HOW TO GET YOUR MONEY BACK

THE UK WITHDRAWAL PRODUCT LANDSCAPE

A MARKET ANALYSIS REPORT FROM

the lang cat

HELLO

BEFORE WE BEGIN

This is an independent analysis of how guaranteed income products, often known as guaranteed drawdown (GD) or unit linked guarantees (ULGs[1]), fit in the landscape of withdrawal* products in the UK today. This means comparing them to 'naked' drawdown and annuities, and trying to work out what fits where.

It's an area we've been thinking about for a while and we decided now was as good a time as any to share our thoughts. Turns out we're not alone as Aegon also has a keen eye on how GD is faring and kindly offered to sponsor our analysis.

Now, clearly Aegon has an interest and is unlikely to be sponsoring analysis of a market it doesn't play in – why would it? So if this feels a little awkward, as is so often the case when money changes hands, you are excused for approaching it with caution.

We don't accept sponsorship very often and when we do we apply some strict ground rules. The analysis and views expressed here are our own. Aegon had no editorial control over the work; there was no tilting of decks to make anyone look good. We thank Aegon both for its sponsorship and its impeccable behaviour. At the lang cat we stake our reputation on our independence so we don't say anything here that we wouldn't say if we weren't being paid. Trust us or don't; it is the truth.

the lang cat
October 2016

A NOTE ON TERMINOLOGY

*We're not fans of the term 'decumulation', mainly because it isn't actually a word. And if it was, it would be a horrible one. In this paper, we're calling the act of clients getting their money back 'withdrawal'. This is on the basis that people save money and then withdraw it. You *could* say that they accumulate and decumulate, but you can't do it here.

1. What's in a name? A guarantee by any other name would still protect income. Unit linked guarantees, guaranteed drawdown, variable annuity. Call it what you want. We're sticking with guaranteed drawdown (GD) for this paper.

WARMING UP: SOME KEY STATS ON WHAT'S GOING DOWN

In the first full year of pension freedoms:

REGULAR INCOME

£2.9bn has been paid out as income

The average pot being used to access regular income is £60,000

Source: ABI

CASH WITHDRAWALS

£3bn was paid out in cash lump sums

The average payment was £14,800

Lump sum withdrawals have decreased from £1.4bn in Q2 2015 to £750m in Q1 2016

Cash lump sums remain popular with the under 60s, accounting for half the value of cash taken in Q1 2016

Source: ABI

GUARANTEED DRAWDOWN (GD)

Only 3 UK providers

SALES: Pension wrappers now account for > 80% of all new GD sales in the UK

Source: Towers Watson Q2 2016

ANNUITIES

80% drop in volumes from Q3 2012 to Q3 2015.

Q3 2015 saw the first increase in annuity sales since Q3 2013, but volumes dropped again in Q4 2015 and Q1 2016

Source: ABI

IN THE FIRST TWELVE MONTHS OF PENSION FREEDOMS, FLEXIBLE PAYMENTS FROM PENSIONS TOTALLED

£4.35bn

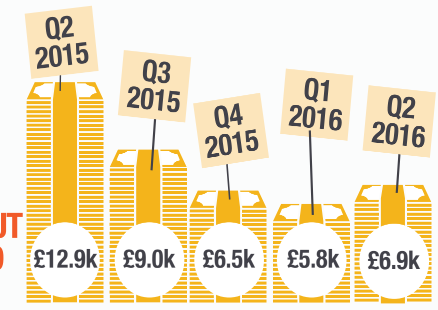
TO 232,000 INDIVIDUALS

IN 516,000 PAYMENTS

516,000

Source: HMRC

AVERAGE FLEXIBLE PAYMENTS FROM PENSIONS HAD SLOWED BUT INCREASED IN Q2 2016



Source: HMRC

So pension freedoms have, on the face of it, had a tangible impact on the product landscape. They're driving client and adviser behaviour: a retirement journey is now, more typically, about targeting income through different stages, based on evolving financial needs. And it's about drawing that income from a wider range of sources.

In this paper, we'll look at four methods of removing money from pension wrappers:

- Annuities
- Naked drawdown (saucy)
- Guaranteed drawdown
- Third-way products

There's lots of nuance within each of the four withdrawal product types, which we'll get into. In fact, the main objective of this paper is to take the products available and scenario test them until they beg for mercy. But for now, let's consider what clients – the poor schmucks – actually need from these products.

WHAT CLIENTS NEED, WHAT THEY REALLY, REALLY NEED…

PwC carried out research[2] in which it asked 1,200 consumers **'When deciding on how you will manage your pension pot, which of the following factors are important in your decision?'** and then asked them to rate importance. We've added a column for outcomes (these are ours, not PwC's).

FACTOR	%	OUTCOME
CERTAINTY OF INCOME	68	Security, the basic needs
TAX EFFICIENCY	61	Avoid being ripped off by the taxman
LIFE EXPECTANCY	61	How long it needs to last
INVESTMENT RISKS	45	Protect wealth
CURRENT HEALTH	45	How long it needs to last
INFLATIONARY RISK	38	Protect wealth
SIMPLICITY OF THE PRODUCT	36	Understand what's going on
DEPENDENTS' SECURITY	32	Leave something behind

If you were starting with a blank sheet of paper, you'd try to create products that target as many of these needs as possible. If you could get something that would meet all of them all of the time, you'd be on to a winner. But sadly the world isn't like that.

SUSTAINABLE INCOME (SI)

The general consensus for SI (or safe withdrawal rate as it's also known) is in the region of 2% to 4%. William Bengen in 1994[3] proposed 4% (which would then be adjusted for inflation) as the safe maximum. Wade Pfau replicated the work in 2010[4] and found that the figure could be closer to 3%, although much depended on the portfolio used.

Recent research by Morningstar[5] puts SI at anything between 1.5% to 5.8% depending on years to retirement and portfolio mix.

WITHDRAWAL RATES BY PORTFOLIOS: TIME PERIOD AND TARGET SUCCESS RATE

Portfolio % / Probability of Success %	Retirement Period (Years) 20	25	30	35	40
0% Equities					
99	3.2	2.5	2.0	1.7	1.5
95	3.6	2.8	2.3	2.0	1.7
90	3.8	3.0	2.5	2.1	1.9
80	4.0	3.2	2.6	2.3	2.0
70	4.2	3.3	2.8	2.4	2.2
50	4.5	3.6	3.0	2.7	2.4
20% Equities					
99	3.2	2.5	2.1	1.8	1.6
95	3.7	2.9	2.4	2.1	1.9
90	3.9	3.1	2.6	2.3	2.1
80	4.3	3.4	2.9	2.6	2.3
70	4.5	3.6	3.1	2.7	2.5
50	4.9	4.0	3.5	3.1	2.8
40% Equities					
99	3.2	2.5	2.1	1.8	1.6
95	3.7	3.0	2.5	2.2	2.0
90	4.1	3.3	2.8	2.5	2.2
80	4.5	3.7	3.2	2.8	2.6
70	4.8	4.0	3.4	3.1	2.8
50	5.4	4.5	3.9	3.5	3.3

Portfolio % / Probability of Success %	Retirement Period (Years) 20	25	30	35	40
60% Equities					
99	3.1	2.5	2.1	1.8	1.6
95	3.8	3.1	2.6	2.3	2.1
90	4.2	3.5	3.0	2.6	2.4
80	4.7	3.9	3.4	3.1	2.8
70	5.1	4.3	3.8	3.4	3.1
50	5.8	4.9	4.4	4.0	3.7
80% Equities					
99	3.1	2.4	2.1	1.8	1.6
95	3.9	3.2	2.7	2.4	2.2
90	4.3	3.6	3.1	2.8	2.6
80	5.0	4.2	3.7	3.3	3.1
70	5.4	4.6	4.1	3.7	3.5
50	6.3	5.4	4.9	4.5	4.2
100% Equities					
99	3.0	2.4	2.0	1.8	1.6
95	3.9	3.2	2.8	2.5	2.3
90	4.4	3.7	3.3	2.9	2.7
80	5.2	4.4	3.9	3.6	3.3
70	5.7	4.9	4.4	4.1	3.8

Source: Morningstar.

