



The 'silver squeeze': Tackling decumulation dilemmas for retirees-to-be



Foreword

Post-retirement is in vogue. As populations age the world over, the average life expectancy at retirement now extends well past a quarter of a century. The years after retirement now represent a significant portion of savers' lives: a third or more.

And, the longer it stretches, the more varied this period becomes. Retirees remain in part-time work, travel, run marathons and are their grandchildren's primary carers – confounding expectations of what 'retirement' looks like. Each successive generation challenges the version set by the one before. Pre-COVID-19, today's Baby Boomer retirees were as likely to be found backpacking around Australia as tending to their plants.

So the upcoming generation of retirees: Gen X, the one which gave us Madonna, big hair and much else besides, are unlikely to want to settle into their armchairs come 65. They need their retirement income to reflect that.

The traditional means of obtaining a guaranteed income after retirement don't work for everyone, and successive UK governments have aimed to tackle this. We've had nearly five years of Freedom and Choice, which opened up the parameters of how savers can take their income after giving up work. Now, the FCA has created Investment Pathways, to help outline the options for retirees more starkly, and equip them to make decisions to best suit their lifestyles.

But is Gen X prepared? At Legal & General, we have long worried that these 'squeezed savers' have fallen into a gap. They don't necessarily have the support of large Defined Benefit (DB) pensions, but neither are they projected to have the Defined Contribution (DC) wealth that later generations will (hopefully) accumulate. We also know that many of those in their 50s do not receive formal financial advice.

However, the basis of pensions management shouldn't just be statistics and projections, but a reflection of how people actually choose to live with the resources available to them. So I was pleased to join forces with NMG Consulting to gather more insight into what the freedom to choose at retirement has meant for prospective retirees' real lives.

We discovered a generation confronting the reality that spending efficiently is as important as saving efficiently, and where greater financial freedom sadly hasn't equated to greater financial knowledge. With COVID having tipped savers' finances upside down, our research explodes retirement myths – including the holy grail of tax-free cash, and asks what more can be done by providers and policymakers to ensure that these members achieve the fullest retirement possible.

Unless we tackle the issues they are facing head on, Gen X could well become the canary in the coalmine. Their decumulation dilemmas will only increase as successive generations' DC pots grow to become retirees' main source of income.

Most of all, as a fully paid-up member of Gen X, this piece of work is close to my heart! Enjoy.



Emma Douglas
Head of DC



A photograph of a man and a woman walking along a beach at sunset. The woman is wearing a red jacket and the man is wearing a dark jacket. They are both smiling and looking towards each other. The sky is filled with soft, golden light from the setting sun, and the wet sand reflects the light.

Five years on from Freedom and Choice, the New Romantic generation is dancing towards a decidedly unromantic retirement.

Here, LGIM and NMG Consulting examine how you could boost the outlook for non-advised prospective retirees.

Key takeaways:

Five years after Freedom and Choice, a whole generation is approaching retirement with little idea of what to do.

2 in **3**

prospective retirees do not feel knowledgeable about the funds their pension is invested in

Almost
60%¹

of those who have already retired **have done so with either no concrete plan or no plan at all for their income in retirement.**

Without advice, we believe providers must act as savers' front-line support. That means aiming to provide potential default options post-retirement, busting retirement myths and engaging members earlier on

Very few customers are keen to make active drawdown decisions,

with

56%

of existing drawdown customers staying invested in the same fund they were invested in during accumulation

Footlose and fancy free?

Nearly

40%²

of prospective retirees plan to access their pot solely for the tax-free lump sum.

For squeezed savers, phasing these withdrawals may help ensure they don't take out too much, too soon

1. 58%. 2.39%

The Freedom and Choice reforms of 2015 opened up a swathe of new options for savers at retirement. At a stroke, retirees no longer had to make a single decision which would govern their whole financial future. This opened the door to staying invested, and bolstered the seemingly universal allure of tax-free cash.

Among the first to benefit from these changes would be Generation X. The older section of this group, who grew up with cassette players, neon jeans and Thatcherism, are now in their early-to-mid 50s. Neither fully 'generation DB' nor 'generation DC', many do not seek financial advice. And without the firm support of either sizeable final salary pensions or government policy, many will need extra help with their savings and planning.

But, over five years on from the changes, how has prospective retirees' decision-making evolved? Is there a greater understanding about pensions, or have new knowledge gaps opened up?

