is this cohort on which UK decumulation policy should principally focus.

6 Investment, inflation and longevity risk, which most individuals would prefer not to bear unilaterally or manage individually in retirement for reasons of complexity and cost, can be pooled via employer and industry group structures in a cost-effective way to dramatically improve outcomes.[26] That said, there has been a lukewarm take up of innovative lifetime income solutions, which manage some or all of these risks, in some other countries.[27]

Although the UK doesn't offer a mechanism to pool these risks, serious consideration is being given to the introduction of decumulation-only Collective Defined Contribution (CDC) funds which would pool all three risks in a cost-effective manner, although possibly at the expense of retirement income levels being cut periodically.

7 Major policy reform is often best enacted via timely public debate, social partnerships (comprising policymakers, employers, unions and members) and proactive regulatory action, as exemplified by the Netherlands.

Policy in the UK is enacted typically after industry consultation though without public debate, with regulation often being reactive, rather than proactive. As the PPI report notes, "consultation and regulation should stay ahead of the market to ensure that consumers are properly informed and protected against new or unexpected risks."[28]

8 Retirement income, hence outcomes, can be compromised, sometimes significantly so, if funds saved for retirement are explicitly made available for other purposes, such as housing and medical costs.[29]

Although UK DC pension pots are not formally segmented for particular expenditures in decumulation, leakage can occur by allowing full or partial cash lump sums withdrawals, so compromising retirement income streams. That said, this flexibility is valued by many in decumulation but can result in the premature depletion of DC pension pots.

9 Although housing wealth is a key asset for many at retirement, in most countries, bar Singapore, housing assets typically play a minor role in satisfying retirement income needs, despite far exceeding the value of other financial assets held outside of retirement asset pots.

Indeed, in the UK, equity withdrawal from owner occupied housing is used sparingly as a means to supplement retirement income.[30]

Some concluding points

In addition to the above takeaways, there are several concluding points to be made in light of the PPI report's findings and how these might be applied to potentially ease the challenges faced by those in the UK who are increasingly reliant on their DC pension pots at and in retirement.

Firstly, a general point. As societies age, so a disproportionate amount of collective wealth will increasingly be held in pension and other assets which will support retirement spending. How these assets are distributed across populations and the extent to which these assets are draw down will not only have a marked effect on individuals' standard of living in retirement but on economies' fortunes and on intergenerational and generational wealth and income inequality. While policymakers around the world are becoming increasingly alert to this, they have yet to fully square the circle on DC decumulation, not least in ensuring the majority of middle-income earners, with appropriate guidance, voluntarily draw down at a sufficient rate to ensure at least a modest income in retirement. This is a challenge UK policymakers should be increasingly cognisant of in formulating policy.

Secondly, two UK-specific points. As noted earlier, over the next two decades we will not only see a marked increase in the proportion of a growing population adopting a phased retirement and reaching State Pension age, but also a generation that will likely be the most long-lived in history and whose financial commitments are likely to increase throughout retirement. As this will coincide with an increasing reliance on DC pension pots to support a desired standard of living in retirement, if left unsupported the consequences of individuals making a wrong decision at and in retirement will rise exponentially over time.

[25] In segmenting retirees, Australian DC policy focuses on middle-income earners, recognising that reliance by this cohort on the state pension alone would compromise retirement living standards. See: PPI report p.2 and p.21.
[26] Group structures are provided in Australia and New Zealand and to a lesser extent in the US and Canada, variously given concerns by DC plan sponsors in the latter two countries around potential litigation and the provision of effective independent oversight. See: PPI report p.2, p.13 and pp17-18.
[27] See: PPI report p.16 and p.19.
[28] See: PPI report p.2 and p.29.
[29] Such as in New Zealand (house purchase) and Singapore (purchasing housing leases, medical and care costs). See: PPI report p.24 and p30.
[30] According to the UK Housing Review 2023, equity withdrawal in the UK since 2015 has accounted for less than 3% of consumer spending. See: https://www.ukhousingreview.org.uk/ukhr23/tables-figures/pdf/23-007.pdf

So where to from here for UK decumulation policy?

With yields normalising, for some, still likely the minority, annuitisation may now seem to be the answer to guaranteeing income security, at least in nominal terms, thereby avoiding the early depletion of pension pots and the risk of living too frugally in fear of the latter.[31] Whereas for others, likely the majority, the solution that most closely meets their needs, demands both income security and flexibility, i.e. income drawdown. The problem is, of course, that income drawdown, which must prospectively underpin a desired standard of living that might extend to 30+ years, must sidestep the worst effects of investment sequencing risk, especially early in the decumulation journey, unexpected inflation and, often vastly underestimated, longevity risk. Of course, annuities and drawdown are not mutually exclusive and can be complementary – as evidenced in some of the pension systems considered by the PPI report.

However, the crux of the issue, as noted earlier, is that most people simply do not know what is feasible and realistic at and in retirement. As a result, to reinforce yet another point made earlier, many are at risk of sleepwalking into poor active and passive decisions and landing in a very bad place. Many already have. Consequently, and perhaps unsurprisingly, it was noted earlier that the contention of many prominent pension practitioners and commentators post-pension freedom and choice is that, regardless of the quantity and quality of guidance provided, most people will never truly engage with the complex decisions to be made at and in retirement. Nor will they ever have the confidence and capability to select and successfully manage the retirement solution that most closely meets their needs.