Suffice it to say there is an emerging consensus that, in light of prevailing market conditions, SI is nudging lower. We settled on 3% to use in our analysis because (1) we have to use something and (2) we have to use something.

THE LANDSCAPE

ANNUITIES

You all know what annuities are.

PROVIDED BY

Lifecos. There are currently about 20 annuity providers in the UK. And dozens of portals and calculators. It's OK, we won't list them.

NAKED DRAWDOWN

You all know what drawdown is. We use the term 'naked' because – no, that's not it. How dare you. We use it to distinguish drawdown without guarantees from drawdown with guarantees.

PROVIDED BY

Lifecos, adviser platforms, D2C platforms, SIPP providers.

GUARANTEED DRAWDOWN

Sometimes called unit linked guarantees as this captures the fact that guaranteed income is also linked to 'unit' (investment) growth. In any case, you've got drawdown style functionality with guarantees built in.

PROVIDED BY

There are currently three UK providers offering guaranteed income products: Aegon, MetLife and Prudential. In this paper, we're focusing specifically on products designed for retirement that sit inside pension wrappers, so we omit guaranteed products available inside bond wrappers.

THIRD-WAY

Where naked drawdown is mixed with either an annuity or GD within the same product. There is flexibility and connectivity between the two, for example the guaranteed income can usually be paid into the drawdown account.

PROVIDED BY

Aegon, MetLife (GD plus drawdown) and Retirement Advantage, (annuity plus drawdown).

2. April 2015, 1201 respondents aged between 50-75. http://www.pwc.co.uk/industries/insurance/insights/pension-freedom-consumer-survey.html
3. Bengen, William P. (October 1994). "Determining Withdrawal Rates Using Historical Data" (PDF). Journal of Financial Planning: 14–24.
4. Pfau, Wade D. (September 2010), "An International Perspective on Safe Withdrawal Rates from Retirement Savings: The Demise of the 4 Percent Rule?". National Graduate Institute for Policy Studies (GRIPS). Available here: http://www3.grips.ac.jp/~pinc/data/10-12.pdf
5. Blanchett, Buffenoir, Kemp, Watt (1 May 2016): "Safe Withdrawal Rates For Retirees In The United Kingdom", available here: http://media.morningstar.com/uk%5CMEDIA%5CResearch_paper%5CUK_Safe_Withdrawal_Rates_ForRetirees.pdf

GUARANTEED DRAWDOWN PRODUCT SUMMARY

Provider	What is it?	Income deferral	Guaranteed death benefits	Capital option
Aegon: Secure Retirement Income Available via both Aegon One Retirement insured pension and ARC advised platform.	Lifetime income ranging from 3.20% (age 55) to 4.55% (age 77+). The client can take out the guarantee pre-retirement for an accumulation pension. The pot can be moved into drawdown in segments as required.	Once a year, before taking income, the original investment (known as the income base) is increased by the higher of 3.25% or the, bear with us, 'monthiversary'[6] lock-in value – which is the highest value that the underlying fund (i.e. the original investment net of fund performance) is sitting at throughout the year. Note: the 3.25% increase isn't compounded.	Offers continuing income. If joint life, a nominee can receive 50% of the secure income rate. If not joint life, the remaining value goes to beneficiaries. Under guaranteed minimum death benefit (GMDB) (if selected) it's the higher of the original investment minus income taken; or the value of the investment (or highest monthiversary lock in).	Yes, but only in the offshore bond wrapper. There's also a range of compatible trusts.
MetLife: Guaranteed Drawdown Held within Retirement Portfolio product. Standalone packaged product.	Lifetime income ranging from 2.00% (age 50) to 4.75% (age 75+). Regular contributions can be paid that match to a corresponding income percentage, depending on how old the customer is when the investments are made.	Income can be deferred and this results in a 4% compound increase in the secure income base. If the customer takes a proportion of their guaranteed income, then the balance is still added as an income deferral (i.e. take 65% of maximum guaranteed income and 35% of the income deferral rate is applied to the pot).	Guaranteed lump sum, either: ■ initial secure income base less any income taken; or ■ the value of the investment.	Yes, in the Retirement Portfolio. Minimum £5k investment with minimum 10 and maximum 20 year terms.

STOP PRESS

The lang cat gets ready to go to press and the guaranteed drawdown market goes wild. By 'wild', we mean that one provider pulled out and another has launched.

AXA Life finally pulled its offering citing 'economic and regulatory factors'. This followed its earlier withdrawal from income guarantees leaving only capital guarantees available. If we're being cynical, we read 'economic and regulatory factors' to mean 'we were not making enough money'. However, just days later Prudential added minimum income guarantees to the Pension Income Account (part of the Prudential Retirement Account), investing in PruFund. The rates don't look hugely competitive – at 65, the rate is 3.50%, which for example is half a percent below Aegon. That aside, it's an interesting and welcome addition to the market.

THIRD-WAY PRODUCTS

This might cause a bit of controversy because there's disagreement on what a third-way product is. That's OK, we've fixed it for you. In the lang cat's (correct) opinion, a third-way product:

- combines more than one type of withdrawal product (sub-products) within a bigger product (master product); and
- the sub-products have some degree of connection/flexibility between them.

And here they are. You will find that both the guaranteed drawdown providers ALSO feature here, because each of the guarantees has some degree of interconnection with another product (note our earlier comment about Prudential).

