Post-retirement investment options for drawdown – how do we help members get the best outcome?

In this session David Bird from WTW take us through the investment needs of members who choose to take advantage of the retirement flexibilities that were announced in the 2014 Budget and came into force in 2015.

The flexibilities have changed how people use their defined contribution pension accounts. The number of people buying annuities has declined and the number of people cashing-in or using drawdown has increased. The average pot size of those using drawdown is larger than the average for annuity or cashing-in suggesting that people are considering their options. Of the people buying annuities some two-thirds are securing enhanced annuities suggesting that they are taking advice and considering the 'deal' on offer to them. Some cause for optimism, perhaps.

The market for drawdown products has been expanded by the arrival of new providers offering a more commoditised product which does not necessarily require the expertise of an adviser to support the member. We can expect more products to come on as well as new entrants like master trusts.

NEST have conducted some valuable research with retirees and developed a blueprint for meeting the needs of their members. It is important to remember that NEST's members are not necessarily typical for all schemes, but the research gives us some powerful insights. NEST's research suggests that member needs change as they move through retirement and that this requires three types of provision, a cash fund, income drawdown fund and protection for later life.

NEST propose some guiding principles and a two passed approach with a default investment and income strategy to help members who are not well equipped to make the decisions for themselves. NEST's blueprint is a useful contribution to what schemes should think about when constructing a strategy.

Taking a step back it is worthwhile also considering the member perspective and what they want when they choose to drawdown it's valuable to think about what members are trying to achieve. It is too simplistic to say that members want income from their DC pension savings, there are more 'missions' that members have depending on their individual circumstances, for example their other assets. Best practice needs to bring together what members are looking for from their drawdown account with the investment risks they face which suggests member objectives which can provide a framework for thinking about investment solutions.

When designing solutions it is important to have a robust risk framework. One of the key risks for individuals drawing an income is the risk of the fund running out before the member dies, or exhaustion risk. Managing against that risk suggests that a bond strategy on its own will not protect the member against exhaustion. However, we also need to guard against the timing risk that members who invest in equities and who face an investment reverse in the early years of drawdown may never recover from that shock to their living standards. It is important that individuals utilise their broader flexibility to allow them to weather this downside risk.

In the future the need for better drawdown investment strategies will grow and we will have more data about what members. We should also anticipate that what members need will change as DC becomes the main or only source of retirement income outside of State benefits.

It may be helpful to establish your own guiding principles to use when assessing different potential strategies for drawdown investment. These principles should think about what members might need and anticipate how they might interact with any choices or options they may be given and what help and advice may be made available to them. The principles might, therefore, cover costs, accessibility to capital, understandability and oversight or governance.

Perhaps the one certainty is that this one area that will evolve and change quickly.