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Illuminate roundtable report

Retirement income

Are we ready for drawdown as the new normal?

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The panel

Illuminate hosted a roundtable debate in June to discuss retirement income and whether we are ready for drawdown as the new normal. The panel was chaired by Natalie Holt, content editor at Nucleus. The panellists were:

Natalie Holt

Content editor, Nucleus

Michelle Cracknell

Chief executive,
The Pensions Advisory Service

Abraham Okusanya

Director, Finalytiq

Richard Parkin

Independent consultant

Rachel Vahey

Product technical manager,
Nucleus

Andrew Pennie

Marketing director,
Intelligent Pensions

1. Introduction

How can financial planners and the pensions industry support clients in delivering the retirement income they need?

It's a question that is increasingly being asked, as drawdown becomes more popular and as annuities seem to be locked in an inevitable death spiral.

Drawdown used to be the preserve of a narrower set of people, perhaps with multiple pension pots, who had ready access to the advice to navigate what is an inherently complicated market. But the dawn of pension freedoms has turned that on its head, with more consumers looking to drawdown to flex their income in retirement.

So the next question becomes, if drawdown is becoming 'the new normal', are we ready for this? Do we need to start having earlier, better conversations with clients about the complex decisions that drawdown involves? Should defaults be used in some way to nudge and help people to manage their retirement income needs, and could defaults potentially have a role as a gateway to advice?

Our panel sought to tackle these issues and explore how retirement planning needs to evolve.

Natalie Holt
Content editor, Nucleus

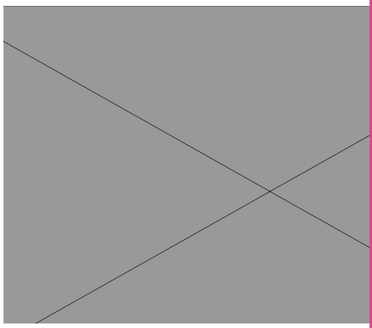
2. Coping with demand

As drawdown has become more popular post-pension freedoms, advisers and the pensions industry have been forced to try and keep pace with the increase in demand.

According to the FCA, more people are moving into drawdown than before the reforms, with twice as many pots used for drawdown than to buy an annuity since April 2015. What's more, different types of people are accessing drawdown than previously.

Intelligent Pensions marketing director Andrew Pennie said he was concerned about those with smaller pots who want to access drawdown but can't afford advice.

The Pensions Advisory Service chief executive Michelle Cracknell pointed out that the difficulty is people are entering into drawdown without understanding all the implications.



He said: "The one thing we've perhaps lost sight of is that drawdown is complicated. It's not easy to get right and it's a changing feast. So while I think advisers are geared to cope with the increased demand, they're geared up to do it for a particular market.

"There are some worrying trends in what's happening with people using drawdown, and their understanding. Fortunately, we're seeing that 70 per cent of people get advice on drawdown, and they're going to be well catered for and well serviced. It's the 30 per cent that aren't getting advice who are really open to scams and to making mistakes. Unfortunately, that's going to end up with people running out of money."

She said: "With pension freedoms people are looking to access their pot. They don't want an annuity, for no other reason than they've heard it's bad, so they don't even consider it, it's off the table.

"One of the things we quite often say to people is: 'Where are you going to invest your money?" And the reply is: 'Oh, I hadn't thought of that'. They're really just using drawdown as a facilitator to access a cash sum, and haven't really thought about the tax implications between the different types of drawdown. They also don't give thought to the long-term position, around 'What am I going to do with my fund?' 'How am I going to draw it down?' And most importantly: 'Where am I going to invest it?'"

Nucleus product technical manager Rachel Vahey argued it is difficult to shape policy for the evolving drawdown market because everyone's individual retirement decisions are different.

She said: "We are looking at different cohorts coming up to retirement, and they have different needs, different circumstances and different backgrounds. We are also seeing the reduction of the defined benefit pension scheme being the mainstay. That obviously puts a different pressure on what the defined contribution pot has got to do for a person.

"There are so many different circumstances and so many different situations – it's very difficult to design one policy that fits all for the next 20 years. Unfortunately, to some degree that's what we're trying to do, and I just don't think it's feasible."

3. Protecting savers

Alongside the concerns raised about non-advised drawdown, Michelle said there was also an emerging issue around the wave of pensions that are being passed on to others on death.

She said: "The secondary worry we have is someone might have gone into a drawdown product and be capable of managing it, but what happens when they die? Who's going to pick up the pieces if it's then being inherited by somebody else? We see this all the time with the phone calls we receive, of people not understanding the retirement product they've got, or the product they've inherited because their husband or wife has died.