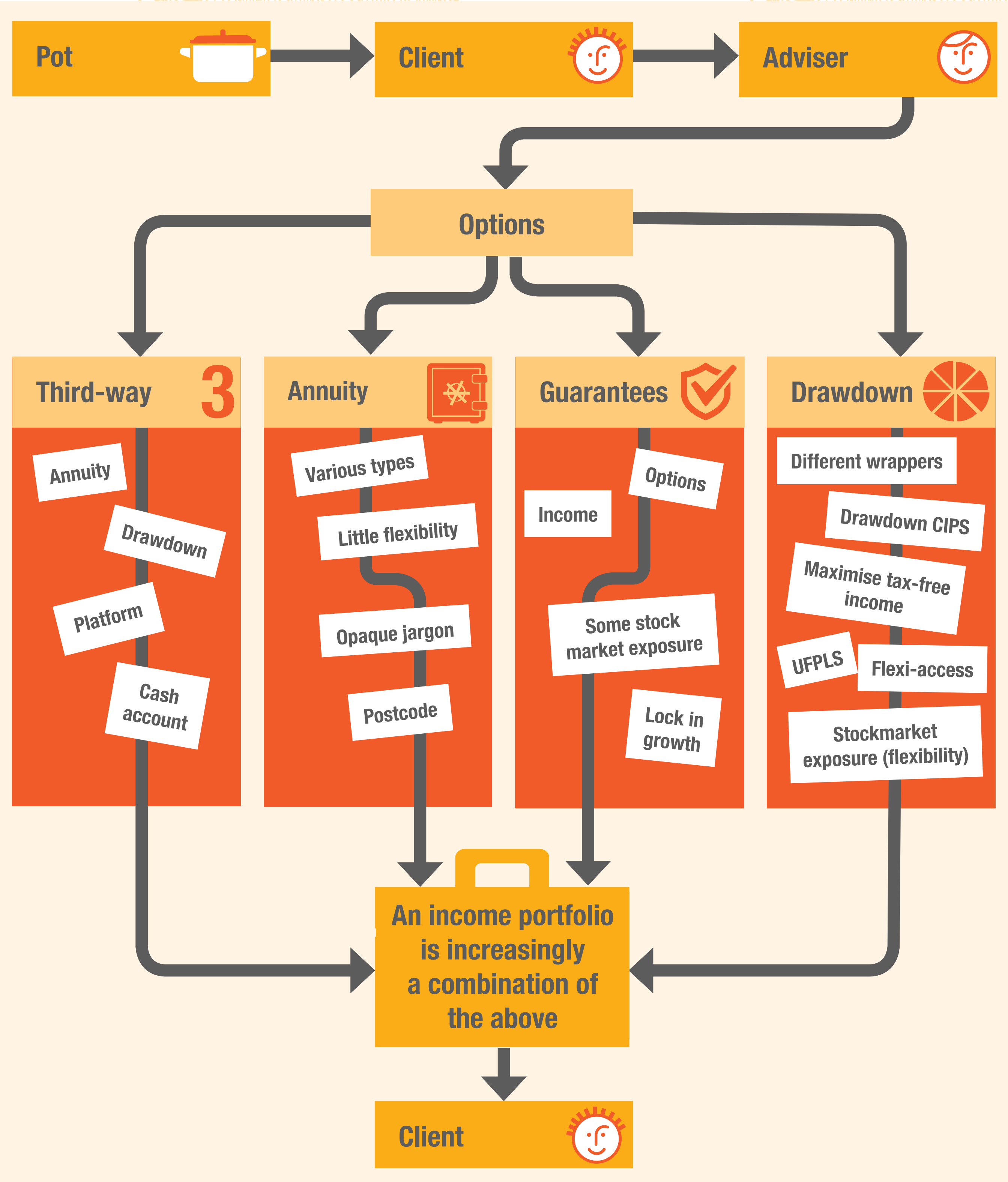
PROVIDED BY

Provider	What is it?	Cost	Death benefits
THE ONE WITH ANNUITY PLUS DRAWDOWN			
Retirement Advantage: The Retirement Account	A guaranteed annuity combined with drawdown. The split between drawdown and annuity is flexible, depending on client needs. Annuity income that isn't needed can be re-invested into drawdown and everything is paid into a cash account. There is a beneficiary drawdown feature, which is interesting because it means the beneficiary becomes the adviser's client/it's a way of farming.	£150 initial charge and… …a tiered annual product charge: First £25k: 0.60% £25k – £75k: 0.30% £75k – £150k: 0.20% Above £150k: 0.10% There's a choice of 14 funds (put together by Square Mile) with varying TERs. Plus annuity charges.	The usual annuity choices (residual fund/dependent's income/money back guarantee) An account is opened for beneficiaries, which is probably cool for advisers.
THE ONES WITH GUARANTEED DRAWDOWN PLUS OTHER STUFF			
Aegon: Secure Retirement Income	Income guarantees inside a drawdown account, inside a pension account, inside a platform (ARC).	ARC platform charges apply to money in naked drawdown, plus the relevant asset charges. Depending on the fund chosen and the life basis selected, the charge ranges from 0.90% (conservative, single life, no GMDB) to 1.55% (cautious, joint life). The platform charge ranges from 0.00% to 0.60%.	As per guaranteed products section for guarantees. Naked drawdown death benefit is return of fund.
MetLife: Retirement Portfolio	Income guarantees inside a drawdown account, inside a pension account (Retirement Portfolio). There's also a secure capital option.	Wrapper costs in naked drawdown and a guaranteed fund are the same. The only variation comes from different asset charges. The guarantee charge ranges from 0.55% to 0.65% and the wrapper charge ranges from 0.40% to 0.70%.	See guaranteed product section. Death benefit is return of fund.

HONOURABLE MENTION: LV= Protected Retirement Plan. We're on the fence about this being third-way. It's a fixed term annuity written under drawdown rules. There is income for 3 –25 years, after which there is a maturity value. It's got a conversion feature, meaning the term can be cut short (care required). It is a bit different but isn't really a mix of products in the same sense as the others. For now, it's got a mention and we are open to being shouted at/persuaded by LV=, or anyone else, who feels strongly that it merits inclusion in the main table.

6. Aegon's terminology. We're saying nothing.

DRAMATIC SCHEMATIC INFOGRAPHIC



THE CASE STUDY BIT

Talking in the abstract about product segments, charging structures and other such goodies is all well and good, but sooner or later you're going to have to look a client in the eye and make some real-life suitability decisions. So we're going to run some case studies to see how different scenarios work for our product segments.

There are – inevitably – lots of assumptions in all of this. Here we go:

- For each segment, we assume a £100k initial investment, net of any initial adviser charges. We know this will wind some of you up as there are different viewpoints regarding the appropriateness of different products for different investment sizes, but that's for another day – we're looking at fair comparisons, and for that we need a consistent value across the board.
- For the guaranteed product, we'll model a simplified version of the Aegon offering. As the peer group here is so small, and the products so specialised, it doesn't make sense to model an 'average' product. And since Aegon is being nice enough to sponsor this paper we thought we'd put its goods under the microscope. We assume investment in the Aegon Cautious Portfolio with an OCF of 0.53%.[7] The income % at age 65 we've used to model guaranteed drawdown is therefore 4.05% (the current Aegon rate).
- For drawdown, you'll remember that earlier we looked at various schools of thought on the level of sustainable income needed to preserve a pot of cash in drawdown. We're going to use 3% as our assumption. We assume an ongoing product charge of 0.40% as that's the mean (average, not angry) market rate for an on-platform SIPP product. We lob a 0.53% OCF on top of that for the fund choice so it's fairsies compared to the guaranteed product, but clearly your mileage will vary depending on your investment proposition.

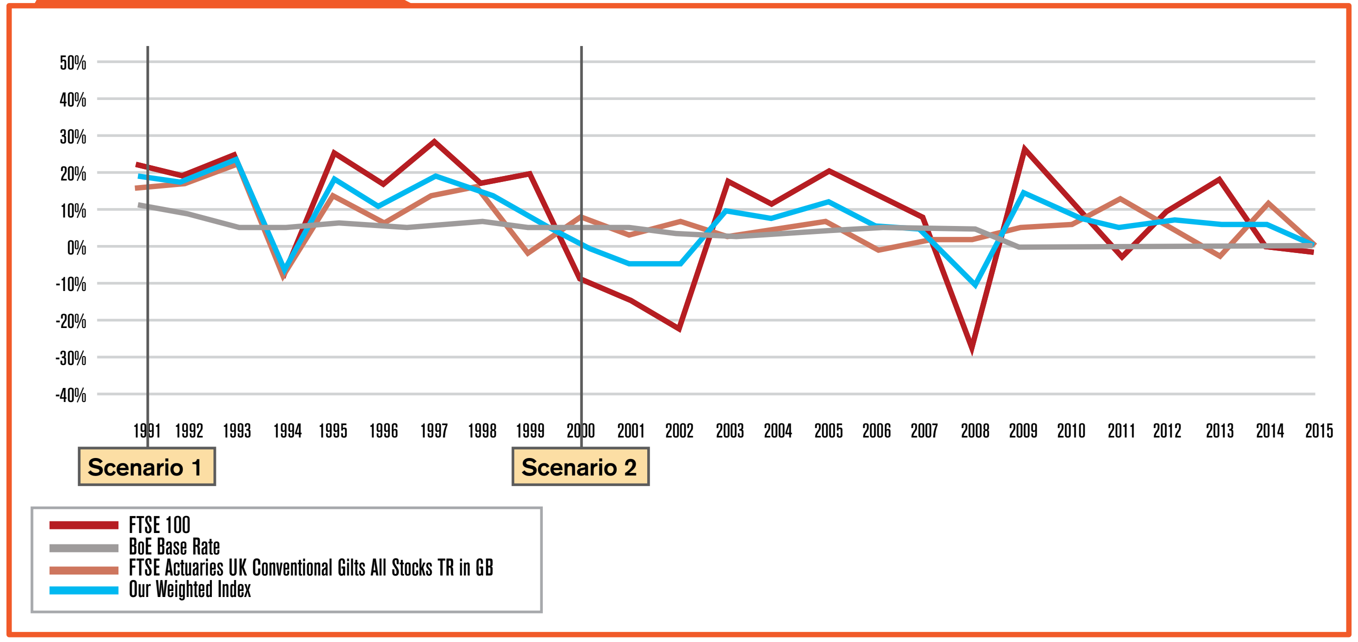
- For third-way, we assume a 50% annuity/50% drawdown split using the same assumptions.
- For each of these products we assume an average ongoing adviser charge of 0.65%[8]
- For the annuity segment, we use a conventional annuity. Our rate is 4.624% as it represents the best buy rate (65 years old, level, single life, no guarantee, no spouse's pension, monthly in arrears without proportion[9]) that Dr Google diagnosed at our time of writing this (3.28pm on 4 October 2016 if you insist). We're going to assume charges of… actually, scratch that, we can't assume any charges as they're inherent within the ~~death wager quotient~~ annuity rate offered to the customer. But you knew that already.

