Pension income: Why drawing down is going up

With over £100bn of defined contribution (DC) assets under management, Legal & General' is the largest DC pension provider in the UK. We conducted a five-year study on our members' retirement choices during the period 2015-2019.[1] Below, we look at the developing trends for members selecting income drawdown.

With 60 being the new 40, savers' active years are far from over when they give up work – for some, life becomes even more frenetic. In recent years, retirees have increasingly turned to income drawdown to help fund the lifestyle they want. 2015's 'freedom and choice' reforms and the Financial Conduct Authority's (FCA) Investment Pathways initiative only underline the importance of getting scheme members' investments right as they pass this milestone and think about how they are going to fund their day-to-day living costs.

But with terms like 'zombie drawdown' starting to be heard, it's clear that greater numbers of members choosing to take an income hasn't necessarily equated to wiser decision-making. Members risk sleep-walking into investment solutions which may not support their desired outcomes after retirement.

So, in our member research, we sought to find out who opts for income drawdown, how much they choose to withdraw and how sustainable this is proving to be, post-retirement. We also investigated what can be done to support members as they make drawdown decisions.

1. The number of members whose choices were reviewed in the study was 16,000 in 2015, 23,000 in 2016, 29,000 in 2017, 42.000 in 2018 and 53,000 in 2019 (rounded to the nearest thousand).

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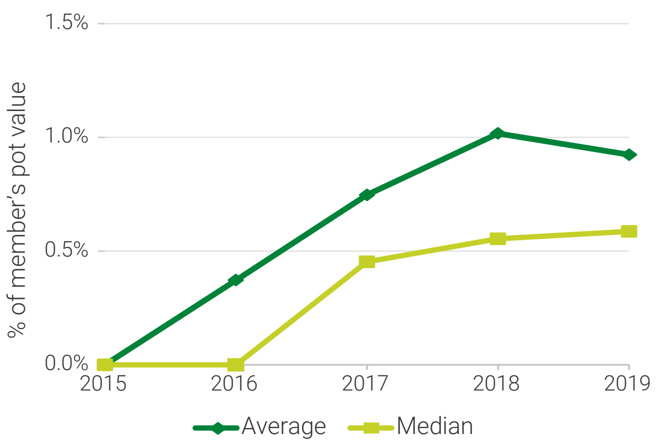
More money, fewer problems

The proportion of our members choosing income drawdown at retirement is still small. However, for those members regularly taking income,[2] the average amount withdrawn each time has increased over the five-year period to just less than 1% of their pot's overall value. These payments are taken frequently, on average every month.

Regular withdrawals are getting bigger



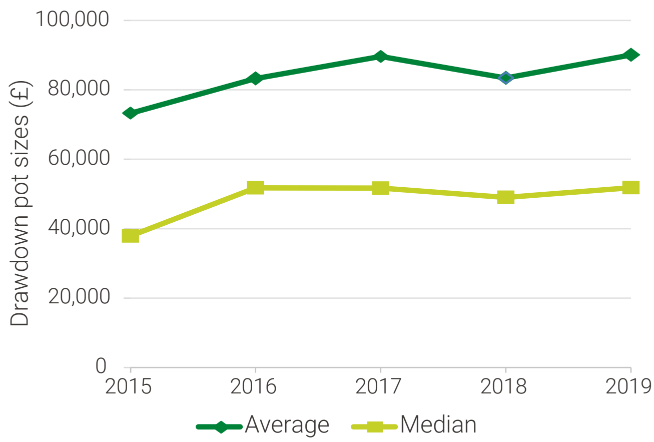
Source: LGIM

Determining a sustainable level of income and how often to withdraw remains a major challenge. The PLSA estimate in their Retirement Living Standards that the average single retiree living in London needs a yearly income of at least £12,400 (including state pension) to cover basic costs. This rises to £36,300 if the saver anticipates living a 'comfortable' lifestyle.

When we narrowed our focus to members with pots of over £150,000 at retirement, the number choosing to draw down increases to nearly one in three.[3]

While it may be expected that those with fuller pots would be more likely to draw an income, what's encouraging is that pot sizes across the board are likely set to increase. The majority of our members (around 60%) currently have pot sizes of between £30,000 and £150,000, but over the last five years, the average drawdown pot has increased by £20,000, with this trend likely to stay as the transition from defined benefit (DB) retirement provision continues.

The average drawdown pot has gained £20,000 over five years



Source: LGIM

Attack of the zombies

Most members who currently choose drawdown do not take a regular income, however. Roughly 65% of members still only take one or two payments before their pot is emptied, with members of all pot sizes accessing a portion as tax-free cash (usually the full 25%) prior to taking regular withdrawals.

A worrying trend is that many members enter so-called 'zombie' drawdown. These members begin the decumulation phase at aged 55 in order to access their tax-free cash and end up being automatically placed in an investment solution where one size definitely doesn't fit all.

Those entering non-advised drawdown risk an investment mismatch with their later-life goals, and ultimately, face running out of money later on in retirement.

It seems we are still some way from all members who choose drawdown at retirement becoming self-sufficient throughout their retirement years. This highlights the importance of providers and trustees engaging members with their pension savings as early as possible.

The FCA has recently released guidelines to tackle this issue, with the aim of helping a large swathe of members make more educated choices about how their pension continues to be invested post-retirement. These are set to come into place for providers from February 2021.

2. We define 'regular' as having withdrawn 12 times or more.
3. The number of members whose choices were reviewed in the study with pots of over £150,000 was 500 in 2015, 1,000 in 2016, 1,000 in 2017, 1,000 in 2018 and 2,000 in 2019 (rounded to the nearest thousand).

Sustainable drawdown and flexible support are key

The challenge of offering members a personalised decumulation experience, while retaining the ease and comfort of a default, will define future pension provision.

And while no catch-all solution will address every member's personal reasons for choosing drawdown, the theme is alive and well.

In the coming years, we expect to see a dwindling, but significant number of people retiring with pots that are too small to live off comfortably. It is incumbent upon providers and trustees to help ensure that they are in investment solutions which support their retirement ambitions.

It is also important to help members consolidate their pots at retirement or before. One of the current curses of the industry is that members are building up lots of small pots with different employers and providers, so it is hard to for them to get a full picture of what they could get at retirement. The Pensions Dashboard will be an important step in helping members see the value of their overall pension savings.

Furthermore, framing the decisions that members need to make in terms of retirement outcomes that make sense to them is a huge leap forward, and we are extremely supportive of the PLSA's efforts in this area. Retirement planning tools can help members assess the financial and wellbeing trade-off to work out how much income they need each month to live the life they want, against different economic scenarios.

And, as the DC pensions market continues to develop (and pots continue to grow), we expect income drawdown to become an ever more popular choice at retirement.

Contact us

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