As the Quilter Investors investment team explains, too many Britons arrive at retirement thinking that their years in decumulation will be just like their years in accumulation. They couldn’t be more wrong. This puts the onus on advisers to make sure clients understand the realities of maintaining a pension pot for decades to come.

New reality #1: Annuities are no longer for everyone
There are many good reasons why advisers need to spend time explaining the potential benefits of an annuity. However, these days only the wealthiest or the oldest Britons can afford to make a traditional annuity a large part of their pension planning because the cost of the guaranteed income they offer has simply become too high.

The most recent Which? survey revealed that the average retired household spends £2,200 a month, or about £26,000 a year, paying the standard bills and enjoying a modest taste of the better things such as short-haul holidays, hobbies and eating out.

This jumps to around £3,250 a month or £39,000 a year for those households that enjoy more elaborate trips, spend a little more and buy a new car every five years.

Using current annuity rates we can illustrate the cost of providing this level of income via an annuity. Don’t forget that our imaginary retiree will also have to pay 20% income tax on the annuity income they receive above the current personal allowance of £11,850, which naturally increases the cost of the annuity.

Consequently, a single life annuity that delivers £26,000 a year, net of tax, and which offers an escalating income of 3% a year (enough to protect its future purchasing power) would cost just under £760,000.

Meanwhile, a post-tax annuity income of £39,000 (with matching escalation) would cost a cool £1.17m – somewhat more than the lifetime allowance.

For most Britons approaching retirement, being confronted with such costs will surely mean that they need to consider using risk assets such as equities, bonds and alternatives as a better way to deliver the secure long-term income they’ll need in retirement.

New reality #2: Your pension pot can live on long after you do
By removing the ‘death tax’ of 55% on inherited pension assets, the pensions freedoms quietly made pensions one of the most tax-efficient ways in which to pass assets from one generation to the next as they have always been free of inheritance tax (IHT).

Under the new regime, if a pension holder dies before reaching age 75, the proceeds of their pension pot can be passed tax free (subject to the lifetime allowance), while benefits passed after age 75 are taxed at the beneficiaries’ marginal rate of income tax.

This change has given a new lease of life to the estate planning market and, along with record transfer values, helped to trigger the deluge of defined benefit (DB) pension transfers we’ve seen in recent years. Such transfers present the opportunity for pension holders to enjoy similar levels of income, more tax-free cash, greater flexibility and the chance to pay less tax in retirement. They also offer the real possibility that – with careful management – a substantial pension pot could still be available at the end of their lives to pass along to loved ones.

This potential only increases the need for most Britons to talk through their changing requirements with their adviser to ensure their retirement stays on course.

These days only the wealthiest or the oldest Britons can afford to make a traditional annuity a large part of their pension planning.
New reality #3:
How you manage the ‘big three’ risks will dictate the quality of life you enjoy in your dotage

The three big risks that every adviser must help their clients to understand are:

**Longevity risk:** Namely the risk that they live too long for their pension pot. To counter it, they'll need to take a view on their likely life expectancy and ensure the level of income they take won’t erode their pension pot.

**Inflation risk:** Inflation is the secret killer. It suddenly becomes an extremely destructive force when someone reaches retirement and stops making contributions to their pension pot. Clients need to know that if UK inflation runs at the current annual rate of 2.4% it will erode more than 20% from the value of their pension pot in the first 10 years. Scroll forward another decade and very nearly 40% of their pot will have gone in terms of real spending power.

**Sequence of return risk (or pound cost ravaging):** This is the increased risk presented by a fall in returns that comes early in a client’s retirement as opposed to later down the line. This will come as news to the average UK retiree because so long as they were in the accumulation phase of their retirement planning, the order in which they got their returns never really mattered. The opposite is true for clients in decumulation; once they start taking income they effectively cement any losses which can cause irrevocable long-term damage to the value of their pension pot.

New reality #4:
Sitting in cash is no longer a safe option

Clients need to understand the role cash plays in a decumulation portfolio. For those still in the accumulation phase, cash provides a safe haven from market volatility and valuable liquidity for a portfolio. However, cash soon loses its lustre in decumulation.

This is because with interest rates so low, cash delivers a negative ‘real’ return after inflation and has done so since the early part of 2009. At current levels, UK inflation will eat about a quarter of a cash pension pot in the first decade. However, the real damage comes from using a depreciating asset like cash to fund regular income withdrawals. There is no better way to terminally deplete a pension fund.

By shunning investment risk in favour of cash, a huge swathe of Britons now risk depleting their pension pots long before their new, longer lives come to an end. Indeed, the depletion rate of a cash-only pension pot is so great that simple arithmetic would suggest most Britons in this position would be better served by buying a series of fixed-term annuities with guaranteed maturity values.

New reality #5:
Tomorrow won’t look much like today

Thanks to our cognitive biases, humans have a natural tendency to approach situations in the context of their recent experience. This is referred to as recency bias. This can be especially dangerous when it comes to investment for obvious reasons.

For example, right now (September 2018) the US stock market is exploring record highs as the longest bull market in its history continues to play out with its ‘trophy room’ of the world’s best-known tech names doing most of the heavy lifting. The picture is quite different in the UK and Europe, which have mostly traded sideways this year, while emerging markets actually fell into bear market territory early in September after racking up significant returns in the decade since the financial crash.

All this means that pension savers have done extremely well over the last decade – especially those who embraced risk assets. It also means that too many retirees consequently see no need to change the investment approach that served them so well while in accumulation.

Unfortunately, there’s no end of potential catalysts that could derail the current fortunes of global stock markets from President Trump’s trade war to Brexit or a host of other geopolitical issues that could suddenly come to the boil.

Any retiree who relies on their accumulation strategy to deliver on their changing income needs in retirement in the next few years is taking a huge risk. If markets change direction significantly in the next few years – which they surely must as this cycle matures – then ‘sequence of return risk’ could well cut the legs out from under their retirement.

According to our own research, some 25% of those aged 45 and over have no intention of changing from their accumulation strategy to one more suited to decumulation when they reach retirement. Meanwhile, only around a third of respondents even recognise that retirement in the next few years is another obvious area where advisers can add real value.

Of course, the clock is ticking; there won’t be any prizes for those advisers who waited until markets had gone into reverse before they helped their clients to recalibrate from accumulation to decumulation.

Further information for financial advisers:
To find out more about strategies in decumulation, visit www.quilterinvestors.com/ generation-range
To speak to one of our Investment Directors call 0207 167 3700 or email enquiries@quilterinvestors.com
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(3) Where the transfer is by operation of law;

(4) As specified in Section 305A(5) of the SFA or

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