7. In fact, the TCO for both products is broadly similar – we'd only be talking about a 5 basis point difference were we to model the average, which doesn't alter the conclusions. We're not modelling the monthiversary feature of the product.
8. 0.65% average taken from CWC and the lang cat research conducted in autumn 2015 (Never Mind the Quality, Feel the Width 2).
9. We know that some annuities offer death benefits in exchange for a lower rate, but that's not what we're modelling here.

THE SCENARIOS

MARKET-WATCHING

Moving on to the proper analysis then. Here's how the investment picture appears at a high level, looking at the indices in isolation. We've sourced 25 years' worth of market data[10] for the indices in question.



ADDITIONAL ASSUMPTIONS KLAXON

For the market data we're going to look at:

- The FTSE 100 Index – as it's the number one financial benchmark that Auntie Moira will look at on the news, and therefore could impact how she feels about her choice after picking up the Money Mail section or logging onto BBC Business News.
- A composite index made up of the aforementioned FTSE 100 Index, FTSE Actuaries UK Conventional Gilts All Stocks and Bank of England Base Rate. We're using this as a reasonable proxy for investment in a fund with a mix of asset types.[11]
- We understand in all of this that modelling based on historical data has its limitations. But, in the absence of finding Biff's Sports Almanac, we don't know what the future holds.

What this shows is that for the time frame in question:

- the FTSE 100 has been a bit spiky (technical term);
- the fixed interest market got a bit choppy (again); and
- cash has done nothing for you.

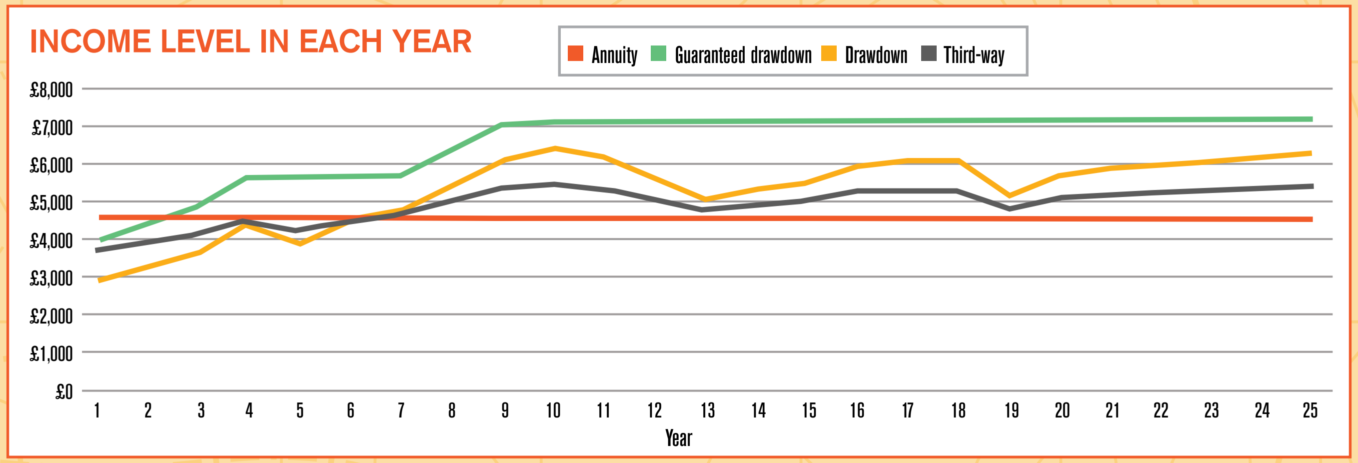
Now, we have quite a heightened sense of self-awareness at the lang cat, so we realise we will win no awards for rudimentary industry commentary like this, but it's vital to set the scene. Consider it set then and we'll bosh swiftly on and look at our product modelling. To reiterate, we're going to use the equities (42.5%) fixed interest (52.5%) and cash (5%) mashup[12] to underpin the investment performance of the drawdown and guaranteed product segments.

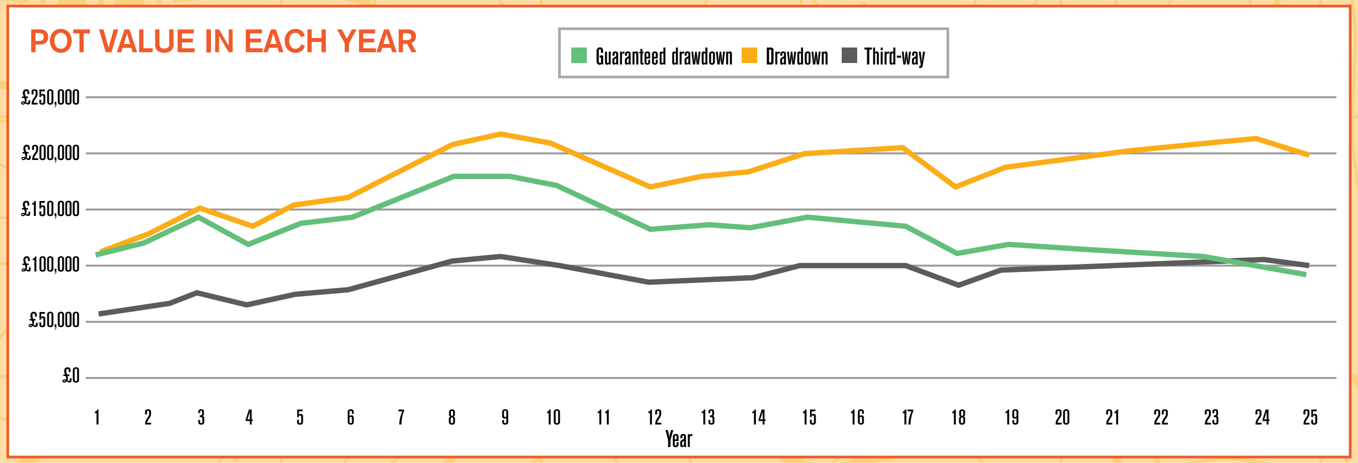
10. In the interest of transparency, the asset split we used was 42.5% equities, 52.5% fixed interest and 5% cash. Clearly, your split will vary and there are myriad investment options out there. But, modelling them all would be a bloody big graph, no?
11. Source: FE Analytics.
12. Worst mashup ever.

SCENARIO 1: LOOKING BACK 25 YEARS

Our agnostic look at the past 25 years based on our data set says:

PRODUCT	NOTES	TOTAL INCOME OVER 25 YEARS, TO NEAREST £1k	FINAL POT VALUE AFTER 25 YEARS, TO NEAREST £1k	TOTAL MONEY BACK, TO NEAREST £1k
ANNUITY	■ Set income of £4,656 a year. ■ No money left for beneficiaries on death.	£116,000	£0	£116,000
GUARANTEED DRAWDOWN	■ Pot value increases over the first 9 years, which results in income increasing from £4,050 to £7,287 – the highest income level. This gets #lockedin. ■ Total overall income £166,999. ■ Upon death, beneficiaries receive just over £92,000.	£167,000	£92,000	£259,000
DRAWDOWN	■ Highest overall payout. ■ Income fluctuates yearly with a high of £6,463 and low of £3,000. The variation (over £3,000 in this case) makes it hard to budget, unless a fixed amount is taken which risks eroding the pot in poorer market conditions. ■ Good pot left for beneficiaries upon death of £201,078 thanks to significant investment growth. ■ Overall income of £134,621 paid out.	£135,000	£201,000	£336,000
THIRD-WAY	■ Income still fluctuates, but not as much as pure drawdown, £3,812 – £5,544. ■ Pot for beneficiaries upon death of £100,000.	£125,000	£100,000	£226,000





KEY POINTS

- Strong market growth for the first 9 years sees all pots grow.
- A slight dip in the market diminishes the pot. Drawdown recovers from this more quickly thanks to lower charges and less income being taken.
- Guaranteed drawdown is slower to react, resulting in a smaller final pot value.
- Third-way, as we might expect, sits between drawdown and annuity for income.

