Summary

- Freedom and choice runs the 'risk of ruin' for people who withdraw funds in an ill-advised way, causing the money to run out too soon.
- To sustain an inflation-proof income throughout retirement, withdrawing around 3.5 per cent a year is recommended.
- The concern about widespread risk of ruin is made more acute by the lack of advised drawdown. The FCA found for the period October to December 2015, 32 per cent of reported drawdown sales were not associated with a regulated adviser.
- Providing a drawdown with guarantees may reduce the risk of the money running out. However, few providers offer this type of product currently, savers may be reluctant to pay for any kind of guarantee and advisers would be required to increase awareness of these products.

Too much, too soon?

The 'freedom and choice' reform was greeted positively by savers. But being free to do what they wish with their pension pot also means they are free to spend their savings too quickly or make investment mistakes. Gill Wadsworth explores how to prevent the money running out

The advent of freedom and choice created something of a paradox. On the one hand savers are given complete freedom to spend their retirement pots as they wish, yet now there a risk that individuals will lose the lot as result of poor judgement or underperforming investments.

Industry commentators call this the 'risk of ruin', an alarming phrase but one that adequately reflects the outcome of withdrawing funds in an ill-advised way.

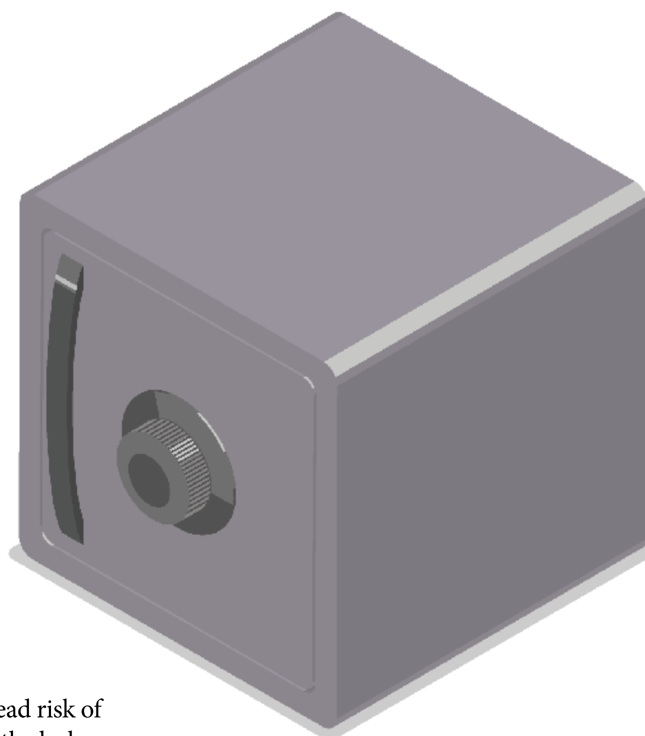
And while it is still early days for freedom and choice, it is already clear members favour accessing their pots flexibly via drawdown as opposed to buying an annuity.

Figures from HMRC show that 158,000 people withdrew flexible payments from their DC pensions in the third quarter of 2016, which compares to 81,000 in the same period last year.

The rate at which the money is being withdrawn is 'sensible' according to the insurance industry's association the ABI, but it is not entirely without concern.

According to the ABI's own research of withdrawals made in the first quarter 2016, the vast majority were less than 2 per cent of total funds. However several thousand savers made withdrawals of more than 10 per cent.

The ABI's director of policy, long-term savings and protection Yvonne Braun says: "The data suggests a minority are withdrawing too much too soon from their pension pot – 4 per cent of pots are having a tenth or more withdrawn - and many other customers are taking their entire pot in one go."



Need for advice

The concern about widespread risk of ruin is made more acute by the lack of advised drawdown. According to the Financial Conduct Authority's (FCA) review of retirement outcomes published in July this year, for the period October to December 2015, 32 per cent of reported drawdown sales were not associated with a regulated adviser. This compares to the 97 per cent of new income drawdown sales that received advice in 2013.

Providers argue it is critical members receive advice if they are to ensure

a sustainable income throughout retirement.

Royal London pensions specialist Fiona Tait says individuals who are advised tend to take less from their pension pots.

Figures from Royal London Intermediary, which only accepts new drawdown plans where advice has been given, show that the level of withdrawals is significantly lower than average.

Tait says: "While the average percentage withdrawal for the ABI was 5.63 per cent across the first 12 months of pension freedoms, members with Royal London plans are withdrawing 2.62 per cent. We believe this is due to advisers helping their clients to understand how much they can realistically withdraw without running out of money in the early years."

