Savings and annuity products in the new pensions world

Summary of a presentation by Adrian Boulding to Association of Consulting Actuaries Members Conference 6th February

We have moved from a world where for most people there was just one solution at retirement – an annuity – to a new world with almost unlimited options.

But already we are beginning to form an opinion on how customers will handle the new freedoms. Many of those with small pots will just turn them into cash. For middle Britain retaining flexibility and access to cash will be important, although they may still annuitise one or more of what could be several pension pots. At the top end, the most affluent are least affected by the changes and their behaviours will continue to be driven by their financial adviser.

There are some lessons we can draw from overseas markets. Australia uses a concept of a “bedrock income” needed to cover the essentials of daily living. People may seek a secure income product up to this level and then use a flexible drawdown above this. And in America you can already buy longevity insurance, in the form of a deferred annuity starting from perhaps age 85, to provide a fallback for drawdown pots that may have become largely exhausted by then.

Innovation may bring us a range of exciting products, mixing up guaranteed income, equity investments with ratchet guarantees to protect against market falls and longevity insurance, perhaps paid for by monthly deductions rather than a single sum up front at retirement age.

The very wide range of choice may make retirement difficult for ordinary scheme members, who probably don’t have the advantage of a personal financial adviser. Employers and trustees may be able to help by framing the way choice is presented. For example, there is a model attributed to McKinsey’s that advocates offering a set of just three choices, followed by another set of three choices and then finally followed by no more than one further set of three choices. This sort of choice cascade can make the whole process so much more manageable.

The best schemes will want to deliver high standards to members, whether they choose to take the whole pot, buy an annuity or use a flexible drawdown approach. As time evolves we can expect best practice to emerge and we hope that good schemes will share what they are doing with others, dragging the quality of the pensions industry up behind them as they do so.

Drawdown presents two particular challenges that will be new to employers and trustees. The first is how much of the pot to consume each year. Whilst trustees may be reluctant to opine on this, it would be really helpful if they did, as the trustees with their knowledge of pensions and access to advisers have a much better idea of what might be sustainable than their members do. Secondly, as drawdown is not a “set and forget” option, it raises the serious question of ongoing governance.

Employers will be reluctant to have any ongoing responsibility for their ex-staff many years beyond retirement, so probably the best we can hope for here is that at the point of retirement employers launch their staff wanting flexible products onto a good quality independent platform with strong governance of its own.