Summary
• The pensions annuity market has been decreasing since 2015 and appears to be levelling off recently.
• Drawdowns have increased in popularity since the introduction of pensions freedoms, but concerns have been raised about the future of the market.
• Flexible savings products have been proposed as a new default journey to allow savers to enter drawdown at retirement and change to an annuity at a later date.

Making the switch

With new retirement products increasingly under discussion, Tom Dunstan investigates the current at-retirement product landscape and the potential need for more flexible products

Whilst saving may take up the bulk of retirement planning, deciding what to do at retirement remains a key aspect of creating an adequate life for savers after they stop working. This can place savers under a lot of pressure at retirement as they struggle to make the right the choice to get the most out of their pension pot.

This is a relatively new problem for savers as, before 2015, all savers were compelled to buy an annuity by age 75, thus providing little pressure or doubt for them. This changed with the introduction of pensions freedoms in 2015, which provided savers with access to more choices at retirement, such as entering drawdown. This policy has proved a popular one with savers, as the number of new retirees entering drawdown hitting massive heights after the introduction of the act.

So, in this relatively new world of pensions freedom, what is the best way to help savers make the best decision in retirement and is there a way to marry the two retirement journeys of annuities and drawdowns?

Set for life

Before pensions freedoms, annuities were the only form of pension product available to savers and, despite having new competition since the introduction of the act, are still available and popular today. Annuities provide a guaranteed consistent income for life, which does provide stability for retirees, but can be less than the value of the retirement pot that they use to purchase it, especially if they die early.

Although annuities remain popular, they are not as popular as they used to be. The general trend in the annuity market has been down in recent years with the Pensions Policy Institute (PPI) senior policy researcher, Dr Mark Baker, identifying "two major dips" in the annuity market. Namely, the immediate reaction to freedom and choice and the Covid-19 pandemic.

Baker explains that the reaction to the introduction of pension freedoms was somewhat expected as "people suddenly got the option to access their pensions in a flexible way and many people saw it as getting a hold of their money". Baker also explains the dip following the pandemic, stating that a lot of saving products felt the squeeze during Covid-19, but that the annuities market didn't fall as much as other products as a result of the pandemic.

Whilst there may have been a decrease since 2015, recently this decrease has become more gradual, as seen in the PPI report, *Set for Life? Guaranteed incomes in retirement,* which says "the number of annuity purchases appear to be levelling off". The report details that: "After a period of decline, the annuities market appears to have levelled off, with a similar number of purchases having been made over recent years." Baker offers an explanation for this levelling off of annuity purchases "perhaps because it has reached its market".

The right timing for an annuity can vary from person to person, something that Age UK head of policy, Chris Brooks, identifies: "The right time to buy an annuity would differ on your personal financial circumstances".

LCP partner, Steve Webb, adds: "Getting an annuity at 60 or 65 years old may not be the best thing to do as it is possible savers could live for another 25 years and, therefore, locking in something that's no risk, low return may not be the best idea."

Webb also discusses the benefits of annuities, saying "by the time you

are 80, an annuity starts to look quite attractive as it can be difficult to manage your money if you don't know how long you're going to live for."

Continuing the accumulation

However, annuities are now only one side of the coin in the retirement market with drawdown making up the other, increasingly large side.

Drawdown allows pension pots to remain invested whilst retirees receive an income from it, allowing for pots to continue to increase in size even post retirement. Whilst there has been an increase in savers entering drawdown since 2015, there have been worries raised about this new form of retirement.

Brooks warns that "it could still be the case" that pensions freedoms could be due for some kind of "scandal" in the coming years as "with so many people in drawdown, if there was a significant dip in the market a lot of people could lose a lot of money".

Brooks also states that the relative youth of pensions freedoms and the sudden increase of savers who entered drawdown as a result could lead to unexpected outcomes: "The cohort of freedom choices adoptees are now in their early 70s so they're getting up to the point where people are more likely to be affected by cognitive decline or getting sicker," which might make it harder to manage their money.

Best of both worlds?

Due to the decreasing demand of annuities and the possible dangers of relying too heavily on drawdown, the market is starting to see the emergence of products that marry the two. One of these is a 'flex first, fix later' product, such as the one proposed by LCP.

This product allows savers to enter drawdown at retirement but automatically purchases an annuity for them at a pre-determined time in late retirement.

Webb discusses the benefit of the product, namely that it defeats the issues with drawdown: "You make the decision when you're, let's say, 65 which means inertia and cognitive decline aren't problems. Guidance also isn't a problem as you're more likely to access guidance at retirement rather than 15 years later."

Webb also identifies demand for a product of this nature: "We published our first paper on this before Christmas and we probably had more interest on that than anything else.

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"We've talked to insurers, master trusts, asset managers, financial advice networks and everybody is starting to talk about what post retirement looks like."

Although the 'flex first, fix later' product may have several points in its favour, there are some practical barriers in the way of its establishment in the UK market. Webb identifies one such barrier as a "regulatory one" that "falls between two stalls", as Webb explains: "TPR is dealing with all the master trusts and people who build up pension pots, then you have the FCA who regulate individual financial products."

Another barrier to the product is how to bring savers into it, as Webb asks if it could be offered on an opt in or opt out basis.

Webb points to a similar product that was used for the University of California pension scheme, which was based on an opt-out basis, although Webb stressed that this was "the legal advice in a very different legal system".

Webb remains optimistic that producing the product on an opt out basis is possible for the UK but is unsure whether legislative change would be necessary and acknowledges that trustees would like to check that.

The product used for the University of California pension scheme is not the only similar flexible product that exists in the world today. Baker identifies other foreign products that represent similar characteristics to the 'flex first, fix later' product, such as in Singapore, which compels savers to use some of their pension to purchase a guaranteed income at retirement which will kick in at the end of their lives.

Baker voices caution about the creation of a flexible pension product, believing it might not be as effective in the future: "It's too early to be prescriptive as creating a product now might mean it doesn't meet the needs of people in 20 years' time."

Therefore, as the annuities market continues to level off and potential problems with drawdown still a possibility, the flexible saving product could offer a happy middle ground between the two. Whilst its ability to become the "default" journey for future retirees remains to be seen, it does appear that the demand for the product exists in the market. It is also unclear how long it will be until flexible savings products will be available, but Webb hypothesises: "I think there is a likelihood that providers will come to the market with variations on these themes in the next 12 months."

Whilst the exact future of the flexible savings product is still unknown, something that seems certain is that, with them, making the switch will be a lot easier.