Running out

But even where lower withdrawals are taken, there is still no guarantee that the individual will not run out of money. The combination of rising longevity, market volatility and low interest rates mean attempting to plan a sustainable income using drawdown is particularly challenging.

Hargreaves Lansdown head of retirement policy Tom McPhail says investors need to lower their income expectations.

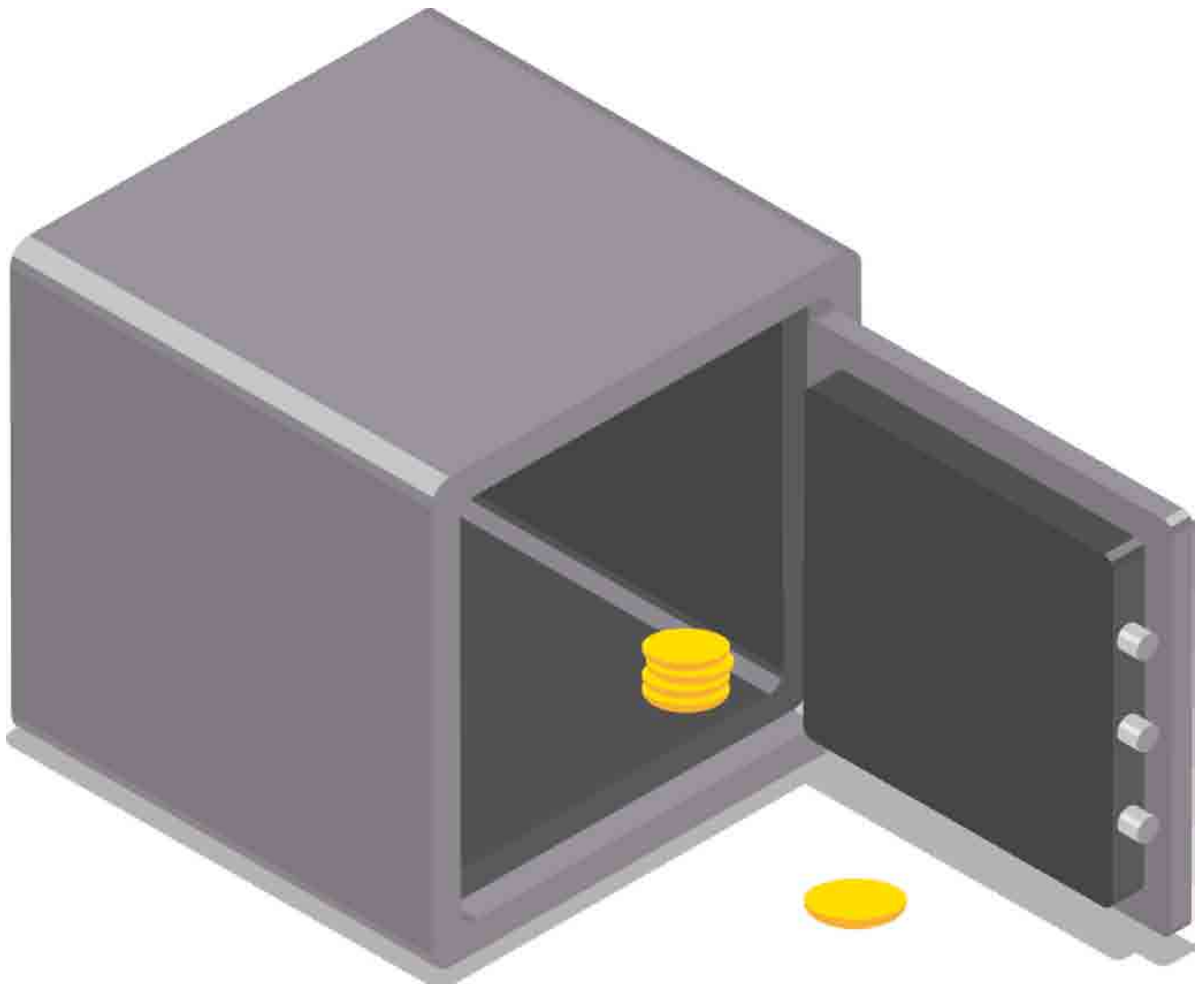
"Investors need to adjust their expectations downwards. If you want to sustain an inflation-proof income through your retirement, you need to think in terms of an income of around 3.5 per cent a year," he says.

