Stepping into danger

Gill Wadsworth considers the many pitfalls retirees may inadvertently fall into when drawing down their pension savings and how the industry can help them avoid the risks

Summary
• Failure to seek guidance leaves UK pension savers facing significant financial risks when drawing their retirement funds.
• New 'stronger nudge' rules are accused of being insufficient in pushing people towards existing guidance services.
• Pension providers are developing solutions to better protect savers but they need more freedom to offer personalised guidance.
• The advent of collective defined contribution schemes could help manage decumulation risk.

There is a huge risk that unguided and unadvised pension savers will make terrible mistakes when they come to draw their retirement savings. This is the view given by Labour backbench MP, Nigel Mills, to a parliamentary business debate this March on the take up of pensions guidance and advice.

Mills said: "We have a hugely complex pension system and people don't always understand their options or take advice when making decisions. This means they make what might have been an avoidable mistake which has a detrimental effect on their quality of life. The question is what can we do to improve that situation?"

Choices

The latest pensions debate was part of a wider effort from government and industry to improve outcomes for those savers making use of the freedom and choice legislation introduced in 2015.

Millions of savers access income drawdown, access to tax-free lump sums and other flexibilities designed to make the at retirement market more flexible.

Yet the Financial Conduct Authority (FCA) Retirement Income Market Data shows that in 2019 to 2020, half of all pots accessed in the contract-based retirement income market were done so without advice or guidance.

And doing so, according to Hymans Robertson partner, Kathryn Fleming, leaves members at risk of making a host of potentially catastrophic financial decisions.

"There are so many ways in which people can make bad choices that can have risky implications for their financial security once in retirement: Taking too much money too early, bad drawdown investment choices, reacting inappropriately to market movements and in some cases not drawing down enough. Our research shows that most people don't know how much they can reasonably expect by way of an income in retirement," Fleming says.

Nudges

In response, this January, the Department for Work and Pensions introduced 'stronger nudge to pensions guidance' regulations for occupational schemes that Minister for Pensions and Financial Inclusion, Guy Opperman, said are "an important measure designed to help people make informed decisions about accessing their pension savings".

The new rules will encourage members to make better use of the government's free Pension Wise service at the point of decumulation. Trustees and managers of occupational pension schemes must book a Pension Wise appointment as for members and if they do not wish to take guidance, this should be 'an active and considered decision'.

The FCA, meanwhile, introduced its own set of nudge rules for contract-based schemes. From 1 June 2022 pensions providers must give consumers a stronger nudge to Pension Wise guidance when they decide to access their pension savings. Providers will be required to refer customers to Pension Wise guidance and explain the nature and purpose of this guidance.

Hargreaves Lansdown senior pensions and retirement analyst, Helen Morrissey, says that while the introduction of nudges is welcome, there remain issues with ensuring consistency between the contract- and trust-based regimes.

"The stronger nudge to guidance

has the potential to really help people make more informed retirement income decisions and boost awareness of Pension Wise. However, we need the rules to be as closely aligned between trust- and contract-based schemes as possible to avoid confusion, and even disengagement," Morrissey says.

More criticism of the stronger nudge approach came from this January's Work and Pensions Select Committee report *Protecting pension savers—five years on from the pension freedoms: Accessing pension savings.*

The select committee says the guidance proposed by the DWP and FCA "will not be enough to make receiving pensions guidance the norm".

Radical action

Instead, it wants the government to commission research that will allow for more radical action. This includes automatically arranging appointments with Pension Wise, including a trial of people having an appointment at age 50 and at the point they want to first withdraw money.

The committee also wants to set ambitious targets for improved guidance take-up rates of around 60 per cent. Current rates are just 10 per cent.

Former Pensions Minister, Ros Altmann, says: "The industry has often complained about the cost of extending the reach of Pension Wise, but I believe the government needs to insist that this is an essential service for pension customers and one that the industry itself should support, because only then will pension customers be able to make better use of their lifelong funds."

While regulations may help individuals make better at-retirement choices, the committee wants more innovation from pension providers, through products that include a combination of different approaches, such as taking some in cash, having a guided drawdown for the early years of retirement and then locking into an annuity later.

Altmann says: "The pension freedoms have not led to a raft of interesting new user-friendly products for people to use when withdrawing their pension income from their pension pot. The old options of those who do not take an annuity either taking cash or drawdown, are relatively unchanged."

Altmann is critical of income drawdown, which she says has "much higher charges than *[a member's]* original pension fund, even if they are intending to just leave the money invested and accumulating more investment growth".

Industry assistance

Responding to the criticism, Legal & General Investment Management co-head of DC, Stuart Murphy, agrees it is incumbent on providers and trustees to support members in decumulation, and says the industry is responding.

"There has been huge evolution in target-date funds away from lifestyle strategies. Eighty-five per cent of new schemes that we implemented last year *[were target-date funds],* which means members are more likely to be invested in the right assets as they approach retirement," Murphy says.

But he says he would like to see more freedom for providers, currently restricted by rules around offering financial advice, the chance to offer personalised guidance.

"Personalised guidance is not about making a recommendation to members but rather helping them make better decisions. It can be digital or face-to-face and the provider bears the cost. The advent of personalised guidance could take *[decumulation]* from something of a wild west to a modern approach."

Fleming agrees personalised guidance is critical to improving at retirement decisions.

"Pension providers may offer guidance, access to advice, annual statements to try to help people navigate decumulation choices, but member engagement is low. The guidance is often provided in the wrong format and infrequently, and this is not helped by the fact that providers are very restricted in what they can comfortably say."

She continues: "Digital tooling can really help get targeted messages across safely and impactfully and digital developments in decumulation is a priority area of focus for many providers."

The advent of collective DC (CDC) schemes may also help protect members in decumulation. In CDC schemes, members pool their retirement savings into a single fund, meaning they share the risks associated with uncertainty about investment performance and longevity. This risk sharing allows the scheme to invest in assets with higher expected returns.

Aon head of CDC, Chintan Gandhi, says: "CDC can deliver a retirement income for life without the member having to buy an annuity or make complex financial and investment decisions along the way in retirement. This alleviates many of the decumulation risks inherent in the system."

Last February the Pension Schemes Act 2021 received Royal Assent, which put the wheels in motion for greater use of CDC schemes in the UK.

However, as Gandhi notes, these plans are "not for everyone" and it will be some time before their structures are fully understood and put to the test.

More than five years have passed since freedom and choice came into force, yet Altmann says members are still "fumbling in the dark due to excessive complexity, disjointed regulation and insufficient guidance or advice".

There is a relatively concerted effort to improve the lot of pension members in decumulation but success rests on implementing a coherent and radical set of changes that pushes members to the support they need.

Written by Gill Wadsworth, a freelance journalist