"It's not just simply a case of sending out letters and telling customers about drawdown, because customers have got to be listening, and I don't think customers know what they should be listening for."

Independent consultant Richard Parkin agreed there was an issue around disclosure from pension firms not working effectively. He said this was backed up by the FCA's own work into non-advised drawdown, which found that providers were complying with disclosure rules but customers weren't listening.

He said: "What this shows is that disclosure, in terms of sending people bits of paper, isn't going to work, so we've got to find a new way of achieving this."

Part of the challenge in protecting clients in retirement is safeguarding them from running out of money, while also ensuring they aren't being overly cautious with their pension pot.

Of course, you can't have a discussion about retirement income without talking about withdrawal rates. On this point, Andrew said he was worried about what trends in the FCA's retirement income data are telling us.

She said: "People discuss what the house down the road has sold for, and they should be discussing pension pots and how to start building them up. But actually, it's much more important to discuss how you're going to take your money, to be having that open and honest conversation with your peers, and get this into real life. That will start off the realisation for them that they don't know it all, and that's the key."

Rachel said better retirement outcomes would have to come from translating the complexity of drawdown, such as when people need retirement income and for how long, into everyday life.

He said: "The data shows that more than 50 per cent of people were taking more than 1 per cent a quarter. Now, we talk about the 4 per cent safe withdrawal rate, and that's kind of agreed that may not be valid anymore, but 50 per cent of people were taking more than that. So, these people aren't running into problems now, but they will do in three to five years' time.

"At what point do we stand up and say, 'Actually, this is a big problem here. People are getting this horribly wrong, and this is going to come back and bite us.'"

Michelle suggested as people aren't going to understand the issues related to drawdown and managing retirement income at the outset, there could be a role for some sort of "pre-emptive action", perhaps a safety video that people need to watch when they are considering going into drawdown. She warned if this kind of intervention wasn't made, the risk was that people would end up "flying without a parachute".

Finalytiq director Abraham Okusanya agreed, and took the idea one step further. He said: "This is the question I asked the Association of British Insurers when they had the misfortune of asking me to speak at an event. I said to them: 'What's the equivalent of your five a day for drawdown advice? What are the things that we universally agree on – the five things that have to be in place when you're going into drawdown?' But providers are nervous of doing this for fear of straying into guidance or advice.

"I can't understand why we can't come up with very simple rules, like keep costs low, have a reasonable default investment strategy and a reasonable withdrawal rate. The broad guidance that someone needs to get started, that is, if you're going to go into drawdown here are the five things you absolutely have to think about."

Abraham added the post-freedoms world where drawdown is more commonplace also required a new way of thinking when it comes to asset allocation in retirement. He discussed how the traditional idea that people at or near retirement should move into defensive assets just doesn't hold up anymore.

Richard supported this argument. He said: "The real challenge of drawdown for advisers is you move from a world of accumulation where you're largely focusing on risk in terms of investment volatility, to a world where you've got two dimensions of risk, which is the investment volatility on the one hand and then the impact of the withdrawal rate on the other. It's understanding how those two operate together."

He added: "That's where you need to look at things like equity release and other options. Without that backstop, you're just going to end up being overly cautious and denying people the retirement they've saved so hard for."

Rachel emphasised the importance of reviews for advised clients in drawdown, and argued the focus should be less on sustainable or safe withdrawal rates.

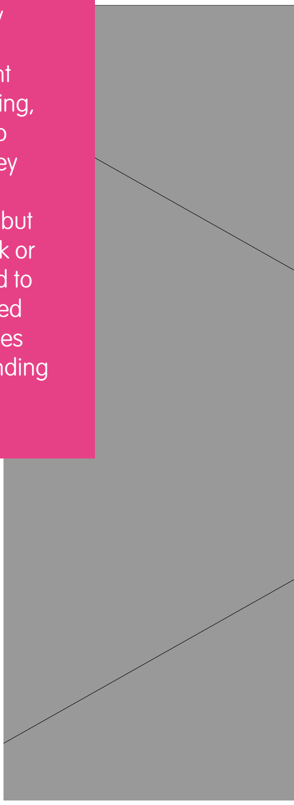
She said: "Retirement income may be a 35 or 40-year problem that people are going to have, and trying to set a policy on day one, I find that really quite frightening. The more I look at it, the more I think there is no silver bullet, there is no safe withdrawal rate. People aren't going to take 3.5 per cent or 4 per cent and take that exact amount for the rest of their life. That's the whole point of drawdown – you get less money, then more money, then less, according to what you need.