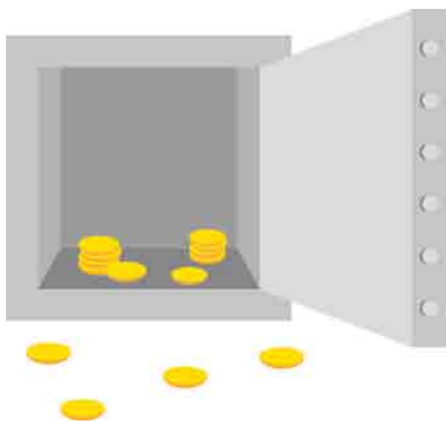
But lowering income expectations still doesn't ensure sustainability of income and that – according to research from PwC - is what 68 per cent of investors want.

The possible middle ground between full or 'naked' drawdown, which offers no protection from ruin, and the annuity that offers full protection but no flexibility, is a drawdown with guarantees.

Guarantees

At present just three providers offer this





type of product – Aegon, Metlife and Prudential – suggesting both a need for more competition in this market and a possible reluctance for individuals to pay for any kind of guarantee.

In a report into drawdown options by independent consultant The Lang Cat, guarantees were initially seen as expensive, but following in-depth analysis of the way in which these products work, the report states advisers should be willing to propose an alternative to naked drawdown.

The report says: "Unless a client is aggressive in their attitude to risk and has a high capacity for loss, we believe an alternative to full naked drawdown exposure has to be considered. That includes guaranteed drawdown, which is designed to offer the potential of capturing market growth."

But again the issue of advice – or lack of – rears its head.

Aegon UK pensions director Steven Cameron says the provider will only sell its guaranteed product to the advised market, so unless an investor sees an IFA they may not be made aware such an option exists.

However, he notes that the free government advice service Pensions Wise also has duty to make clear the existence of guaranteed products.

Cameron says: "Maybe the question should be: is Pension Wise allowed not to mention *[drawdown with guarantees]*? Pensions Wise is there to help individuals understand all the options out there and drawdown with guarantees is now a legitimate consideration."

Cameron is hopeful that drawdown with guarantees will become a mainstream product thanks to endorsement from the FCA, The Lang Cat, the National Employment Savings Trust *[see box out]* and a growing number of advisers.

But the market has a way to go. A lack of providers, an entrenched belief that guarantees are expensive and the need for advice present significant obstacles. However, as the number of retirees relying solely on their DC pots increases; the sources of protected income from other savings such as defined benefit plans reduces; and if drawdown with guarantees proves successful, it seems likely these products will gain a market place.

Written by Gill Wadsworth, a freelance journalist

A new kind of Nest egg

The Department for Work and Pensions (DWP) put the cat among the pigeons in July when it proposed extending the National Employment Savings Trust (Nest)'s remit to include an at-retirement offering based on the drawdown with guarantees model.

The consultation ended in October and providers have expressed their discomfort with the possibility of Nest offering drawdown to its members since the government-backed provider was set up purely to plug a gap in the provision of auto-enrolment pensions.

AJ Bell senior analyst Thomas Selby says: "While it would be good for existing Nest members to have access to a drawdown solution in the wake of the pension freedoms, it is questionable whether there is a market need for a wholesale state-backed individual pension and drawdown provider."

Aegon UK pensions director Steven Cameron agrees that Nest will be given a competitive edge thanks to its relationship with government and argues that the trust should be forced to seek external support in developing the product.

"We don't believe that Nest should spend taxpayers' money developing this in-house as it requires strong, specific expertise to understand how to design the product," he says.

However, advisers are more open to the expansion of Nest's remit. Lane Clark & Peacock partner Andrew Cheseldine says that far from Nest lacking the requisite expertise, it has conducted more research and analysis of the retirement market than anyone else.

Cheseldine says: "I can understand why some providers are nervous about Nest moving into new markets when they have quite a narrow brief and may be perceived to have a taxpayer subsidy. But I think it's a good thing. The problem from the rest of the market's perspective is that to work *[drawdown]* needs transfers in to Nest at retirement – which is just where the competitors hope to make their profit."

Willis Towers Watson's master trust LifeSight head of proposition David Bird says he welcomes Nest's offering, arguing that additional competition 'cannot be a bad thing', but says members should receive advice before being moved into any at retirement product.

Bird says: "Nest, or any provider who offers you the opportunity to switch from savings into drawdown, should give you help. you don't want *[members]* coming back in 10 years saying 'you let me do this, it hasn't worked and you earned out of it and it's your fault.'"

The DWP is yet to report back on the outcome of the four-month consultation.