To find out, LGIM and NMG Consulting conducted in-depth interviews and quantitative research with DC pension scheme members aged 50+. All were in the run-up to retirement or had already entered it, and none had received formal financial advice.

By comparing them with recent retirees, we examined how the 'squeezed savers' of older Generation X are handling their pension planning decisions as they approach retirement. In particular, we honed in on the challenges of the COVID-19 pandemic and what the best remedies are for some of the thorny issues they face.





Our methodology:

Legal & General Investment Management joined forces with NMG Consulting to investigate how well today's savers are equipped for non-advised drawdown five years on from Freedom and Choice. This was achieved through:



Qualitative research of 40 1 hour individual in-depth interviews took place during September 2020 amongst an even split of non-advised consumers in drawdown and those approaching it



Quantitative research in October 2020 amongst 1,150 non-advised consumers:

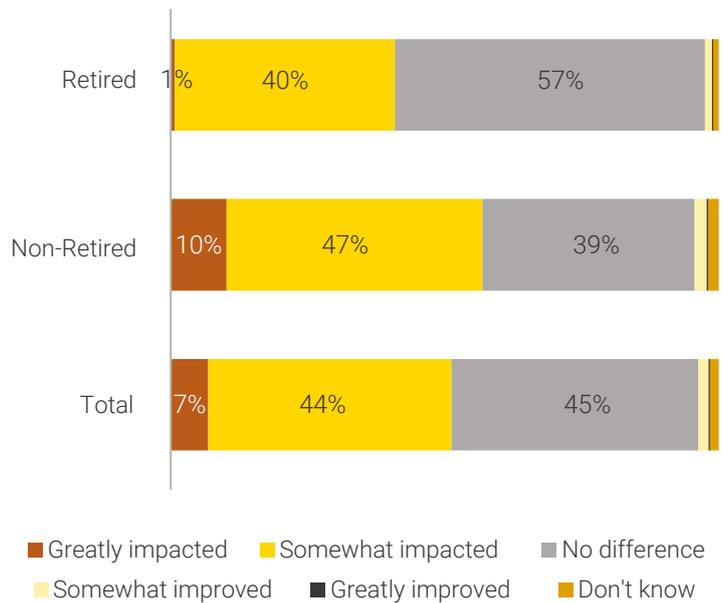
- 64% pre-drawdown, 36% in drawdown
- Aged 52+ for prospective drawdown savers and aged 55+ for those in drawdown
- Pot sizes were mixed, with pots under £10,000 excluded and a quota on £10,000- £30,000 pot sizes

Stuck in the middle

Sandwiched between Baby Boomers and Millennials, Generation X truly are the ‘squeezed middle’ – in more ways than one. Many in this cohort lack earlier generations’ property and investment assets, as well as higher value defined-benefit (DB) or personal pensions. Nor is this generation supported by early access to the state pension. At the same time, Generation Xers (Xers) over 50 don’t have younger members’ projected DC pension growth. This causes some consternation amongst savers: just 34% of the non-retired group say they have no concerns about their retirement plan, versus 57% of those who have already retired.

But along with relatively precarious finances, Xers face myriad financial pressures. Care costs for children and parents, a reduction in state benefits and unemployment uncertainty have all been compounded by COVID-19 and asset volatility. The pandemic is the single biggest trigger of anxiety for all age groups about retirement finances. 57% of the pre-retired group told us that COVID-19 has impacted their confidence in their retirement finances, compared to 41% of the already-retired group. Attitudes like this prospective retiree are common: *“I have not really checked but I suppose COVID has brought the value of pensions down.”*

The impact of COVID-19 looms large for both groups but especially for those who have not yet retired



57%
of pre-retired **feel impacted by Covid-19**

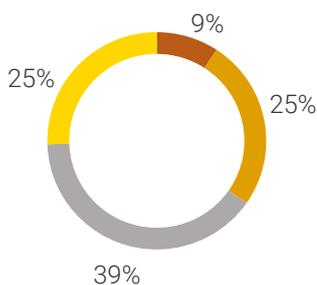
Source: LGIM and NMG Consulting, October 2020

Q4: How has the COVID-19 situation this year impacted your confidence on your financial situation for retirement?

