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Retirement income defaults: What it means for trustees

027 could herald a sea change in how DC members take their retirement benefits. If the Pension Schemes Bill passes swiftly through parliament in its current form, it will introduce a requirement for all trust-based schemes to offer their members a "default pension benefit solution" that provides a regular income in retirement. This will shift a lot of the onus of

deciding how to 'do retirement' from the individual member to trustees.

So how can trustees approach the concept of a retirement income default, and what are the key things to keep in mind?

Defaults in retirement: A different challenge

The concept of a retirement default is more nuanced than the default investment solutions used in the savings phase. While saving for retirement, the vast majority of people have a common aim: to grow their savings cost-effectively. It's therefore relatively straightforward to offer one solution designed to meet that objective.

At retirement, however, people have a range of individual needs as well as significant differences in their wider financial circumstances. For example, Standard Life research found that:

- More than a quarter of people (28 per cent) expect to use non-pension savings as part of their retirement income
- One in seven people anticipate using an inheritance for their retirement income, despite the risks around the amount and timing of such windfalls
- More than a third (38 per cent) of Gen X homeowners view property as their main retirement asset

This makes it very hard to design one solution that is suitable for all.

We can tackle this challenge by separating out the different retirement objectives that people may have. Despite the wide variances in people's circumstances, in almost all cases people's requirements can be met through a combination of:

- Guaranteed income
- Regular drawdown income
- Ad-hoc or 'lumpy' drawdown
- Immediate cash withdrawal



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We can therefore design default retirement solutions by separating the 'default' into two stages.

Firstly, a default decision framework with:

- Pre-set structures for how an individual may wish to set up their retirement
- Different options for cohorts of members with distinct characteristics for example, a cohort with relatively low need for additional guaranteed income to cover essential spending needs might have a profile allocating 20 per cent to guaranteed income, and 80 per cent to regular drawdown
- High quality, behaviourally aligned decision journeys to help people understand whether the default structure is right for them

And secondly, default options for putting each element into practice:

- Default investment solutions to deliver the drawdown elements (whether regular or ad-hoc)
- A supported process to enable the individual to secure the best whole-of-market annuity for their guaranteed

income

• Seamless processes to deliver cash withdrawals

The engagement challenge

This structure can be used to offer a 'true' default, where the individual doesn't need to make a decision other than when to begin drawing their benefits. It is clear, however, that this would be a relatively limited solution, and particularly difficult in the context of purchasing any element of annuity.

It is equally apparent that most individuals will

receive a better solution if they are willing to engage to some extent with a decisionmaking process. There are encouraging reasons to think that this will be possible:

- 1. People are naturally engaged at the point of retirement decision-making they have an immediate goal (getting their money) and will put effort in to making it happen in a way they simply aren't during the savings phase when retirement feels like a distant challenge.
- 2. The default structure allows individuals to focus their input on factual information that they know about themselves, rather than asking them to make decisions they do not feel equipped to make. For example, offering a pre-designed structure for their retirement and asking them to consider whether it looks appropriate for what they want is very different – and much preferable for most people - to asking someone to work out, from scratch, what they think the structure should be for their own individual circumstances. Equally, suggesting that a particular amount of annuity is appropriate and then asking for input to shape and more accurately price the annuity is likely to be something most people can engage with.

Designing a default decision framework

Finally then, how do you decide what combinations of solutions should be offered to which group of members?

Our philosophy is to help people build up their retirement by considering their essential spending needs first. Do they have sufficient guaranteed income to cover those – for example, through their state pension or any defined benefit pensions they may have? If not, their DC savings can be used to purchase an annuity to 'top up' their guaranteed income.

Any DC savings left can be used to fund more discretionary spending through either regular or ad-hoc drawdown.

This is where our Mixed Income Builder, a retirement income planning tool, may help – by allowing individuals to balance guaranteed income with flexible withdrawals from their pension savings.

The Mixed Income Builder allows users to explore a combination of guaranteed income options, such as annuities, alongside flexible withdrawal strategies from their pension pots. This tool aims to provide a balanced approach to retirement planning and addresses the common desire for both security and flexibility among retirees – a growing trend in retirement planning.

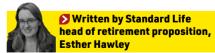
Building on this philosophy, we can design default options offering different balances of guaranteed versus flexible income for different groups of members at retirement.

A worthwhile challenge

It's clear that there is much work to do to put in place default retirement income options for members, but the challenge is worthwhile. Standard Life research shows that:

- Two-thirds of people (66 per cent) do not seek professional financial advice before accessing their pension
- A quarter (24 per cent) worry whether they have enough to live comfortably, while one in ten (11 per cent) regret the timing of their income decisions

By providing clearer and simpler ways of helping people access regular income in retirement, default retirement income options could go a long way to alleviating the pressure people feel around making their retirement decisions.



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