No guarantee with flexibility

As people become drawn to more flexible pension options, Jack Gray looks at the impact this is having on the drawdown market

Drawdown burst in popularity as a retirement income option for people wanting and requiring more flexibility from their pensions, and the introduction of pensions freedoms in 2015 helped facilitate the demand.

Since the introduction of freedoms, 435,769 people have put their pension into drawdown, according to the Financial Conduct Authority's September 2018 data bulletin.

Royal London head of investment solutions, Lorna Blyth, has witnessed this change first hand: "We have seen continued growth in the use of drawdown following the introduction of pension freedoms, as well as an increase in the number of customers who are choosing an investment strategy designed specifically for drawdown.

"This change in customer behaviour led us to change our default for workplace pensions to target a drawdown outcome."

Despite the increase in the amount of individuals using drawdown, Standard Life head of global savings policy, Jamie Jenkins, has concerns that the figures are being skewed.

He comments: "It should be noted that a significant element of this growth is down to people accessing tax-free cash, rather than drawing a regular income.

"As such, it's still a little unclear whether these same people will ultimately draw income from their invested pot, or buy an annuity at a later age."

Although using drawdown provides the member with greater flexibility in retirement, it does not provide the security and guarantee that they would get with an annuity.

Blyth explains: "There are no guarantees your money will grow and if your investments perform poorly you could get back less than you started with. If you take out too much money and or live longer than expected you could run out of money before you die."

Furthermore, once the consumer is taking a drawdown income on their savings, the government limits the amount they can save into a pension while still getting tax relief.

As the pensions landscape changes over time, Blythe expects it will have an impact on drawdown: "There are still a large majority of customers who have DB pensions and their DC pots are still relatively small in comparison.

"Over time this is likely to change and we will see more customers where DC is their only source of pension income. This will drive a greater focus on income sustainability."

Additionally, in a report published on 22 October 2018, actuarial firm Milliman found that the combination of an annuity and a drawdown product would potentially deliver "a higher likelihood of achieving a person's target income and a higher death benefit".

The combination could provide a 'best of both worlds' scenario, which provides some flexibility on a retirement income while also supplying a guaranteed income.

Commenting on the report, Just Group communications director, Stephen Lowe, highlights the importance of its findings: "This is a ground-breaking report at a time when many thousands of retirees are seeking ways to balance pension flexibility with sustainability.

"It demonstrates that combining an annuity, rather than bonds, with equities in a drawdown strategy will increase the likelihood of maintaining the target level of income over the course of retirement."

It could also be an answer to the risk of drawdown customers withdrawing incomes at an unsustainable level to last them the rest of their lives.

A recent Royal London study found that over half (53 per cent) of members using income drawdown are withdrawing their savings at a rate that would leave them high and dry financially before they die.

Like other retirement options, it seems as if the consumer needs to think hard, and be provided with the tools, to be able to make the right decision.

Jenkins concludes: "Drawdown will suit someone who has varying income needs and who wants the flexibility to draw money when they need it."

Written by Jack Gray

The more options the better

Jack Gray investigates whether annuities have a place in today's flexible pensions world

After the introduction of pensions freedoms in 2015, many people believed that annuities had had their day. To a certain degree, they were correct.

Prior to pension freedoms, approximately 350,000 annuities were being sold each year, according to Association of British Insurers figures published in 2014. In contrast, according to Financial Conduct Authority data, between April 2015 and March 2018 only 186,818 annuities were sold, highlighting the annuity market collapse once pensions freedoms came into force.

Although she admits that pensions freedoms had "a catastrophic effect" on annuity sales, Royal London pensions specialist, Helen Morrissey, believes that there is hope for annuities: "While many people said freedom and choice would spell the end for the annuity market, this has not been borne out and the market has shown signs of recovery.

"It is important to point out that for some people they remain the most appropriate retirement income option."

Annuities may seem to some like an outdated pension option, but Morrissey insists that there is still a place in the market for them: "Overall, annuities are best suited to those who have a need for a secure income that will last them through retirement.

"In recent years we have seen an increasing number of annuities purchased on an 'enhanced' basis, which enables people in poor health to get a higher income."

However, most over-55s (76 per cent) do not know that medical conditions or lifestyle choices increase the amount of money they receive from an annuity, according to research from Legal & General (L&G).

L&G Retail Retirement Income managing director, Emma Byron, believes that customers are "confused" about how annuities work: "People with health conditions, as well as smokers and drinkers, stand to benefit from better annuity rates – but only if they disclose everything to their financial adviser or annuity company.