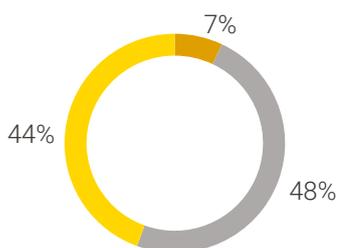
All of these issues have led to a realisation for many Xers that retiring before they reach state pension age is likely off the table, with 39% expecting to be working part-time to boost their retirement income. With 22% of women and 16% of men concerned that they have not saved enough for retirement, the pre-retired group have generally modest expectations of their retirement living standards. Even so, many expect to use their housing wealth to finance their retirement needs.

Ready or not? Just one in four of the non-retired group feel they will be able to meet their every need in retirement, versus nearly half (44%) of the already retired

Non-retired



Retired



- I struggle / will struggle to make ends meet
- I can meet / am confident I will meet my basic needs
- I can meet / am confident I will meet my basic needs plus occasional nice to haves
- I can meet / am confident will meet my basic needs plus all the nice to haves I want

Source: LGIM and NMG Consulting, October 2020

Q12: What does your financial situation in retirement look like?



Non-advised consumers can display hard-wired negative perceptions of financial advisers, tipping the onus of support onto their pension provider

Mind the (knowledge) gap

Unfortunately, greater need is not matched by greater knowledge. Driven by a lack of early engagement in pensions, today's prospective retirees are less clued up on their income options than might be expected, nearly five years on from Freedom and Choice.

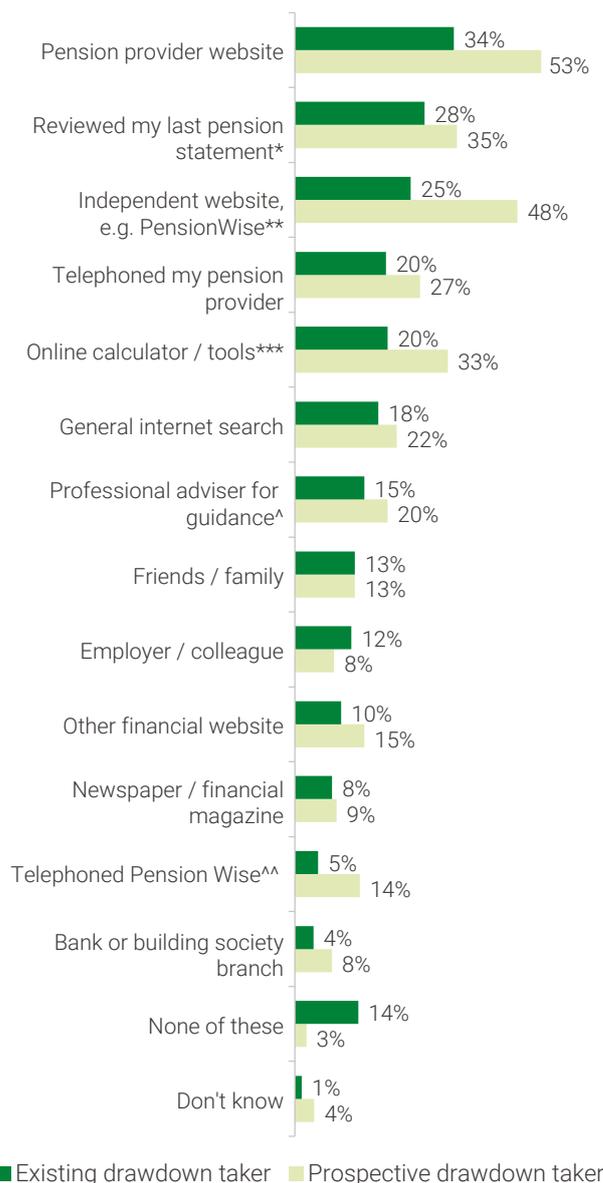
Among the prospective drawdown group, just 8% feel 'very knowledgeable', with 22% describing themselves as not very or not at all knowledgeable, 35% admitting they know nothing about the funds they are invested in, and another third unsure. Those in the middle were perhaps generous about their understanding, as savers often stumbled when asked more detailed questions about their pension during the qualitative interviews.

Around one in 20 of our sample was more engaged: tending to express a higher capacity for loss and preferring to select their own funds. These investors are more likely to be professional, male and older, with personal pensions and higher levels of assets. However, amongst prospective retirees in general, there is a low appetite for risk, with only 10% describing themselves as 'daring'.