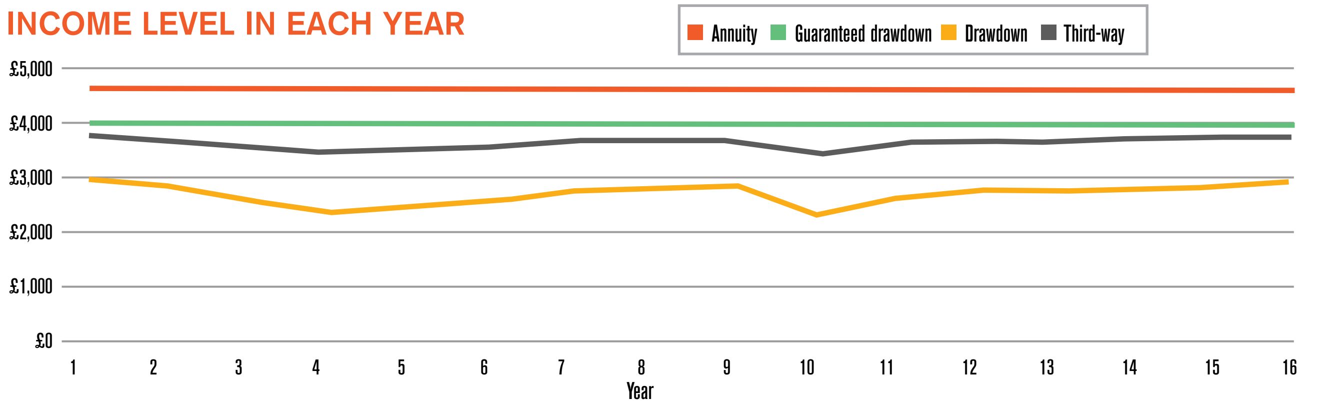
SCENARIO 2: LOOKING BACK 16 YEARS

We've all been around the industry long enough to smell conveniently structured examples designed for marketing fluff. So, we're going to deliberately illustrate a scenario now where things might not be smelling so rosy for the sponsor.

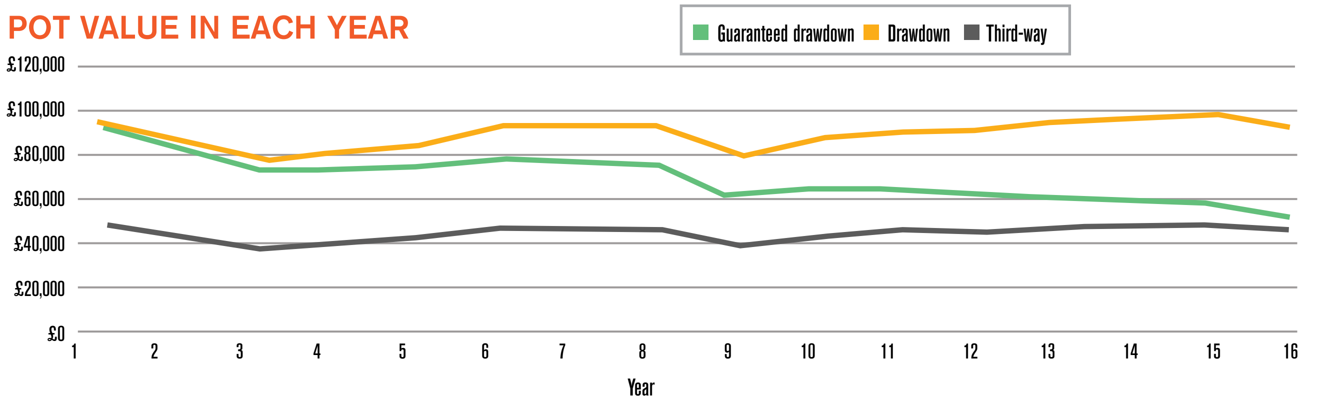
This time, we're deliberately starting the example at a time when the FTSE is going to go through a rough patch. So, how do the numbers look if we fire up the flux capacitor, get all 'new millennium' and illustrate a 16 year time-horizon? Let's stop with the pop-culture references and look at the numbers.

PRODUCT	NOTES	TOTAL INCOME OVER 16 YEARS, TO NEAREST £1k	FINAL POT VALUE AFTER 16 YEARS, NEAREST £1k	TOTAL MONEY BACK, TO NEAREST £1k
ANNUITY	■ No change here. You're getting this by now, right? ■ Total income of £74,000.	£74,000	£0	£74,000
GUARANTEED DRAWDOWN	■ Due to the poor initial investment performance, the pot never gets to a level where the guaranteed income increases, instead it stays at £4,050. ■ Final pot left at the end of the 16-year period is £51,000. ■ This scenario really demonstrates how guaranteed drawdown can insure against market volatility.	£65,000	£51,000	£116,000
DRAWDOWN	■ As with the guaranteed product, poor index performance leaves the value of the initial investment on a shoogly peg on a number of occasions, notably down by 20% in 3 years. ■ Things do recover: £93,335 is left at the end of the 16-year period, mainly thanks to the stellar performance of the FTSE in year 10. This assumes the same risk appetite has been maintained throughout.	£44,000	£93,000	£137,000
THIRD-WAY	■ Similar to our other examples, the annuity element is fixed at £2,312. ■ Overall pot left over is significantly down at £46,667.	£59,000	£47,000	£106,000

INCOME LEVEL IN EACH YEAR



POT VALUE IN EACH YEAR

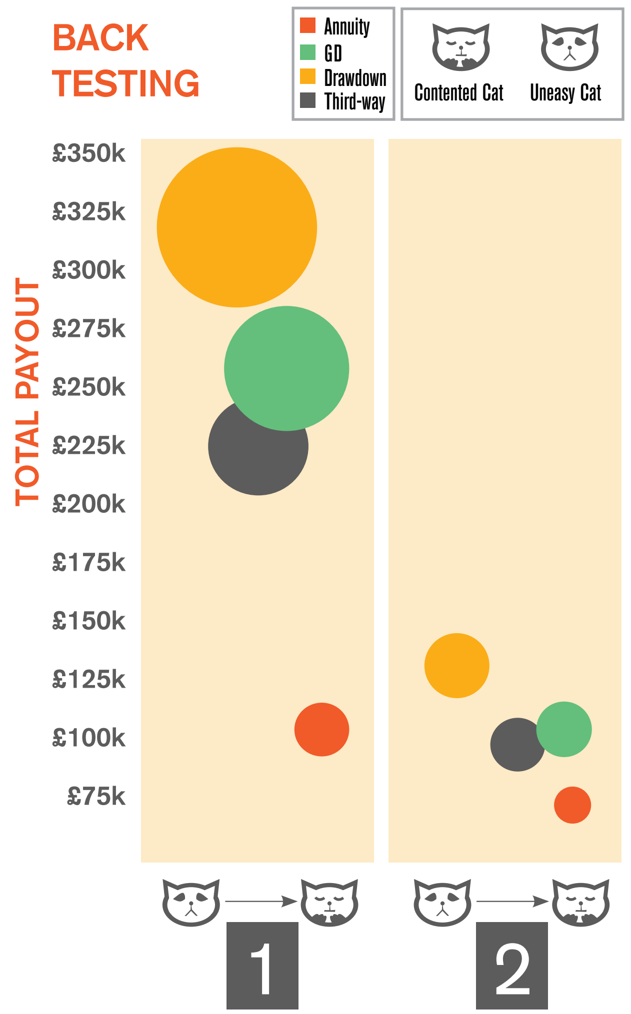


KEY POINTS

- All pots lose value due to a decline in the market.
- Guarantee charges (or the insurance premium if you like) mean that the guaranteed drawdown never really recovers from the loss, however income has already been locked in.
- Meanwhile, drawdown and third-way experience some growth, which benefits income a little.