"First and foremost, we need to help customers to understand the potential benefits of annuities, which offer them a guaranteed income for life in retirement."

Morrissey adds: "This will be a priority for many people and should not be underestimated as there is always a chance that those who take their money as a cash lump sum or go into income drawdown may run out of money."

Education for those approaching retirement could be the key to helping people make informed decisions on how they want to structure their retirement income. Annuities can restrict scheme members and is not as flexible as drawdown.

Morrissey explains that there are drawbacks to purchasing an annuity: "The key disadvantage is that, once made, the decision to purchase an annuity cannot be undone and so if your circumstances change – for instance you may become ill or your partner may die – then you have no opportunity to get rid of the annuity and purchase something more suitable.

"If you are relatively young and in good health then an annuity may not be the best option as you may need more flexibility."

The need for pensions flexibility could be one of the main factors in the dwindling popularity of annuities. Individuals are generally living longer, healthier lives, which could make annuities an unappetising prospect, as staying invested could provide higher returns.

Annuities can also restrict the retiree if they wanted to take out a lump sum to move abroad or pay for unexpected medical or care costs for themselves or a loved one. Fear of being left high and dry and trapped by their annuity could put members off.

However, although their popularity has fallen, it seems as if annuities have a role to play in the modern pensions landscape. They increase the number of options available to retirees so members are more able to tailor their retirement to best suit themselves. Despite many people thinking that pensions freedoms would spell the end for annuities, they seem to fit into the flexible, multi-option industry that people are striving for.

Written by Jack Gray

Closure order for property investment

Jack Gray looks at how tax and regulatory changes have caused a reduction in people choosing property investment as their retirement saving method

Property investment is a high risk but high reward strategy to retirement planning. An Office for National Statistics survey, published in February 2018, found that 49 per cent of people believe that property is the best way to save the most money. Its nearest challenger, employer pensions, was named as the best retirement saving method by just 22 per cent of participants.

Although property investment can prove lucrative, the same survey discovered that only 30 per cent think that it is the safest way to save for retirement. In comparison, 40 per cent say that an employer pension is the safest retirement saving method.

Royal London personal finance specialist, Becky O'Connor, explains: "Some property investors think that property is simpler and more understandable than other options, although in reality, investing in buy-to-let can be fraught with problems and unforeseen costs, such as high maintenance and repair bills and void periods.

"There's also the risk of being exposed to house price falls if you become a landlord and pile all your savings into one or two properties."

Furthermore, recent tax and regulatory changes for landlords have put some prospective house buyers off purchasing property with the intention of letting it out. The changes are ongoing after beginning in April 2017 and are being phased in gradually until 2020.

Once they are complete, landlord will no longer receive the same tax breaks as they used to and will also be hit with additional tax charges.

O'Connor continues: "There has been a slowdown in property purchases among landlords, which has been attributed partly to the tax and regulatory changes but also to wider uncertainty in the market.

"House prices continue to rise but relatively slowly, with the latest Land Registry data showing annual growth of 3.5 per cent since August 2017. Rents increased by 0.9 per cent in the UK in the year to October 2018, according to the Office for National Statistics."

The slowdown in savers investing in property does not seem like it will be improving any time soon, as the recent Budget seems to spell more doom and gloom for the market.

Tilney head of estate planning, Ian Dyall, agrees with this sentiment: "In his Budget, the Chancellor announced that from April 2020 the government will reform lettings relief so that it will only apply where the owner of the property is in shared occupancy with the tenant and that the final period exemption will also be reduced from 18 months to nine months.

"Three years ago, George Osborne hit property investors hard by announcing an increase on stamp duty for second homes and limited mortgage interest tax relief.

"This announcement is another nail in the coffin for buy-to-let property investors."

It seems as though property investment as a retirement saving option is dying a slow death, as government policy, high risk and an uncertain market are putting potential investors off of taking the plunge.

However, the reward offered for a successful investment cannot be ignored. If property prices continue to increase at the same rate for the next 20 years as they did the 20 years previous, then a property that is worth £235,000 today will be worth £1 million by 2038.

Despite this, the future of property investment is uncertain and a market crash could result in people losing their savings, highlighting the high risk but high reward nature of property investment.

Some believe that it can still play a part in people's retirement plans. Diversifying asset classes could be the answer to balancing risk and reward, says O'Connor: "Diversifying across a range of different asset classes in different markets is less risky than putting all your eggs in the property basket."

Dyall agrees: "Property can have a role in a fully diversified investment strategy, but I would warn against it playing a major part in a retirement plan, particularly where large mortgages are involved."

Written by Jack Gray