Summary
- The pension freedoms have been popular with savers, but the industry has a mixed view of the policy.
- The industry is worried that people will make the wrong choices, especially as the number of people taking independent financial advice before accessing the freedoms is low.
- The challenge is to ensure good outcomes for all members, regardless of whether they take advice or not.

Sweet or sickly?

A bit of what you fancy is good for you, but how much is too much? Sara Benwell considers whether the pension freedoms offer too much choice, and how the industry can ensure people make the right decisions for them

It's no secret that consumers have been delighted with the introduction of the pension freedoms. In fact, you only need to look at the numbers to see that people have been voting with their feet.

Since April 2015, more than a million and a half over-55s have collectively withdrawn over £23 billion from their savings.

However, while members seem happy, the industry is less uniformly delighted. And when you ask financial experts whether the pensions freedoms were a good idea, you tend to get more mixed reviews.

It makes for an interesting – if ultimately futile debate. Because the fact is that the freedoms genie is out of the bottle, and it would be extremely difficult – not to mention political suicide – to change the rules now.

But even though experts disagree on whether choice is ultimately a good or bad thing, there is one thing which pensions providers, regulators, schemes and consultants can agree on – everyone is extremely worried about people making the wrong choices.

This is hardly surprising. We've had four years of freedoms now, and one thing we know for certain is that lots of people are making poor decisions.

Mercer principal Stephen Coates points out that most people selecting drawdown say they did so purely to access their tax-free cash and that only 10 per cent want to generate a regular retirement income (surely the intended aim of the strategy).

He says: "More choice has led to consumers buying products other than annuities but the level of suitability of those products for those individuals is still highly questionable."

Portafina managing director, Jamie Smith-Thompson, adds: "The risk with people managing their own pensions is they go into drawdown and park their money in cash. That money then gets eroded by inflation, so their pension loses its purchasing power.

"An adviser is unlikely to recommend this route, which raises the question of whether people making a conscious decision based on all the facts or taking what feels like the safest option, which often is far from that?"

Clearly, removing your money from a pension only to stick it in cash for 30 years is unlikely to be the best option for most savers. This is quite straightforwardly true, and yet despite the collective efforts of the industry, it is still failing to help people grasp the array of options available to them or the best course of action for them to take.

Franklin Templeton head of UK DC, David Whitehair, says: "The pensions industry and regulators are attempting to educate savers approaching retirement… If these messages were resonating and engagement levels were high, we would see a rise in the number of people taking advice and guidance, moving providers, using the freedoms and avoiding large tax bills.

"However, the evidence presented by the Financial Conduct Authority (FCA) in its reports and *Retirement Outcomes Review* suggest that this is not the case."

One suggestion is that people are paralysed by the vast array of options and are therefore unable to make even the most straightforward choices. But a quick look at the consumer market suggests that choice in of itself is not necessarily a debilitating force.

Altus head of retirement strategy, Jon Dean, explains: "You only need look at the mobile phone market for a comparison, which shows that choice works as long as help is available to guide the customer through.

"The main barrier at retirement is the lack of understanding of investing. Unlike a phone, investments are intangible whereas everyone can relate to cash."

The problems, therefore, arise not from the number of choices available, but from a range of other factors.

Finding your way through the maze is even harder than it seems

In reality, consumers are faced with more than three or four choices. While the options are, at face value, drawdown, annuities, UFPLS or cash, the optimum outcome for most people will be generated by a mix of the four. This means that the permutations are endless.

Standard Life head of customer and workplace proposition and strategy, Neil Hugh, says: "It's important to remember that 'choices' for customers don't have to be binary, one or the other. They can mean one and the other.

"Combining various options can often be the right thing for people taking money out of their life savings, for example, opting for a blend of a fixed (annuity) income and flexible income (through income drawdown), as well as considering other forms savings like ISAs or bonds."

Coates adds: "The problem is that in order to evaluate those choices other conditions need to be met. Those conditions are an understanding of the complexities of the products and their benefits, ease of transaction, ease of comparison of the alternatives, and an understanding of your own preferences.

"We haven't yet managed to satisfy all these conditions sufficiently well and so whilst the number of options, in themselves, is not overly daunting, the ability to evaluate those options certainly is."

In a nutshell, most consumers have a poor understanding of the issues involved and are unwilling to take (or pay for) advice to help them understand the plethora of products. And this reluctance to take advice can have catastrophic consequences.

Smith-Thompson explains: "An untrained mechanic wouldn't open the bonnet of a car and expect to be able to diagnose why it had broken down. Yet more and more people are choosing to turn to Google first for help before seeking advice from someone who is expertly trained in their field.

"The same applies to pensions. Some people are making decisions about their financial future without undergoing the rigorous training and exams financial advisers are subject to. And with all the choices available to investors, I'm not sure how they are doing this."

Getting retirees on the right track

All the evidence suggests that in the current marketplace ordinary savers need advice to get a good outcome that suits their post-retirement needs.

The combination of multiple products, complicated tax rules and confusing terminology means that creating a sustainable retirement income is difficult for financial professionals, let alone ordinary savers.

FCA figures show that a third of non-advised drawdown consumers are holding their funds in cash compared to only 6 per cent for advised consumers in drawdown.

Whitehair says: "People are strongly encouraged to seek financial advice or at least enter into a guidance conversation before making any important retirement finance choices. The bigger picture to keep in mind is that choice and freedom are providing people with the framework to build a retirement income stream suitable for their individual needs."

Of course, advice is not a panacea, and even if it was, uptake remains worryingly low. But there are reasons for this – even though most retirees would benefit from regulated advice, the reality is that few are keen to take it and even fewer want to pay.

Here though, innovation can help. New tactics such as guidance and robo-advice structures can point people in the right direction, at a sustainable cost.

However, the industry needs to make sure that initiatives such these enable savers to make decisions. Otherwise guidance can just leave people frustrated.

Pensions Management Institute president, Lesley Carline, explains: "For member engagement to be successful it needs to result in the member acting. That could be something as simple as reviewing their forecasted pension and taking no further action because they have sufficient retirement income, through to taking action to increase their contributions because they need to.

"Often engagement is wasted as it relies purely on informing members rather acting as a call to action."

Royal London director of policy, Steve Webb, adds: "The biggest challenge is making sure that those who do not take advice still get good outcomes.

"There is evidence that some people have been 'recklessly cautious', accessing their tax-free cash and leaving the rest in low-return cash accounts. The FCA is rightly trying to nudge savers and providers to make sure that this does not happen."

Written by Sara Benwell, a freelance journalist