Here's a visualisation (consultancy for 'picture') showing the total return for each scenario plotted alongside certainty of income. That's total income plus the remaining pot left for beneficiaries. The bigger the circle, the more total income you get in each scenario. The further to the right the circle, the more certain the level of regular income is.

BACK TESTING



CONCLUSIONS FOR SCENARIOS 1 AND 2

This just in. Guaranteed drawdown actually does what it says on the tin in real life, or would have done in our modelling. It actually proved itself to be more effective than we thought it would be, even allowing for the cost of guarantees.

- In scenario 1, the income guaranteed drawdown generates is higher but the value (and therefore death benefit) is lower than both naked drawdown and the third-way mashup we've chosen. And in scenario 2, we really see how guaranteed drawdown can provide peace of mind when the markets are choppy.
- In poorer markets, annuities rule in terms of pure income, because they're stripping your fund and not returning a death benefit. Both drawdown and guaranteed drawdown (where targeting sustainable income) will usually trail annuities (unless markets perform particularly well in the early years leading to high bonus lock-ins).
- The flipside is that drawdown and guaranteed drawdown give much more flexibility than annuities. Guaranteed drawdown falls neatly in between: it is linked to gilt yields, but will always have greater flexibility to access funds, change the plan and leave money behind.
- If we imagine that in any of these scenarios, the client needed access to money at year 5, because of a family emergency say, or just went a bit loco and decided to travel the world, guaranteed drawdown gives that flexibility (as does drawdown of course; our point is that guaranteed drawdown is not as locked down as it might first appear).
- In a straight fight on how much total value is returned, drawdown wins in both of our scenarios. **However, any adviser knows that raw return is only part of the story – how clients feel along the way is just as important.**

So what's it all about then, Alfie? It's all about mixing it up to achieve the outcomes you've agreed with your client. After doing all the modelling, where we get to is that we are much less minded to be declarative about 'this product for that situation' or 'that product for this situation'. All of our product categories have a place – and our third-way mashup shows that it's perfectly possible to create acceptable outcomes using a hybrid approach.

LOOKING FORWARD TO 2046

So far, we've assessed how the different withdrawal solutions would have behaved taking the historical financial markets into consideration. Let's do a bit of future-gazing now. We're going to do this because:

- We want to model 30 years as longevity is on the increase, and 30 year retirements are more and more common.
- The economy has fundamentally changed. Gone are the days of double-digit bank accounts and the fixed interest market is also significantly flatter.
- It's kind of interesting.

BIG CAVEAT KLAXON

Here's what we are most DEFINITELY NOT doing:

- **Predicting the future. We have no idea what's going to happen. Neither do you. Neither do your clients. Neither does Dr Emmett Brown nor anyone on YouTube.**
- **Presenting scenarios that we claim are likely to happen, or aren't likely to happen. This isn't stochastic modelling. We do predict there will be a future though, probably.**

We have deliberately modelled two market scenarios to demonstrate:

- one where guaranteed income products will perform well on the bottom line (giving you more money back); and
- one where naked drawdown will perform better on the bottom line.

In short, we are illustrating that different market conditions *will* result in different financial outcomes for the client. And this really comes down to what is going to make your client happy. That means taking into consideration the pros and cons of paying more to insure income, weighted against straight stock market exposure and the potential gains available.

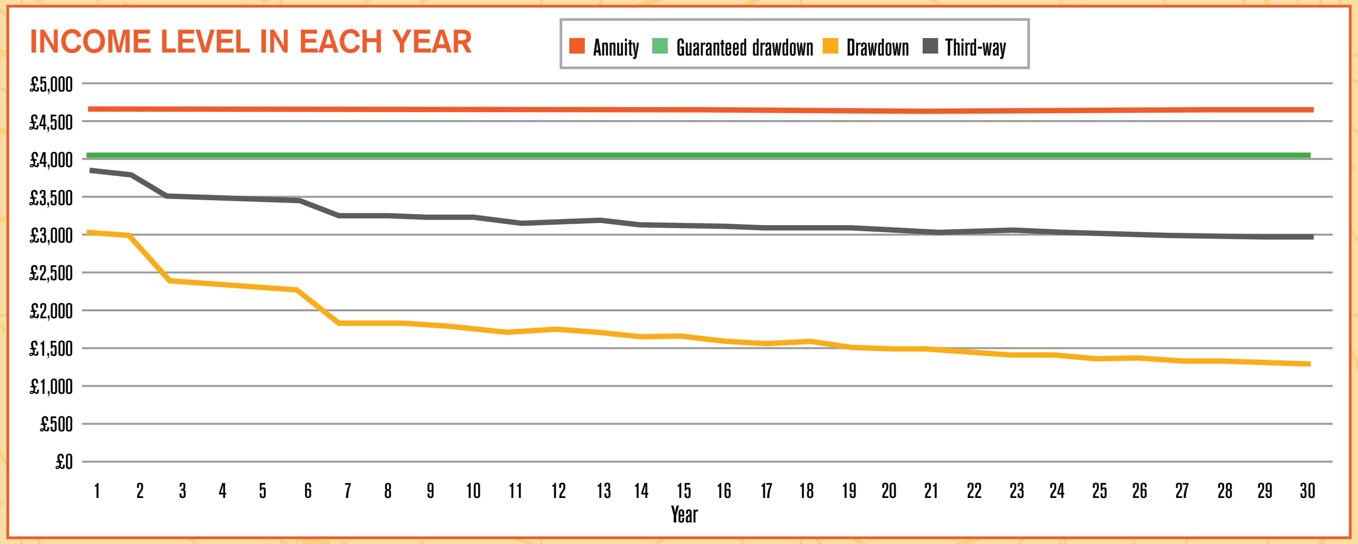
Whatever future scenario you, or more importantly your client, believes in must be a factor in withdrawal product choice. And that's that. But it's not the only thing. Their overall circumstances, attitude to risk and capacity for loss all come into it too.