At the same time, non-advised consumers can display hard-wired negative perceptions of financial advisers, tipping the onus of support onto their pension provider. For many, the cost of advice, a possibly over-stated belief in their own capabilities or a concern about the value of advice means their reliance on themselves – and their provider – is high. Provider websites are the most popular source of information for both pre- and post-retirement groups, and pension statements and documentation were used, or expected to be used, by around a third. One respondent about to enter drawdown said: "If the provider makes things simple, I would have no need for advice."

Some respondents gave clues as to where we expect an increasing number will go in future to get information: pension forums on social media, such as Facebook. That said, many of this generation still expressed a preference for face-to-face and phone contact, with one member summarising this well: "I am quite 'old-fashioned' and like to talk to people on the phone."

Pension providers remain the number-one source of information for prospective retirees



Source: LGIM and NMG Consulting, October 2020

Q4: Did you use any of the following when researching your options? / Q7: Which of these options do you expect to use when researching your options around taking your pension benefits?

*Reviewed my last pension statement / documentation sent by my pension provider **Independent websites, e.g. Pension Wise / Money Advice Service / Citizens Advice / Pensions Advisory Service*** to work out possible future income from pension/other savings ^ rather than paid for advice ^^Citizens Advice / Pensions Advisory Service

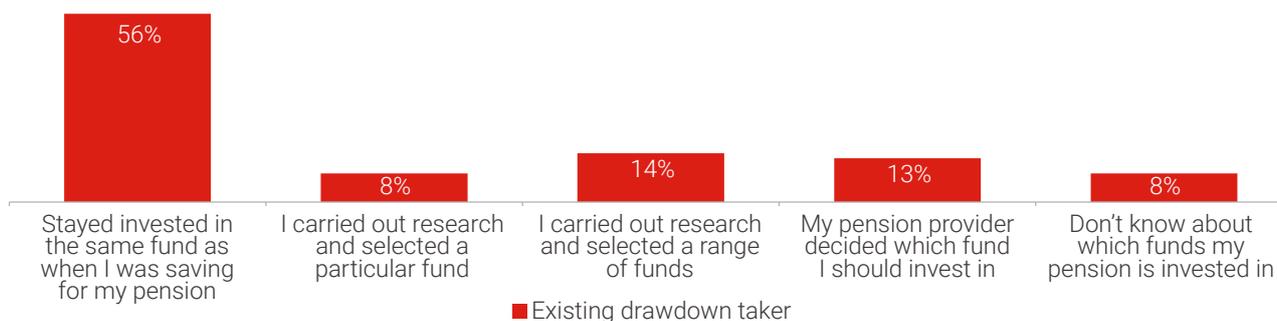
Better by default

All in all, we discovered a widespread lack of proper retirement income planning. 17% of retirees have accessed their pots without any planning at all and 41% haven't made any concrete plans. Just one in three prospective retirees have made a plan. One in five existing drawdown consumers have used online calculators from pension providers, however, others are cynical about their objectivity.

Resultantly, present bias is common, while issues such as sequencing risk and sustainability of income present a challenge. There were no examples in the qualitative interviews of consumers choosing to reduce income payments in light of challenging market conditions or opting to draw down cash rather than pension savings. Many do not want the additional burden and related risk of having to choose funds, with most preferring a single fund solution. 56% of those who had used a default fund during the accumulation journey wanted to stay in the same product during decumulation.



During decumulation, most members prefer to stay invested in the same fund they used to save for their pensions



Source: LGIM and NMG Consulting, October 2020

Q5: When you decided to take money out of your pension did you make any changes to how your pension monies are invested (i.e. the funds they are invested in)?

We found that most savers are not well equipped to make optimal fund choices for their individual needs without advice. This means that – as at the accumulation stage – future decumulation provision should include a strong set of default funds. For those already in drawdown, we observed a reliance on providers to select, or at least highlight, the most appropriate funds. Respondents invariably assumed their investments had a 'low-to-medium' risk profile, in the absence of more detailed knowledge. There is little appetite for anything beyond moderate risk at this stage in life and loss aversion is evident: "I'm more frightened to lose money than to gain it" remarked one prospective drawdown member.

