Master trust savers need a retirement support system, not just a drawdown option

The support that master trusts offer to members after they retire will become a crucial differentiator in the near future

Anyone who has ever attempted an endurance event, from a weekly Parkrun to my own personal favourite, a triathlon, will appreciate the importance of pacing. Start too quickly and you will have nothing left later in the race. Fail to manage your nutrition and hydration needs and you will struggle to keep energy levels up.

Managing defined contribution (DC) pension spending throughout retirement presents similar challenges. Members need to pace their spending, have access to suitable guidance and tools to sustain them, and put available funds to the best use across their long, and hopefully enjoyable, years of retirement.

Until recently, managing DC funds post-retirement was tomorrow's problem. Many retirees had defined benefit (DB) funds providing core retirement income. DC pots were mostly small and as a result many members opted to take them as cash.

Now, post-retirement is becoming a much more significant challenge for members and schemes alike. Members who retire in the coming years will have most, if not all, of their savings in DC schemes. The growing value of assets under management in DC schemes pays testament to this; The Pensions Regulator estimates that within the next 15 years, the value of DC assets will overtake those of DB assets and much of that growth will be in master trusts. At some point, individual members will need to rely on DC funds to sustain them through their later life. Is the master trust industry ready to support this?

From at retirement, to post-retirement

Employers, schemes and the wider pensions industry have already started to put more emphasis on support for members in the lead-up to retirement. Mid-life MOTs, signposting to guidance services such as PensionWise, and apps that help members frame pension savings as a standard of living in retirement, are some of the ways that schemes are responding.

We have also seen schemes become more proactive in offering at-retirement options. Aon's *2022 DC Pension Scheme and Financial Wellbeing Survey* found that two-thirds of schemes now offer some form of access, either direct or indirect, to a drawdown solution – double the number that were doing so in 2020.

Despite this progress, you could still be forgiven for thinking that retirement is a one-off event. To date, there has been little focus on helping members manage their money over the 20 to 30 years that they may spend in retirement. And between the ages of, say, 65 and 85, people's health, wealth and personal circumstances typically change radically. A decision that was appropriate at the point of retirement may need careful rethinking 10 or 20 years later.

Many members need help. Recent research from insurer LV found that 58 per cent of working adults say they do not know how to ensure that they will not run out of money in retirement, and data from the Financial Conduct Authority found that in 2021/22, 40 per cent of members took annual drawdown from their pensions at a rate of over 8 per cent. This is double the 4 per cent figure that is typically used as a benchmark for sustainable drawdown. This shows how master trusts must do more to help members, not just before and at retirement, but also throughout their later lives.

Innovative thinking for post-retirement

The good news is that the pensions industry is starting to respond to this challenge. The Pensions and Lifetime Savings Association's (PLSA) 2021 *Guided Retirement Income Choices* proposal included a framework of three elements to support DC savers in retirement: better engagement and guidance for members; improved decumulation solution design (including fixed and flexible income) and good governance to help schemes deliver guidance and better solutions for all savers.

Its 2022 follow-up, *Retirement Choices: The Evolution of Products and Support,* noted some schemes are considering options, such as blended retirement solutions, combining flexible drawdown early on in retirement with the certainty of consistent income from an annuity in later life.

According to the Pensions Policy Institute, annuity purchases have declined among younger retirees, but increased among those over the age of 75. This implies that savers seek the security of a consistent income as they get older but may want to retain more flexibility while they are younger.

However, these figures reflect the behaviours of older, potentially more

sophisticated savers who are also likely to be receiving DB pensions. We have yet to see how retirees dependent on DC will manage the balance between drawdown and annuities through retirement, potentially with little investment knowledge and limited access to financial advice. This new generation of DC retirees will need to rely on their scheme for ongoing support with decision-making and money management.

Retirement support systems for DC savers

To support those needs, master trusts need to offer broad retirement support systems, bringing together appropriate retirement products and income solutions, improved investment options, guidance on how to monitor money in retirement, and digital tools enabling members to take control of their own finances.

Here are four priorities to help build better retirement support systems:

Continue to find new ways to help members mix annuities and drawdown. There are many different theories about the optimal balance of certainty (annuities) and flexibility (drawdown) that savers need and how to package them to be manageable and affordable for members. The key is to provide access to all benefit options alongside the right support to ensure the right blend for individual members' own situations.

Create more flexible investment solutions. Post-retirement, members still need to plan for the short, medium and long term. Being able to split assets into two or three accounts within a single pot, based on day-to-day income needs, emergency savings and long-term investments to cover care or inheritance, could help members plan for the future and clarify how much money they can spend day to day. Further, as the rules around collective defined contribution (CDC) take shape and providers draw on the experiences of early adopters such as Royal Mail, this structure could open up innovative opportunities for alternatives to traditional drawdown and annuity purchase.

Improve financial wellbeing support. Good financial wellbeing habits, such as tracking spending and sticking to budgets, are just as important in retirement as in working life. Offering digital money management tools and information, both pre- and post-retirement, helps members improve their money management. Tools to help manage drawdown and keep withdrawals at an appropriate level are vital for retired members. Additional services, such as helping members make their money go further with everyday product discounts, also help. Good quality communications remain as important as ever – these should include seminars or webinars, annual statements with an estimate of how long current income might last, as well as prompts to reconsider options such as annuities.

Link everything together. Most retiring members will have built up workplace pensions in several different schemes, plus in other savings vehicles such as ISAs. By linking together pension schemes, bank accounts, savings accounts and other financial products through a single online dashboard, members can keep control of all their finances and plan more effectively for the long term.

Enabling members to support themselves financially through retirement is the reason that pensions exist. As DC pensions, and particularly master trusts, become the dominant source of retirement income, it is crucial that we put systems in place now for everyone to enjoy the best possible standard of living their savings can offer, throughout their retired life. Comprehensive, easy to manage post-retirement products, guidance and investment options are set to become a major differentiator both for master trusts and other types of DC scheme.

To find out more about the Aon Mastertrust contact us at talktous@aon.com.

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