Leading on from this, three additional points are increasingly being made. The first is that a collectivist solution – one that pools the largely unquantifiable risks, noted earlier, that accompany flexibility in decumulation – trumps an individualist retail-type solution. Indeed, the latter can prove sub-optimal and costly, in both absolute and opportunity cost terms, not least given the lack of shopping around and advice being taken in the UK prior to purchase. Consequently, decumulation-only CDC, while not yet a reality in the UK, already has a core band of supporters. The second is that the success of automatic enrolment in the accumulation stage of DC is testament to the power of harnessing the inertia of the disengaged by opting eligible employees into pension saving and so should be replicated in decumulation. The third is the legendary power of the default. In pensions, as in all aspects of life, the default option is that which is overwhelmingly selected.

A potential solution …

Therefore, for a largely unsupported and unadvised mass market, principally comprising middle-income earners seeking to supplement the state pension, to underpin a desired standard of living that might extend to 30+ years, the solution prospectively lies in an auto-enrolled, well-governed, behaviourally robust, appropriately charge capped, institutionally-managed DC, or CDC, decumulation default, which combines income security with appropriate flexibilities. These flexibilities could comprise an option to finesse the default's key defined parameters at set times, within certain tolerances, to meet individual preferences – contingent on the flexing of the other features, the individual's age and the size of the remaining pot. Ad hoc cash withdrawals to meet one-off expenditures or contingencies would also need to be accommodated, again within set tolerances.

Opt-out provisions could be made available to those who are better able and willing to make their own decisions and create their own bespoke decumulation solution, notably higher earners with less need for high replacement rates. Of course, both opt outs and flexibilities should only be enacted with regulated advice.

Crucially, to support a desired standard of living with no nasty surprises, any solution would need to be underpinned by an investment medium which obviates the threats to the preservation of capital, noted earlier, and an ability to sustainably generate a real stream of income to meet budgeted spending. This could be supplemented by a minimum income guarantee underpin, to support a well thought through mandated minimum rate of drawdown, along with longevity insurance, the latter provided courtesy of a deferred annuity.[32]

Not that this suggested solution is breaking new ground. Indeed, as the PPI report notes, "Three national actuarial bodies of the US, UK and Australia have jointly concluded that there would be value in developing appropriate defaults that allow individuals to access their pensions through an income stream that offers flexibility on their early years of retirement. However, in the latter years, they could provide, at a minimum, a structured lifetime payment with a potential for a lifetime income guarantee to protect against their longevity risk. [Moreover] previous global reviews have recommended that defaults to hybrid or multiple retirement income solutions are needed for DC pensions to balance flexibility with protection."[33]

But what if…?

However, if a collective auto enrolled default isn't regarded by policymakers as the solution, then there's no getting away from the fact that people will need to be properly supported

[31] While effectively the default pre-2015, annuitisation – typically via level, rather than escalating or index-linked, annuities – has been the minority choice during, what has been, an exceptional period of historically low yields, accounting for between 9% to 16% of UK DC pots accessed. Source: Retirement Income market data 2021/22. FCA. 6 October 2022. Although sales of annuities in Q123 recorded their highest levels since 2014, they were only up 7% on Q122. Source: Association of British Insurers. 30 May 2023.

[32] See: Generating Retirement Outcomes to be Enjoyed and not Endured. Chris Wagstaff. Columbia Threadneedle Investments. February 2018. The selection of an appropriate investment medium is quite nuanced and warrants a separate paper. Indeed, views vary as to what asset class and strategy best underpins a sustainable real withdrawal rate – i.e. one that doesn't need revisiting with every twist and turn in financial markets. These range from global equity, combining global equity with local bonds, through to well diversified multi asset portfolios and to secure income assets, such as infrastructure debt. Of course, environmental, social and governance considerations are increasingly instrumental to the choice of investment medium. Also see: the experience of US Managed Payout Funds. PPI report p.16.

[33] See: PPI report p.7.

throughout the retirement planning, implementation process and retirement journey – with all of its twists and turns. People will need to have their options, choices and potential outcomes explained and illustrated to them in a simple, clear, understandable, relevant and practical manner, and be assisted by the more widespread provision and signposting of accessible and behaviourally robust tools, guidance and, crucially, advice. That's quite a resource-heavy ask but a necessary one.

Why does this matter?

To end on a blunt note, ultimately whether a minimum, moderate or comfortable retirement in the UK becomes the norm, is largely contingent on timely and decisive action or continued inaction by both the pensions industry and policymakers. To yet again reinforce the points made earlier, over the next two decades we will not only see a marked increase in the proportion of a growing population adopting a phased retirement and reaching State Pension age, but also a generation that will likely be the most long-lived in history and whose financial commitments will most probably increase throughout retirement. In coinciding with an increasing reliance, principally by middle-income earners, on DC pension pots to support a desired standard of living in retirement, if left unsupported the consequences of making a wrong decision at and in retirement will rise exponentially over time.

Thankfully, despite the marked differences between the UK and the PPI report's comparator countries, there are lessons to be learnt and practices that merit further investigation by UK policymakers, providers and practitioners. In fact, the UK is at an inflection point, in that there is the potential – indeed a unique opportunity – to demonstrate pre-eminence in decumulation policy if the best is taken from what the rest of the world has to offer. More specifically, if policymakers, providers and practitioners can agree on appropriate defaults, a suite of good guidance and advice more broadly, then it's reasonable to expect that this could unlock better investment strategies and culminate in better retirement outcomes. However, timely intervention is needed if the potentially significant, if not catastrophic, economic and societal risks that could result from continued inaction are to be avoided. In short, the clock is ticking.

To find out more visit **columbiathreadneedle.com**

COLUMBIA THREADNEEDLE INVESTMENTS