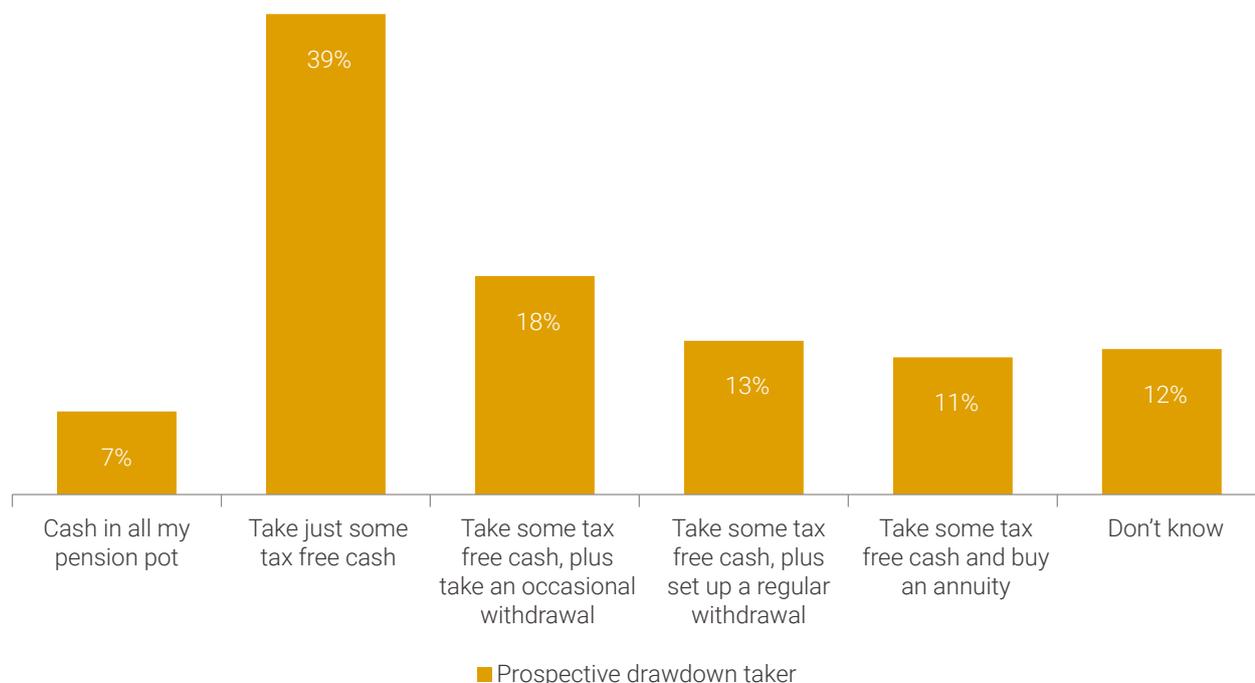
As most savers do not access advice, it's especially important that providers get communication right, at least until savers' attitudes towards advice change. In the meantime, developing strong educational tools to engage members is particularly important earlier on in the savings journey.

Footloose and tax free

Better education may just mean a nudge in the right direction. For example, the 25% tax-free cash lump sum accessible from aged 55 is one of the most widely known and appealing elements of today’s DC pensions. 42% of those that have accessed their pot already have done so only in order to take advantage of this perk, whilst 39% of prospective drawdown users expect to withdraw it and leave the rest of their pot invested.

