

The blended strategy

Life was a degree more simple before “pension freedoms”, if clients had modest pension pots they were generally offered a lifetime annuity. This provided a guaranteed income for life. From an advisory position knowing from outset how long the process will take and charging a fee that was in line with client expectations was straightforward.

However, for many clients annuities may have felt like a straight-jacket solution - no flexibility whatsoever! With annuity rates under considerable pressure after the financial crisis, the inevitable questions emerged from financial journalists as to whether they were providing value for money? Could retirees be better served by allowing choice over how they take their savings? And so pension freedoms were born.

Does that now mean the abandonment of annuities – do they still have a place in the advice process?

The answer is no and a definite yes.

The need to meet a range of different client objectives particularly for clients who would have previously purchased an annuity is reason enough. Abandoning the security that annuities offer would be foolhardy and unnecessary. Adopting a blended strategy could be the answer - a good compromise with striking a balance between risk and reward, security and flexibility.

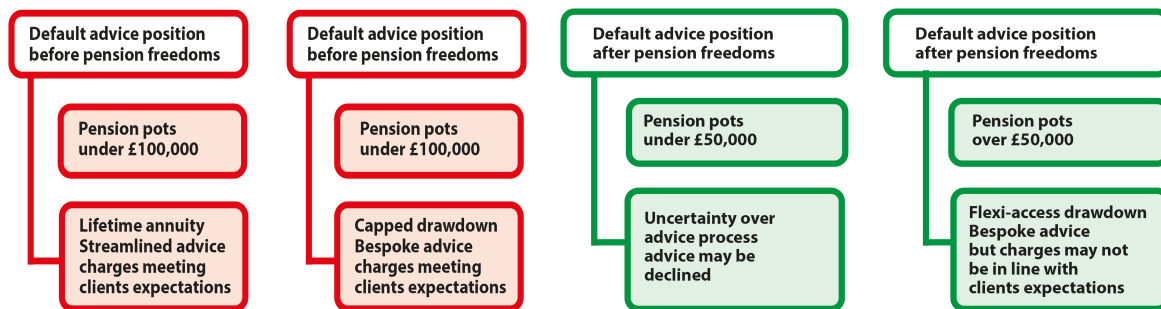
What do we mean by “A Blended Strategy”?

A Blended strategy is simply the process of using more than one retirement product/wrapper to provide a solution (usually by mixing guarantees with non-guaranteed investments). It can be the most straightforward way to meet retiree objectives. I use the term “retiree” in the loosest of terms as we should recognise that many individuals may take retirement benefits without actually retiring.

Changes to the pension landscape have been gradually evolving over the past decade partly as a result of final salary schemes closing and a stubborn financial climate of low interest rates. These factors have impacted savers significantly in pension arrangements and for those retiring. Advisers are used to adapting to new financial legislation but these pension reforms have brought new challenges.

The introduction of pension freedoms has for many advisers resulted in a change to the default position of recommending an annuity to that of investing in a flexi-access drawdown arrangement. In the past, income withdrawn from a drawdown arrangement was restricted to a level set by the Government Actuaries Department (GAD) primarily to avoid running out of funds. This restriction has been removed.

The shift away from annuities to drawdown exposes the client to a new risk of running out of income. It's not simply the uncontrolled level of income that a client can withdraw but also how their investments perform. Without professional advice, this risk increases significantly for a retiree.



Given these new risks it is understandable why advisers often find themselves caught between a rock and a hard place when it comes to giving advice for clients who have modest pension pots. Because the process involves advising on all the new options there may be underestimation of what is an appropriate charge.

No magic bullet

There is no magic bullet to achieving both total security and total flexibility for the client. Guarantees will generally mean some degree of restriction and flexibility meaning accepting some degree of risk. When asked to prioritise objectives, many clients say, a guaranteed income is top of their list, followed closely with the ability to alter requirements if circumstances change. It's no great revelation, that typically but not exclusively, those with larger pension pots (the higher net worth) worry less about security and focus more on flexibility.

Pension pots between £50,000 and £200,000



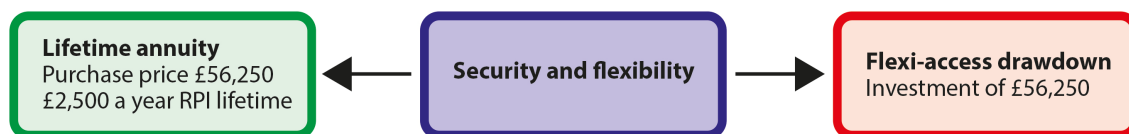
Striking the right balance - is it possible to have both guarantees and flexibility?

Yes is the answer – either by using investment funds to provide the guarantees / level of protection required or by using traditional annuity products alongside a drawdown arrangement. The client's objectives and risk profile will determine the appropriate allocation of funds to each element as shown above.

Let's look at a simplistic case study

Jack is married to Peggy and looking to retire at age 65. Jack is going to sell his business for an expected sum of £100,000 and also has a private pension of £150,000. Peggy is already in receipt of her NHS indexed-linked pension of £16,000 a year and her state pension of just over £6,000 a year.

Their expected outgoings or living expenses are £30,000 a year. So with Jack's full state pension their total secure income is £28,000 a year. Jack and Peggy are fairly cautious in respect of financial investments. Jack decides to invest half his pension pot, £56,250, in a single life, RPI linked lifetime annuity, to ensure they can continue to meet their ongoing living expenses throughout retirement. The balance of £56,250 could be invested into a flexi-access drawdown. This element will provide the potential to grow income whilst helping meet any unforeseen capital requirements – although Jack has some liquid reserves from the sale of his business and his pension tax free cash.



(Income shown above is for illustrative purposes only)

Fixed term annuities

Fixed term annuities which are written under drawdown, rather than annuity rules, can be a useful part of a retirement portfolio.

Clients often want a degree of flexibility and do not want to put their capital at risk so they could opt for a fixed term annuity. This retirement plan can provide a guaranteed lump sum at the end of a selected term which can be set between one or up to 40 years. Alternatively, clients can opt for a fixed income. Death benefits can be incorporated and kept within a pension wrapper for a beneficiary.

For cautious clients who want some short term security whilst still keeping all options open, fixed term annuities can deliver a good solution.

For example, David is aged 60, with a pension pot of £40,000, due to poor health he wants to reduce his working days from five to three. David has living expenses to meet for the next five years and a small mortgage of £10,000 which he would like to pay off.

He needs to know he can continue to meet his outgoings until he receives his state pension and his deferred final salary pension.

David crystallises his pension and uses his 25% tax free cash to pay off his mortgage and with the balance purchases a fixed income of £6,300 for five years to help meet his outgoings.

Mixing and matching -new product initiatives

Some providers have launched Retirement Accounts (generally under a SIPP wrapper) that can hold lifetime and fixed term annuities (their own products) plus a flexi- access drawdown within the same wrapper. Importantly, these retirement plans also have a cash account. This addition allows income (which must be paid from the lifetime annuity) to be paid into it. This can be extremely tax efficient in the event the member no longer requires income from this source.

Blending products may only appeal to a select number of clients and probably few who have larger funds. However, even for these clients who want security and flexibility blending could be appropriate.