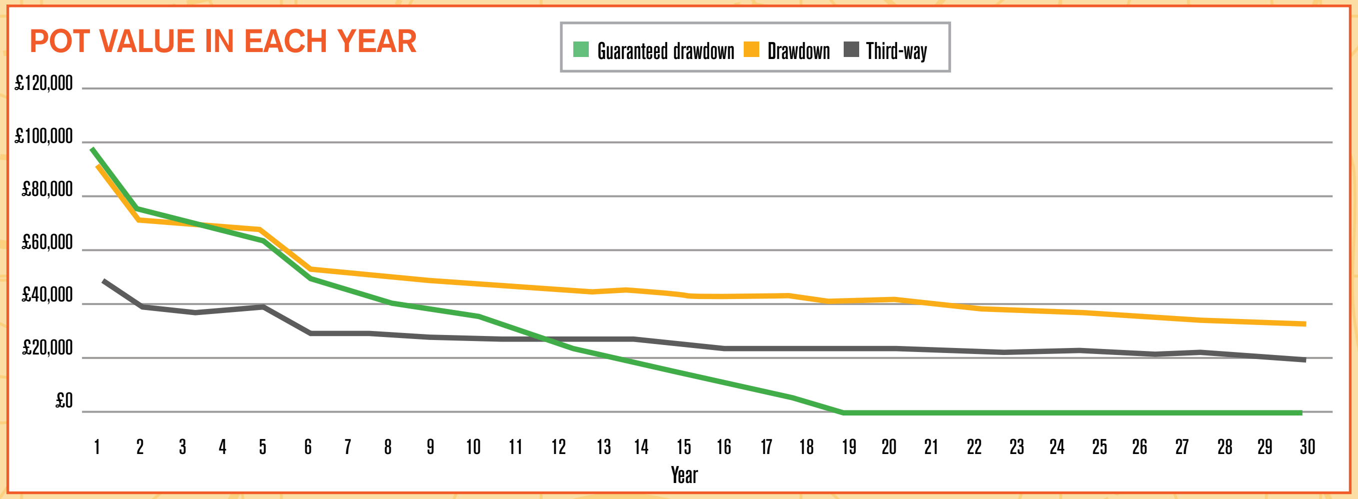
SCENARIO 3: LOOKING FORWARD 30 YEARS, GUARANTEED INCOME GIVES MORE MONEY BACK

ASSUMPTIONS

- £100k pot.
- Client aged 65 and all relevant product terms as per the previous scenarios.
- We assume 3% growth for the full 30 years, but with 2 market crashes of 15% each. The first in year 2 and the second in year 6.
- An income rate of 3% for drawdown.

PRODUCT	NOTES	TOTAL INCOME OVER 30 YEARS, TO NEAREST £1k	FINAL POT AFTER 30 YEARS, TO NEAREST £1k	TOTAL MONEY BACK, TO NEAREST £1k
ANNUITY	■ Annuities do what they do, the same as they always do. ■ The highest total income, just shy of £140,000.	£139,000	£0	£139,000
GUARANTEED DRAWDOWN	■ GD does what it does when there are negative market periods and low growth environments – maintains the same income back for the duration, totalling £122,000. ■ The pot whittles away to nothing.	£122,000	£0	£122,000
THIRD-WAY	■ Takes less of a hit than naked drawdown, because the annuity element acts as a smoothing mechanism. ■ A creditable £21,000 to leave behind.	£95,000	£21,000	£116,000
DRAWDOWN	■ The crashes decimate the pot and consequently the level of income drops over the years. ■ However, it leaves the highest final pot of £41,000.	£52,000	£41,000	£94,000





KEY POINTS

- The low growth rate eats away at all the pots.
- Guarantee charges and high income withdrawals combine in GD to drive the steepest decline in underlying pot value, although the income level is protected by the guarantee.
- Drawdown has lower charges and a proportional income rate dependent on the pot size, so underlying pot value dwindles more slowly. This is similar for the third-way product.

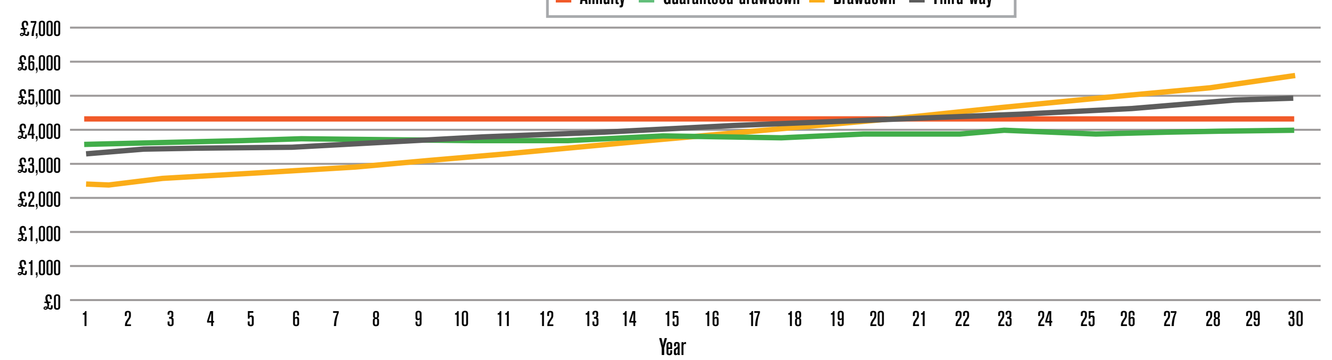
SCENARIO 4: LOOKING FORWARD 30 YEARS, DRAWDOWN GIVES MORE MONEY BACK

ASSUMPTIONS

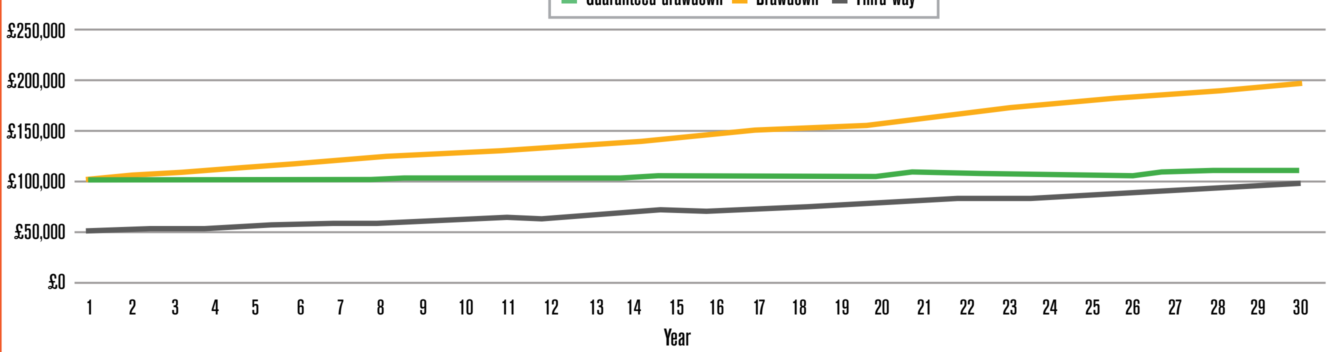
- £100k pot.
- Client aged 65 and all relevant product terms as per the previous scenarios.
- For this scenario we assume 7% growth and no crashes.
- An income rate of 3% for drawdown.

PRODUCT	NOTES	TOTAL INCOME OVER 30 YEARS, TO NEAREST £1k	FINAL POT AFTER 30 YEARS, TO NEAREST £1k	TOTAL MONEY BACK, TO NEAREST £1k
ANNUITY	■ Annuities continue to do what they always do. ■ Again, this means the highest total income at £139,000.	£139,000	£0	£139,000
GUARANTEED DRAWDOWN	■ A reasonable uptick in income in the middle years means a comparable total with drawdown. ■ Leaves £108,000 upon death. Less than drawdown, thanks to charges deducted and higher income, but still highly respectable.	£126,000	£108,000	£234,000
DRAWDOWN	■ Starts to pay the highest income rate towards the end of the retirement term, after lower income in the earlier years. Clearly a choppy ride, but ultimately rewarding. ■ Significant pot of just under £200,000 upon death.	£127,000	£195,000	£322,000
THIRD-WAY	■ Third-way smooths out the peaks and troughs here too but this time it's starting at a lower income and moving more slowly to a higher one. Overall though, returns a good income. ■ Just under the £100,000 upon death.	£133,000	£98,000	£230,000