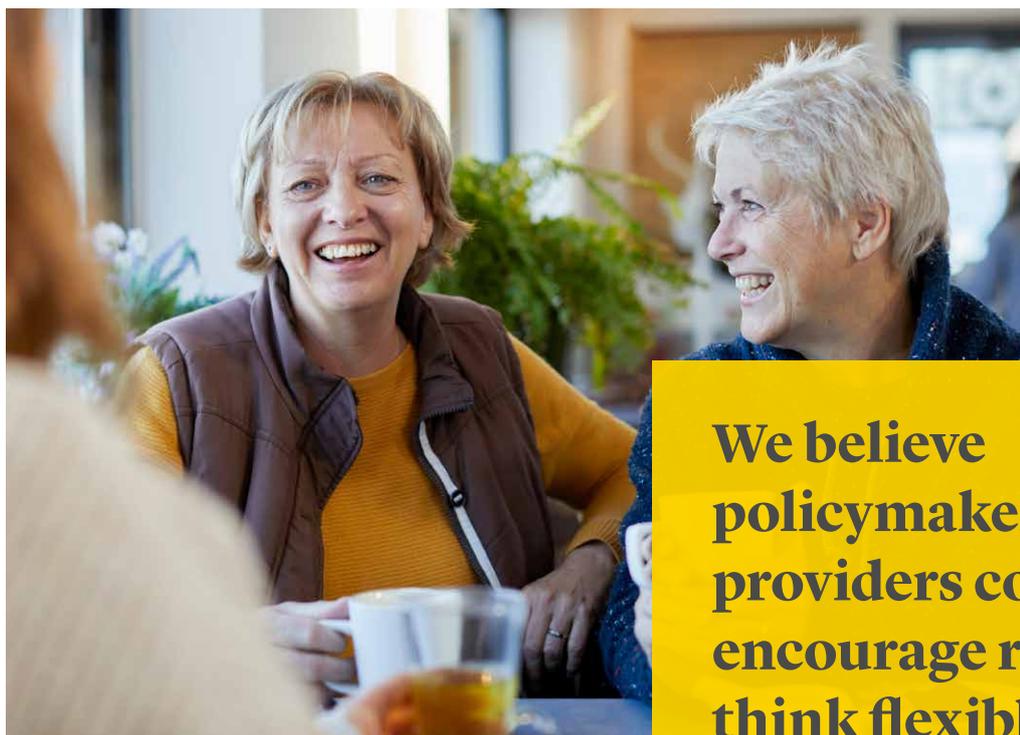
Broadly, the lump sum is treated as a mid-life bonus, with savers telling us that it allows them to buy “something special” a car, house extension, or holiday. Meanwhile, some investors’ risk-aversion dominates their decision: “I have a fear of my investments dropping, so maybe having some cash up front would be nice.”

Tax-free-cash is king: TFC remains the number-one reason members access their pension pots



Source: LGIM and NMG Consulting, October 2020

Q8. Which of these options do you expect to choose when you decide to first access your pension savings? You can still continue to pay into your pension under some of these options.



We believe policymakers and providers could encourage retirees to think flexibly for their individual needs

But are people doing it right? With so many members expressing concerns about their projected retirement income, or moderating their aspirations, we believe policymakers and providers could encourage retirees to think flexibly for their individual needs. That may mean taking their cash as phased income, rather than as a retirement windfall which leaves them with less invested later on. Providers could model the impact on savers' portfolios of taking the cash all at once, versus incrementally, so that members have an easy and tangible comparison of the real effects on their retirement income.

And there were other myths to bust and knowledge gaps to fill – some of which have sprung up since the Freedom and Choice reforms were:

- The idea that buying an annuity is always a poor choice
- The challenges of consolidation
- Explaining the tax liability of drawdown: including thresholds and lifetime limits
- The effects of inflation
- The potential pitfalls of withdrawing too much in one go

For instance, one existing drawdown customer was surprised to find that *“the pension we take out, (means) we are now 40% taxpayers”*, adding that it *“probably wasn't a good decision for us.”* A better understanding of their tax allowances, combined with spacing out tax-free-cash withdrawals over several years, could have left these savers with more spending money.

So it's important not to discount options too early, and to convey to members that their needs will change throughout the decumulation period, just as they did during accumulation. For example, **particularly after the age of 75, a guaranteed income could make sense for some members**, as part of their decumulation package.

And case studies of 'people like me', online tools, illustrative performance projections and fund information were all given by our respondents as examples of information to help reassure and equip non-advised consumers to make choices that work for them.

Doing extra for Gen Xers

Five years on, we are still only partway towards ensuring the Freedom and Choice reforms fulfil their promise for this generation of retirees-to-be. It's certainly welcome that members have more flexibility, and tax-free cash is a well-known and well-used feature. The key will be helping savers capitalise on these benefits as they enter drawdown, rather than leaving them mired in a consumer's dilemma where more freedom to choose actually leads to more confusion.

