CLIENT GUIDE: WHY BUYING AN ‘ANNUITY PLUS DRAWDOWN’ PACKAGE CAN BEAT BUYING SEPARATELY

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By their 75th birthday nearly half of all Australians have exhausted their pension savings [1]. True, the Australian pensions landscape is different to the UK. Nevertheless, this statistic should not be dismissed lightly. Drawdown is rapidly becoming the product of choice for UK retirees with more people buying drawdown than annuities, and investing more money in drawdown too [2].

Is drawdown a solution or a problem?
It’s not difficult to understand the appeal of drawdown. Ready access to funds, money can be invested for growth, and on death any balance can be passed to dependants tax efficiently.

What’s more, drawdown provides the income flexibility today’s retirees need. With retirement routinely lasting 20 or more years one thing is certain. Neither clients nor their advisers can accurately predict income needs over the course of retirement. Someone may be active for more than 20 years or fall seriously ill a year after retiring. They may die after a short illness or require long term care. If the latter, care may be provided in the home (often by friends and family at little cost) or in a residential nursing home where the costs are considerable. All these, and many more unknowns, mean that the ability to vary income in retirement is critical.

That makes drawdown a valuable solution for many people but, as the Australian experience highlights, drawdown can spell disaster if clients withdraw too much too soon, manage their investments poorly or simply live too long!

Could happiness be annuity-shaped?
Though the overall income required during retirement is likely to vary, there will be certain expenses that are fairly constant from one year to the next. These essential expenses, like gas and electricity, should ideally be covered by a guaranteed income.

Annuities still represent the only certain approach to guaranteeing an income for life. What’s more, the value of annuities isn’t measured purely in economic terms. They have emotional value too. Research [3] has shown higher satisfaction with retirement and lower levels of depression among retirees with the greatest levels of annuitisation. Knowing that they will receive a regular income every month is likely to encourage people to spend more freely on enjoying life. In contrast, the stress of not knowing whether you’ll run out of money before you run out of breath can cast a shadow over retirement.

Blending can offer the right balance
A blended approach, combining annuities and drawdown, can often be the right solution. On one hand, the risks of drawdown can be offset by the security of a guaranteed income. On the other, the lack of growth potential from a conventional annuity can be boosted by the prospect of higher returns from drawdown. It’s what people want.

A YouGov survey [4] asked people approaching retirement to rank flexibility, certainty, income growth, and instant access in order of importance. It was no surprise to find that flexibility and certainty
came out on top. Most of us crave the certainty of an income that will last a lifetime, but also want the flexibility to vary income from time to time (and to dip into our fund for unforeseen expenses). These needs can be met using a combination of an annuity and drawdown.

Many IFAs would naturally recommend a blend of annuity and drawdown, sourcing best of breed for each component. It is possible in theory to offer everyone a tailored solution, but in practice it isn’t viable to do so. This is where packaged products can help. They can provide a simple, economic approach to blended solutions.

**The magic of packages written under drawdown rules**

Some providers offer blended solutions that are simply two products sold together in a marketing package. However, the more advanced solutions combining annuities with drawdown are written under drawdown rules. This way, the annuity is an asset of the client’s drawdown portfolio, which can have significant advantages. For example:

<table>
<thead>
<tr>
<th>Feature</th>
<th>Traditional Annuity</th>
<th>Annuity within drawdown</th>
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<tbody>
<tr>
<td>Income</td>
<td>Healthy and unhealthy lives catered for.</td>
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</tr>
<tr>
<td>Income flexibility</td>
<td>None – income is paid as decided at outset.</td>
<td>Full – income can be reduced, stopped or recommenced at any time. Excess builds up in drawdown element.</td>
</tr>
<tr>
<td>Death Benefits</td>
<td>No tax planning – lump sum or income paid out immediately following death.</td>
<td>Full tax planning – death benefits paid into beneficiaries account, allowing them to withdraw in stages and minimise tax.</td>
</tr>
<tr>
<td>Commutable income</td>
<td>No.</td>
<td>Yes, remaining income guarantee following death can be commuted to lump sum and paid to beneficiaries account.</td>
</tr>
<tr>
<td>Protect against future</td>
<td>No flexibility or adaptability.</td>
<td>Flexibility to change to suit future circumstances, helping customers meet changing needs.</td>
</tr>
<tr>
<td>Adviser future earnings</td>
<td>None from annuity.</td>
<td>Yes, ad-hoc/ongoing fees available if funds in drawdown.</td>
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1. What freedom and choice will mean for UK pensioners, Social Market Foundation, 2015  
2. ABI data, Q3 2015 (https://www.abi.org.uk/News/News-releases/2015/11/Pension-Stats-six-months-on)  