A year older, a year wiser?

One year on from the introduction of the pension freedoms, what has changed for defined contribution scheme members, and how are employers engaging with wider options for employees? The pension changes have brought a whole new range of options to consider. Individuals now have to think about whether they want an annuity, drawdown, cash or a combination of options; when to access their pension; if it is better to use savings first before drawing their pension; and so on. Making the right choices in the lead-up to and at the point of retirement is no simple task and getting it wrong could be extremely costly.

However, it seems many individuals don't really understand the consequences of these options. Initial survey findings from the Pensions and Lifetime Savings Association (PLSA) found that of those who were planning on using income drawdown, some pension savers thought there were no risks with drawing a regular income from their pension and over half thought it would provide a guaranteed income in retirement. Yet despite these misunderstandings, more recent PLSA findings highlight that only a minority of people paid for advice.

Given the low take-up of the Pension Wise service, we need to ask whether pension savers are confident about their decision-making abilities and if not what can and should be done?

Despite some reported inaccuracies in the data collected by the Financial Conduct Authority (FCA), it is still reasonable to assume that the initial findings are a fair reflection of what is happening in the retirement market. It found that of pension funds which had been fully cashed out, the majority of these had values of less than £30,000. It also found that even some very large funds had been fully cashed out; presumably triggering a hefty tax bill and a shift towards more self-managed income drawdown, i.e. without the help of a regulated adviser.

This is a concern, especially after the turbulence experienced recently in world stock markets. Also, new research from the PLSA suggests that many may take income from pensions to simply re-invest into cash, stocks or shares (even after an income tax liability was incurred).

Employers not yet adapted

Since the pension changes, some employers have adopted new default investment strategies for those still saving. Broadly there are two approaches; one advocating the use of target-dated funds, offering flexible asset allocations and risk profiles, and the other which has a three-pronged approach with defaults aimed at cash, annuity and drawdown.

However, our research indicates that employees default to a 'pre freedom and choice path'. 43% of employers surveyed default employees to an annuity-tracked glide path, despite the recent significant fall in annuity purchase. The results also reveal that over a quarter (26%) of employers do not allow their employees to take money from their pension (from age 55) whilst they are still working for them and almost one third (32%) of employers do not provide access to the new pension flexibilities in their scheme at-retirement. However, it's encouraging that nearly 60% of employers surveyed are providing financial education about the pension flexibilities at retirement and overall around half offer access to a regulated advice service at the point of retirement.

Whilst the pension changes offer a great deal of flexibility, they also carry many pitfalls and risks, especially around tax and investment loss. A powerful way to address this is for employers to provide financial education in the workplace, supported by regulated advice and embedding it in the company culture.

And if they do, it's a win-win – there's a shared goal in making sure employees are on the right path to retirement.

And the future?

It is too soon to say whether early behaviours become the long-term norm. With a secondary annuity market on its way, robo-advisers claiming they have the answer, and a possible meltdown in the world of defined benefit, what we are confident about is the greater need for financial education, guidance and advice than pre pension freedoms, and this isn't likely to change any time soon.

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