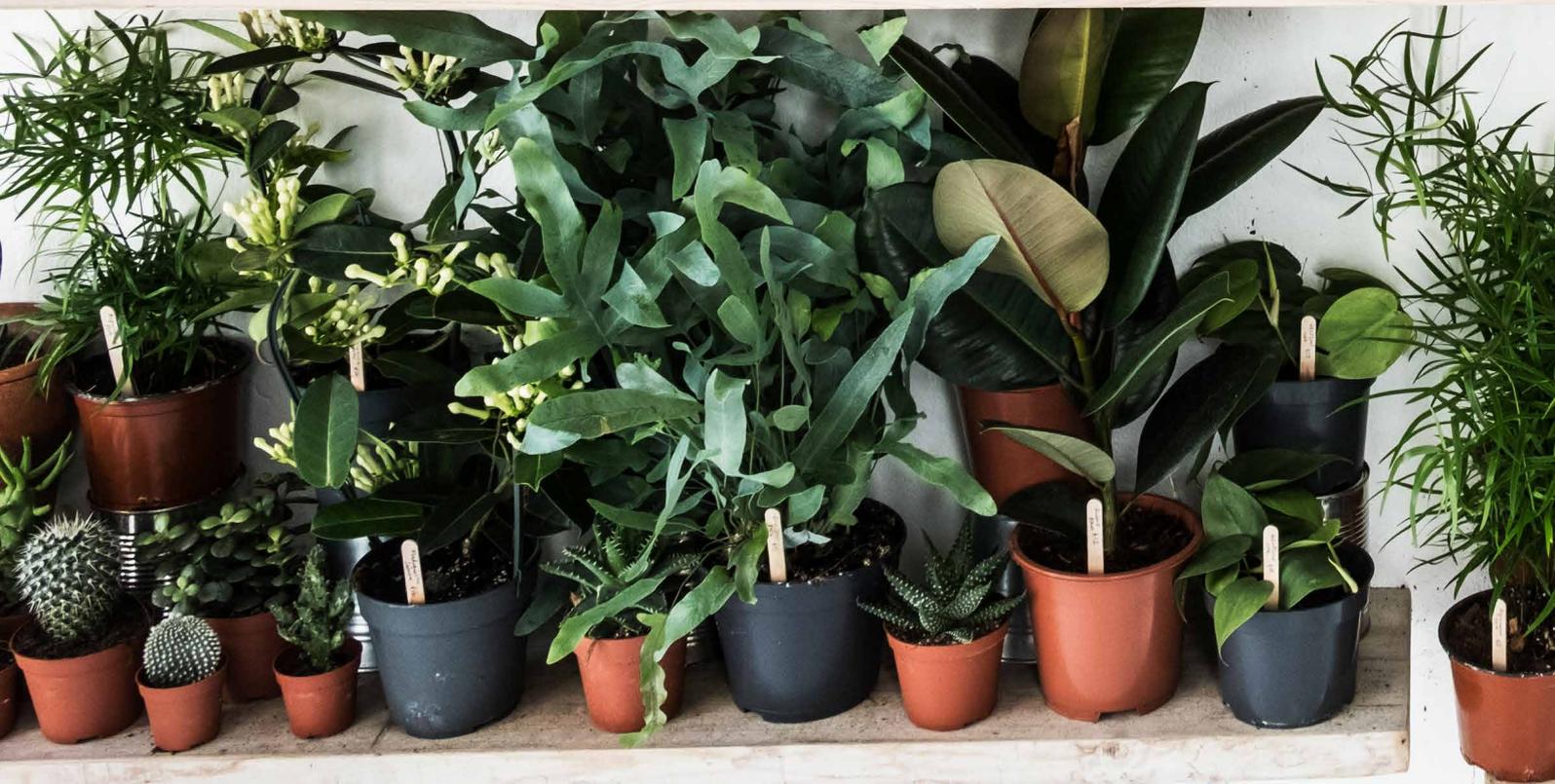
For Generation X, a mistrust of financial advisers has combined with a lack of understanding about pensions, general risk aversion and the fear of not having enough in retirement. This makes it all the more important that these members have access to simple, easy and accessible default funds which meet their needs while potential risks and rewards are communicated in clear language. And there is a need for more relatable communications which engage members earlier on and throughout their accumulation journey, whether that's online or through more traditional media. Savers' increased reliance upon them means providers and regulators play an important role breaking down long-held preconceptions, be they about tax-free cash or annuities.

The Financial Conduct Authority has taken significant steps towards this with its Investment Pathway default fund solutions. We welcome this as a way of personalising the retirement journey for each saver's unique circumstance, as well as giving them the flexibility to alter their investments as their circumstances change. But what did our group of members think? Read the second part of this article series to find out.





It's important that members have access to simple, easy and accessible funds while risks and rewards are communicated in clear language





Contact us

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