"So the idea behind it all is reviewing. Review, review, review, that's the whole secret. Clients have to adjust for what life throws at them."

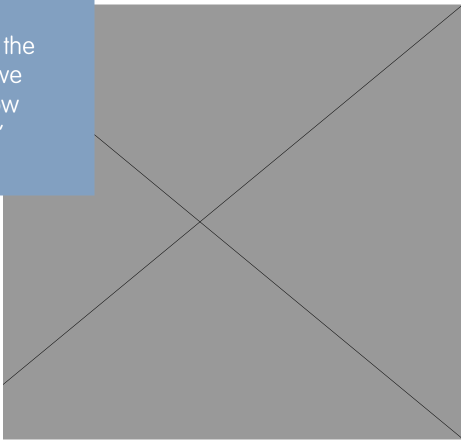
4. Adviser capacity and client input

Yet if client reviews are at the heart of a robust drawdown strategy, this raises the question of whether advisers are prepared to take on this additional workload.

Andrew said: "The feedback we get from our client surveys every time is that they've gained an understanding of their retirement model and the cashflow modelling, that's the bit that makes sense to them. Once they've seen that they can engage with it. The words around it might be challenging, but seeing whether they are on track or not, and whether they can afford to spend more or whether they need to cut back a bit, that's what drives our engagement and understanding with the client."



Richard said: "One of the things that certainly is being talked about a lot is not just the capacity to deal with drawdown now, but how much review work is being built up for the future, and whether advisers have really got their heads around how much they're actually taking on."



Andrew said Intelligent Pensions' experience is that drawdown advice is becoming a fluid process, with relationships being formed with clients' beneficiaries.

Intelligent Pensions carries out annual reviews for its drawdown clients, with investments tracked quarterly. Andrew estimates the firm has around 1,800 clients in drawdown.

Michelle argued the adviser/client relationship is key in managing drawdown effectively, and said advisers need to rely on the client investing time into the process as well as their money.

She said clients should understand what drawdown involves, with their adviser explaining that "unless you're prepared to spend this amount of hours looking at your drawdown, it's not the right product for you."

One experience when she was an adviser typifies this point for her: "A client came in for the annual meeting and he turned to me and said: 'Michelle, I'm done. You're a lovely person, but I don't want to be coming up to London every day, I want to be with the grandchildren. Sell everything and buy me an annuity.'

"That was a client who really knew what drawdown was about. I don't think enough clients make that call that they've had enough of reviewing their drawdown. An adviser can't do it by themselves, and the investments can't work unless they adviser has got that client input."

5. The role of defaults

The complex decisions that drawdown involves has led to a conversation among policymakers about whether defaults could be used to help people with those retirement decisions.

In April the Work and Pensions Committee called for default drawdown, where those who haven't made an active choice on investing or spending their pension pot would move into a regulated default product.

In the FCA's Retirement Outcomes Review final report, published in June, the regulator said it is considering requiring providers to offer ready-made drawdown investment solutions, what it calls 'investment pathways'.

Panellists tended to side with the FCA on this. Rachel said on the surface the Work and Pensions Committee's proposal around defaults made sense, but she went on to question how this would fit with the advice process.

Rachel added: "At the moment, 70 per cent of people in drawdown are advised. They have got that advice and support, so they should not be defaulted into anything because they have their adviser there to help them pick the right investment strategy. Default drawdown seems like quite an easy answer, but we need more deep thinking around this."

She said: "I can understand why the conversation has turned to having a default which works, and I understand why we have got to that point. I'm not entirely sure it's the right one though because I just don't think it works in the context of 20 to 25 years. I'm not sure that people just being defaulted into drawdown is the right response. They need to have that active conversation."

Richard agreed, though he said he could see a good argument for the FCA's investment pathways idea, given the range of drawdown customers' needs.

He said: "I always talk about there being three or four different types of drawdown investors: you've got the guys who want to get their money out quickly, and for them some sort of short-term cash investment's going to be right. You've got those who want to leave money behind for the next generation, so they're more growth orientated. Then in the middle you've got either people who are taking ad-hoc lump sums or those who are actually trying to create sustainable income, and they need a mixture of growth but also some sort of volatility management.

"You've still got to get people to understand what it is they want, and defaulting people into one of those buckets is just not the right way to go."

He added: "This is how we got here in the first place, because we were just chucking people into annuities and that probably wasn't the right thing for them, and on top of that, they weren't always getting the best value. To go back to that with drawdown, I think, would just make the problem far worse than it was before."