INCOME LEVEL IN EACH YEAR

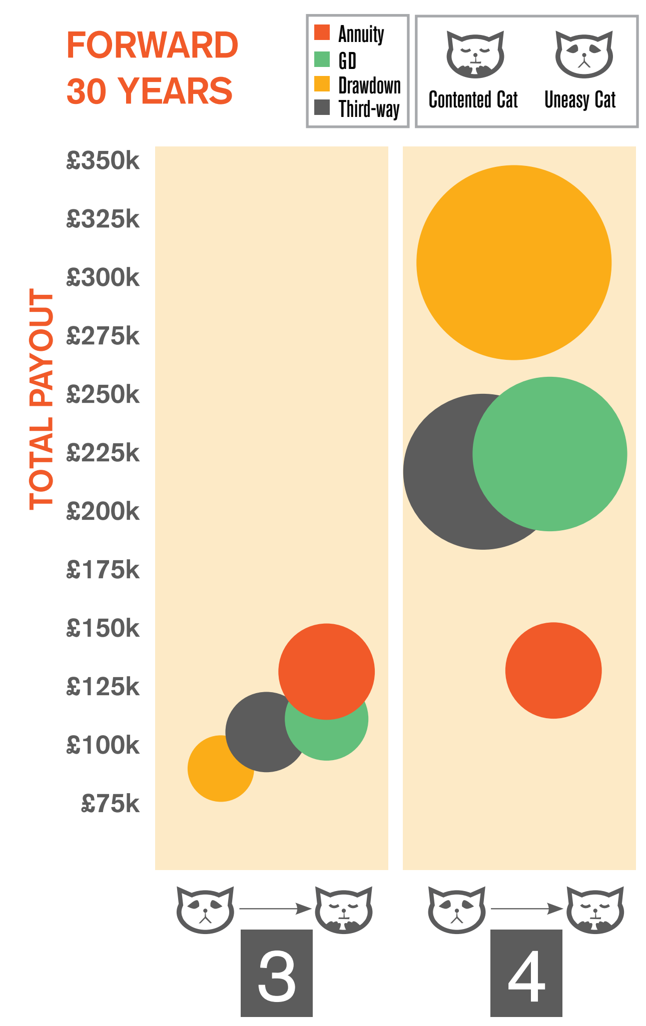


POT VALUE IN EACH YEAR



KEY POINTS

- The higher growth rate of 7% coupled with lower charges result in a strong growth rate for the drawdown pot. Third-way follows with a similar growth rate.
- Underlying GD pot value grows, but only marginally, due to the combination of higher income being taken and the charges.



SCENARIO 3 AND 4 CONCLUSIONS

In the event of a 30-year retirement, there is clearly much more chance of the pot being totally eradicated. In scenario 3, we see this happening to guaranteed drawdown with the naked drawdown and third-way pots coming under serious pressure. This is why we have the concept of a sustainable income rate. It's not hard to imagine scenarios where, without serious care, naked drawdown could lead to some awkward conversations. We haven't modelled one here, but anything with especially low growth and big crashes, particularly in the early years, has the potential to end up there. This is where timings are paramount and sequencing risk is a huge factor.

On the other hand, naked drawdown has the potential to react to positive market conditions and give more back – and always puts less charge deduction stress on the pot. That's just basic arithmetic (naked drawdown costs, on average, around 1% less for the customer) but worth pointing out.

We know that in the event of using naked drawdown (and indeed any solution) people aren't going to necessarily just take the SI, especially if the pot drops to a low level – it just wouldn't be enough in many circumstances. But what we've done throughout is model what we think is one way of making a fair comparison. If we had, for example, identified a fixed income level (say, to cover bills and core expenditure) and modelled that instead, the core finding would still be that the individual products will react in a consistent manner to the different market conditions.

In a sense, guaranteed drawdown thrives on market volatility. It needs the good years to share the spoils in terms of increased income. Specifically, guaranteed drawdown will need performance of around 7% (taking into account the net effect of withdrawals and charges) to grow the underlying fund sufficiently for the chance of increased income. This needs to happen year-on-year or, in the case of the Aegon monthiversary feature, a very special month would do it. You can see this just happening in the second scenario. However, they also need the bad years to validate the decision to use an insurance product in the first place.

We've established that annuities do what they do, the same as they always do. Repeat as required.

We find that in most outcomes, mixing things up and using a third-way approach is likely to smooth the ride.

We're going to stick our paws out now and look at withdrawal product suitability matches. And this gives you the lang cat's WITHDRAWAL PRODUCT SUITABILITY HEATMAP. If you're not familiar with heatmaps, they work on a sliding scale from green (best match) to red (poorest match).

ANNUITY

CONSUMER NEED
Withdraw whole pot
Lump sum(s)
Guaranteed income
Flexible income
Stock market exposure
Tax efficiency
Simplicity
Death benefits

GUARANTEED DRAWDOWN

CONSUMER NEED
Withdraw whole pot
Lump sum(s)
Guaranteed income
Flexible income
Stock market exposure
Tax efficiency
Simplicity
Death benefits

DRAWDOWN

CONSUMER NEED
Withdraw whole pot
Lump sum(s)
Guaranteed income
Flexible income
Stock market exposure
Tax efficiency
Simplicity
Death benefits

After much soul searching, we haven't included third-way in these tables. There are so many permutations that we couldn't give you anything meaningful. And of course, third-way is just a combination of the other products here.

Also, more red here isn't necessarily bad. Not everything has to work for everyone all the time. The advisers we spoke to as part of our research for this paper weren't looking for one cure-all; we were impressed by how ready firms were to adopt a 'whatever works' attitude.

AND THAT'S IT

So there it is, our analysis of withdrawal options in the UK today and where guaranteed drawdown sits within that landscape.

Something that struck us in particular was that pension freedoms, although hugely significant, might not have the predicted long term impact on behaviour. There was an initial rush to drawdown, which may have been due to a combination of the initial publicity and most of the money that was always going to be taken out being, er, taken out. The rate is slowing – and annuities appear to be (just) still standing after taking quite a beating.

Terminology continues to be poor right across the pension and withdrawal product world. So the lang cat is looking forward to the outcome of the ABI's consultation on pension jargon. The answer, chaps, is 'withdrawal'.

So let's bring it back to guaranteed drawdown, as the original focus of this paper. When we kicked off, it was with a reflexive 'meh' – guarantees are expensive, and clients wouldn't go for them if they saw what they cost. After the exercise – we still think they're expensive, but once you get in and start doing the modelling across economic cycles, you can start to see how they work.

And that's sort of the main learning here: perception is much more of a barrier to guaranteed drawdown usage than raw cost. We think we've proved that with an outcome-focused approach, client needs can be well met from the range of products available now, and that includes guaranteed drawdown. But no adviser or client is going to use something he/she doesn't understand, and it shouldn't take a PhD to work out what's going on. This is one for the marketing departments to sort out – and if they can, there is no reason why guaranteed drawdown shouldn't form an ever greater part of the retirement planning landscape.

In the end, the only three things that can ever be fully guaranteed are these:

- economic reality over what could easily be a 30-year or greater period in retirement will have little or nothing to do with any modelling and back-testing we or anyone else does.
- clients will die at some point.
- the only predictable thing about markets is that they cannot be predicted.

How a client feels about the journey in light of point 1, and what they want their finances to look like at point 2, will – as ever – be the most important determinants of suitability, and the reason that professional advice remains so crucial in this area.

And now let's be crystal clear on what we're saying here.

Having done this analysis, the value to clients is going to be experiential over time. **We do not know what is going to happen.** All you can do is explore what sort of line of thinking is going to make your client happy. It depends on what economic scenario they believe is most likely. It depends on their personal circumstances. It depends if they are worried about market crashes. It depends on their capacity for loss. It's the difference between speculation and insurance.

Unless a client is aggressive in their attitude to risk (and has a high capacity for loss) we believe an alternative to full naked drawdown exposure (that almost sounds rude, it might have been deliberate) has to be considered. That includes guaranteed drawdown, which is designed to offer the potential of capturing market growth.

Outcomes are not just what happen at the end.

In all of these scenarios we are showing base financial differences. These numbers don't show how your client feels along the way, outcomes are not just about sums or what happens at the end. Some people will want to pay for a guaranteed income. Some will enjoy riding the markets. Some might want a bit of both. Those views may change during the course of retirement. We think that all options need to be considered.

Throughout this paper we've been looking at the detail of how income might be generated from various products. But we're well aware of the importance of keeping one eye on the bigger picture. Whatever their benefits, it's very unlikely that an individual will only have a drawdown or guaranteed drawdown product. It will, in most cases, be part of a balanced retirement income portfolio – not the whole portfolio.

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