A retirement income blueprint for NEST's members

Introduction

There is a wealth of evidence to indicate that large proportions of automatically enrolled savers in the UK want and expect straightforward solutions when accessing their retirement savings.

Insight gathered through NEST's retirement solutions consultation process suggests inertia and a lack of confidence in constructing retirement portfolios are likely to be powerful drivers for members at retirement, just as they are when they build up their savings.

An ability to self-select different retirement paths and products will remain an important feature for some. However, NEST's research confirms behavioural finance theory that individuals being able to access choice is important to their retaining a sense of control, even if these choices are rarely used. This is also in line with how savers around the world respond to investment fund choice as they build up their pots. They wouldn't want to be forced to save in the default, but most are happy to stay once they are in.

For a large proportion of savers, constructing a decumulation strategy that manages their own longevity, inflation and market risk is likely to be extremely challenging. There is a consumer expectation straightforward products that do this for them should be available.

In February 2015, based on our consultation findings, NEST published the design principles for core retirement income products.

The eight[1] principles are:
1. Living longer than expected and running out of money is the key risk in retirement and a critical input into retirement income solutions.
2. Savers should expect to spend most or all their pension pots during their retirement
3. Income should be stable and sustainable
4. Managing investment risk is crucial as volatility can be especially harmful in income drawdown-type arrangements
5. Providers should look to offer flexibility and portability wherever possible
6. Inflation risk should be managed but not necessarily hedged
7. That the governance body should determine on a regular basis the sustainable income levels so members do not need to take advice
8. The product should deliver value for money (at preferably low cost).

NEST's analysis has provided a deep understanding of what the new generation of defined contribution savers want. It has also clarified how products of the future should be designed, bearing in mind that savers often have competing needs and preferences.

The NEST core retirement income strategy

NEST has designed a blueprint for a core retirement income strategy it believes would best meet the longer-term needs of a large proportion automatically enrolled savers.

NEST's proposed 'core strategy' could be considered as the equivalent to default strategies during the accumulation phase, but with one key difference: savers have to engage when they come to take their money out. They need to tell their schemes when they want to start accessing their savings and where they want the income to be paid into.

[1] Originally there were six principles…we have subsequently added 7 and 8.

NEST is calling this a ‘blueprint’ core strategy as it is a broad specification for something the evidence suggests understood would meet members’ needs. Strategies consisting of all the features set out in the blueprint are not currently available off-the-shelf in the UK for savers/retirees.

By sharing the blueprint NEST is looking to the market to respond with innovation, in particular in delivering the later life protected income element of the product, which is described below.

What makes up the core strategy blueprint?

The blueprint strategy comprises three building blocks:

1. an income drawdown fund
2. a cash lump sum fund
3. later life protected income

How would the blueprint work for members?

The blueprint strategy is designed to provide the member with a sustainable income for life.

When a member approaches retirement, an initial option would be to access a core strategy such as the blueprint. This strategy aims to increase retirement income in line with inflation up until age 85, though this would not be guaranteed. From age 85 onwards, the member’s income remains level. At this point it is guaranteed to never run out.

The member also has access to a fund that they can dip into for ad hoc cash lump sums. This provides for unexpected expenses without interfering with their sustainable regular income.

A key feature of the entire strategy is that the member would have the reassurance they can change their mind and take all of their remaining money somewhere else if they want to.

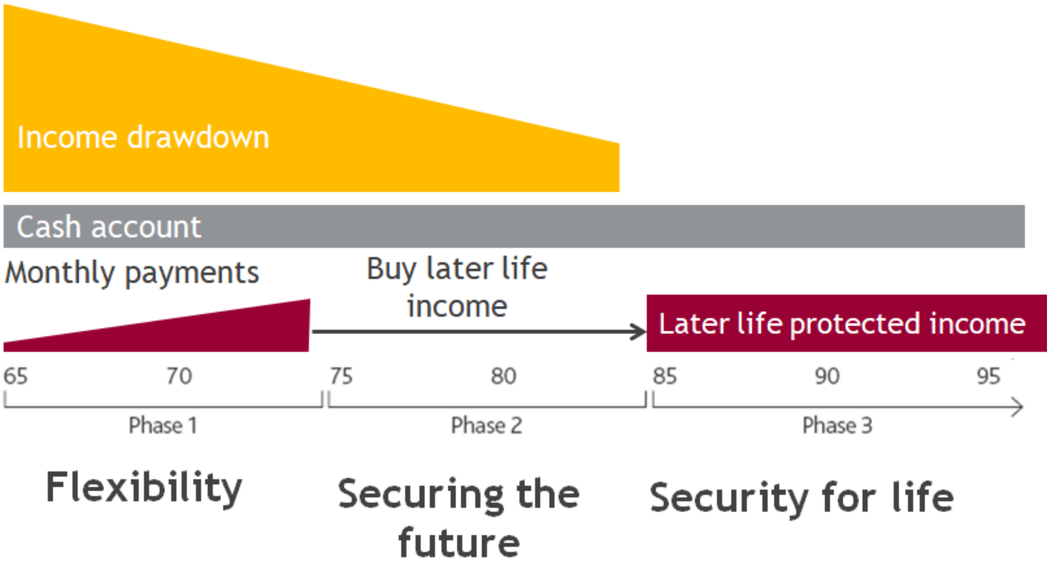
Any money in the strategy before the member is 75 can be passed on. Beyond age 75, a small portion of their assets are locked away to provide for later life income.

How the blueprint would work ‘under the hood’

- At age 65 around 90 per cent of the member’s pot would be allocated to an income-generating investment portfolio. Each month from then on an income would be paid out from this pot. In most scenarios this income would increase year on year in line with inflation[2]. Before age 85 the member can take this money out if they change their mind or the money can be passed on should they die. If there is extra money above what is needed to pay the member’s expected income level, this will be transferred into the cash lump sum fund for a member to spend as they please.
- The 10 per cent of the member’s pot that is not allocated to the main portfolio is set aside in cash-like investments so as to be accessed on request at any point in retirement. This is the cash lump sum building block.

[2] Since publishing our research we are re-examining the need for inflation linking given the expected pattern of retirement spending.

Fig 1. The blueprint – under the hood



- From age 65 to 75, each month a payment is taken towards building up a later life protected income. This is in addition to charges. NEST expects this amount to be between 1.5 and 2 per cent of the pot each year. The payments towards later life protected income would be allocated to a different portfolio that would be used to obtain that income. Importantly, before the member is 75, the member can still get this money back should they change their mind. Should they die, then this money can be passed on. After age 75, the payments towards later life secure income are locked into a mortality pool. From age 85 this building block pays income to the member.

Further blueprint design points	
Minimum pot size	Depends on the individual, but could work and there is likely to be demand from £20k plus
AMC	Not known currently, but would need to represent a low-charge offer to be appropriate for NEST
Level of income	Not known currently, but around 4 per cent is a reasonable assumption taken together with other benefits of product
Investment portfolio	Likely mix of bonds, equities and property, possibly with a volatility management overlay or other risk management strategy