6. Breaking down barriers

Michelle believes we need to engage with people at an earlier stage, to get them thinking about what drawdown involves.

In her experience, once customers receive their wake-up pack, or equally when they request a defined benefit transfer value, they see the headline number and have almost spent it already.

Michelle said: "I would like to see some things explained before they get that pack. We should try and break down some of the barriers, and some of the preconceived ideas consumers currently have, like: 'Annuities are bad. Drawdown is good. It all happens for me, the money doesn't have to be invested, or advice is expensive'.

"These are the preconceived ideas that we hear, and before somebody gets their pack someone should go through it with them to say: 'Actually, none of that's true. This is the reality.'"

Andrew emphasised the need for more effective engagement, and for a better connection between the workplace pension and advice.

He said: "The big problem the pensions industry and employers have is they are the ones that have got everyone up to this point where they're ready to take their benefits, but they just don't know their members. They don't know the people they're engaging with, and because of that they have to communicate every single option on the table. Hence the reason wake-up packs are ridiculously big, and why people don't get past the first few pages."

So while politicians are keen on default drawdown, our panellists largely agreed it wasn't the way forward. Andrew argued no two drawdown plans should be the same. He said advisers, fund groups and pension providers are often guilty of "building boxes to put people in" and for drawdown that simply doesn't work.

He added: "Encouraging people to speak to The Pensions Advisory Service, for example, or to seek independent advice, have become throwaway lines. They sit on the back page of documents that people don't get to, and therefore it's not taken seriously. There is no impetus to try and change the dynamic between how people access that advice. That, for me, is the missing key in all of this: advice."

Rachel said she was also saddened there was no reference to access to advice in the FCA's Retirement Outcomes Review.

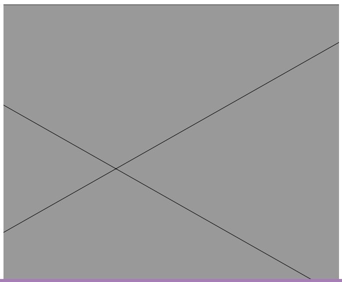
She said: "The best outcome is for people to have somebody there helping them constantly, over the next 20 to 30 years. If we can find a way of extending advice to drawdown customers then that's what we should be striving for."

Richard pointed out there were interesting parallels between what's going on in the wake of the British Steel pension transfer saga, where employers are realising that if they don't put something in place for their members those people may end up making bad decisions.

He said getting people to understand the value of advice was crucial. "There are some really interesting triage services that are coming out – short videos that explain the basics before you get into the numbers. It's that kind of thing that we need to promote."

But not everyone was convinced we should rule out the concept of defaults in drawdown completely.

Abraham argued that clearly in an ideal world everybody going into drawdown would receive advice, where people are informed about things like sequence of return risk, when to buy an annuity and would keep their situation under review.



He said: "But I don't know how we get there. So in the absence of that, the question I ask is: How much worse can having a default be compared with what we have right now?

"Some of the ideas coming from the auto-enrolment world are actually very good. For example, having some sort of independent board that assesses the outcome for members and tracks that regularly. I'm not naïve enough to think that would solve all of the problems, but I get to the point where I'm thinking great is the enemy of the good in this case."

