Summary
- The Treasury has bagged £2.6 billion in extra tax from retirees accessing DC plans following freedom and choice. This payment outstrips the £920 million projected at the start of the policy.
- Income drawdown does not fall under OMO. Consumers can switch providers whenever they want.
- Charges and value are extremely important in the drawdown space along with flexi-access drawdown and must be noted by consumers.

Adding to the trolley?

Gill Wadsworth explores the idea of 'shopping around' and whether this has been inherent within the drawdown space following the freedom and choice reforms

Pension freedom and choice has been a real money spinner for the government. In the two years since the regime has been in place, the Treasury has bagged £2.6 billion in extra tax from retirees accessing their defined contribution (DC) funds.

Research from J.P. Morgan shows this bumper payment far outstrips the £920 million projected at the start of the policy back in April 2015, and the gravy train shows no sign of slowing.

The Chancellor of the Exchequer expects freedom and choice to contribute £5.1 billion in additional tax revenue by April 2019, which compares to the original estimate of just over £3 billion.

Allowing retirees to draw their pensions as regular income, in one lump sum or purchasing an annuity has certainly proved fruitful for the government, but what of individuals themselves?

The purchase of annuity products - which offer a guaranteed income for life - has been in fairly steady decline over the past two years as individuals favour taking lump sums or entering flexible income drawdown.

Nearly 800,000 people bought income drawdown products in the third quarter of last year according to the FCA's retirement income data, compared with just over 20,500 who opted for the annuity.

So while it is clear people are taking advantage of the newfound freedom, there is no equivalent data to demonstrate whether they have made the right choice.

Given the government's emphasis on the need to seek financial advice – or in the very least have some guidance – it is perhaps disconcerting to learn that a good proportion of retirees are failing to do so.

More than a third (35 per cent) of those surveyed by the FCA failed to take independent advice when buying a drawdown product in the third quarter 2016; a rise from the 30 per cent recorded in the first quarter of the year.

These findings may be even more

alarming to the financial advice advocates on learning that in an independent survey of more than 2,000 people, commissioned by insurer MetLife, 30 per cent of over-40s are behind on their retirement saving. Meanwhile 16 per cent of those aged 55 and over, who are the first generation to benefit from pension freedoms, admit they have not saved enough.

Income drawdown and OMO

For years pension providers have been subject to the open market option (OMO) rule which obliges them to make clear the need to shop around for the right annuity. Income drawdown, however, does not fall under the OMO.

Whether this matters depends on where you see drawdown in relation to annuities.

AJ Bell senior analyst Tom Selby says that while shopping around is important for all products it may matter less when buying drawdown rather than an annuity.

"Buying an annuity is a one-and-done decision, so failing to shop around could mean you're locked into a bad value or inappropriate product for the rest of your retirement. In drawdown, however, there are no such restrictions and savers are by-and-large free to switch provider whenever they want," Selby says.

So anyone suffering buyer's regret can wriggle out of their drawdown agreement, but it would be preferential to avoid making the mistake in the first place, which brings the issue back to shopping around.

For those who do seek advice – which accounts for 65 per cent of buyers between July and September last year – shopping around is part and parcel of the service provided by an adviser.

Other considerations

But for everyone else, there are multiple considerations to make which may not be covered by a comparison site or Google search.

Aegon pensions director Steven Cameron says: "With drawdown there is a whole range of factors that you want to compare. These factors will have different importance to different individuals so choosing a product is a personal decision. It's not as simple as entering details online

How to shop for income drawdown:

1. Ensure your drawdown provider offers good range of investment funds with varying risk profiles.
2. Look for a provider offering access to a high quality fund manager.
3. Check whether the provider offers fully flexible drawdown.
4. Decide whether you want any guaranteed income as part of the drawdown product.
5. Find out whether the provider offers access to ongoing advice and how that is paid for.
6. Consider the provider's digital offering, for example online modelling tools.
7. Understand and compare charges and fees.
8. Make sure the provider is regulated with the Financial Conduct Authority.

and using an algorithm to come up with the best drawdown product."

Cameron lists eight factors that buyers should be aware of when choosing their drawdown product (see box).

Predictably charges features as a consideration, but Cameron argues these are not the most important factor.

He says: "The importance of charges can be over emphasised. We are looking for good retirement outcomes and value for money. I am not suggesting that charges don't matter but they are not the be all and end all."

Tilney Financial Planning financial planner Gary Smith agrees but reminds consumers to look at how providers charge as well as what they charge.

He says: "Does the scheme offer a percentage fee or do they charge a fixed amount? If you have a £30,000 fund and your joining fee is fixed at £500; that is over 1 per cent of your fund. But another provider might charge 0.2 per cent of the value of the fund, which makes more sense."

Smith also reiterates the importance of value. He notes that some providers will offer more flexibility and functionality than others.

In particular he highlights the importance of successor flexible drawdown. This allows the fund to pass to a dependent on death and remain as a pension rather than becoming part of an estate which is then subject to inheritance tax.

Smith says: "Not all pension schemes have to offer successor flexi-access drawdown. Consumers need to look at the death benefit options. If the provider only offers a lump sum payment on death that is not necessarily the one you want."

A provider's propensity to keep up with legislative change is another factor consumers might want to consider.

Smith states: "Retirees need to check if the provider has a history of adopting new legislation as and when it is introduced. You need one that is attracting new business and adopting legislative changes when they arise."

While some providers may have been reluctant to embrace freedom and choice, plenty of players were keen to up their product ranges, which brings with it a new set of challenges for consumers.

An FCA report into updating the rules governing providers under the new regime, identified a danger that 'with this increased flexibility there is a risk that greater choice and more complex products may reduce consumer confidence and appetite to shop around'.

MetLife intermediary development manager Richard Evans recognises the FCA's concern and notes that while retirees may want flexibility it can lead to indecision.

"Our research shows investors want certainty in a world of freedom and choice, and that adds complexity, which leads to a lack of understanding and that leads to inertia about making decisions," he says.

Outlook

Freedom and choice was always going to create a conundrum. People should be allowed to spend their retirement savings as they see fit, yet they may not be equipped to make the right decisions and may be unwilling to seek advice.

Free support and guidance already exists for consumers navigating this difficult area but more can be done to help those shopping around. Providers should continue to improve wake up packs which are sent to those approaching at retirement, and communicate earlier with their members. The new government backed guidance service due to replace Pension Wise will also need to be equipped to manage the myriad consumer nuances.

But most important of all, advisers need to find ways to reach the mass market and mop up the 35 per cent of those who currently fail to see the benefit of advice, or simply cannot afford to pay for it.

Written by Gill Wadsworth, a freelance journalist