7. Moving forward

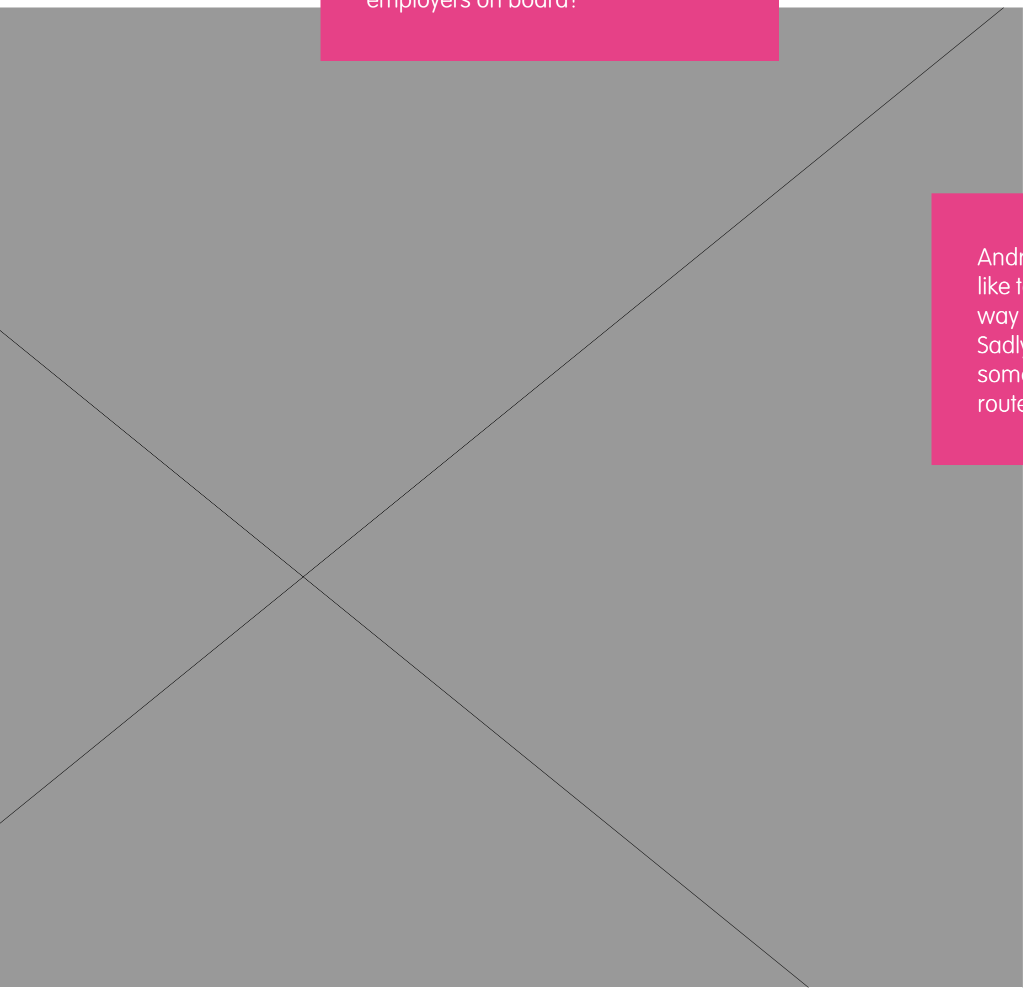
Richard said it was time to get creative when it comes to helping people make informed decisions about investing for retirement.

He said: "It's not a wake-up pack anymore, it's a wake-up journey. This is a very complicated process, so it's about using technology, probably getting people to watch video, plus using real people where you can, to build a much better journey, rather than just moving stuff around on bits of paper."

He said: "We see people who come to us at the point of taking benefits and they're usually holding the wrong assets to execute that strategy. So they're already in line for a poor outcome because of where they've been invested for the previous three or four years.

Andrew agreed, and returned to his central point about increasing the proportion of customers in drawdown who take advice.

"When you look at the FCA's retirement income data it's very clear those clients that are getting advice on drawdown have a better understanding, are getting better outcomes, they are in a safer place and have full regulatory protection. What's not to like about all those things? So why isn't the government, the regulator and the pensions industry out there shouting about that, and getting employers on board?"



Andrew added: "That's what I would like to see happen, but we're a long way away from that at the moment. Sadly, I think we're going to see some nasty car crashes along the route before that happens."

8. Conclusion

It's clear that since the introduction of pension freedoms over three years ago, drawdown has become an increasingly popular option for those in retirement.

Data from the FCA shows twice as many pension pots have been used for drawdown than to buy an annuity.

Financial planners have traditionally catered to drawdown clients in the context of a much smaller market. If they haven't done so already, advice firms will need to adapt their processes to reflect this increase in demand, and consider whether they have the capacity to carry out the extra review work that will be needed as a result.

Consumers need to be safeguarded in this new environment, both in terms of avoiding running out of money, but also giving people permission to live the retirement they've earned. Both may involve rethinking traditional approaches to retirement planning.

Default investment pathways may have a role in guiding people to better retirement outcomes. But the ultimate failsafe in getting people to make informed retirement decisions will always be advice – we need to work together to make that a reality for as many retirees as possible.

A huge thank you to all of our panellists in helping to shape an interesting and ongoing debate. Let us know if there's any topics you'd like to see covered in future illuminate pension roundtable debates.

You can watch the summary video of the discussion on our technical studio: illuminate.nucleusfinancial.com/technical-studio

9. Finding out more

Nucleus

Nucleus is an award-winning, adviser built wrap platform. Since launch we've established ourselves as a major force for change in the market. We're a thriving community of over 800 adviser businesses who currently manage over £14bn of client assets. For further details please go to www.nucleusfinancial.com.

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Can we help?

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