Adviser Home
DEVELOPMENT PLATFORM

RETIREMENT INCOME ADVICE

An Adviser Home Guide

Providing financial advice in a shifting landscape

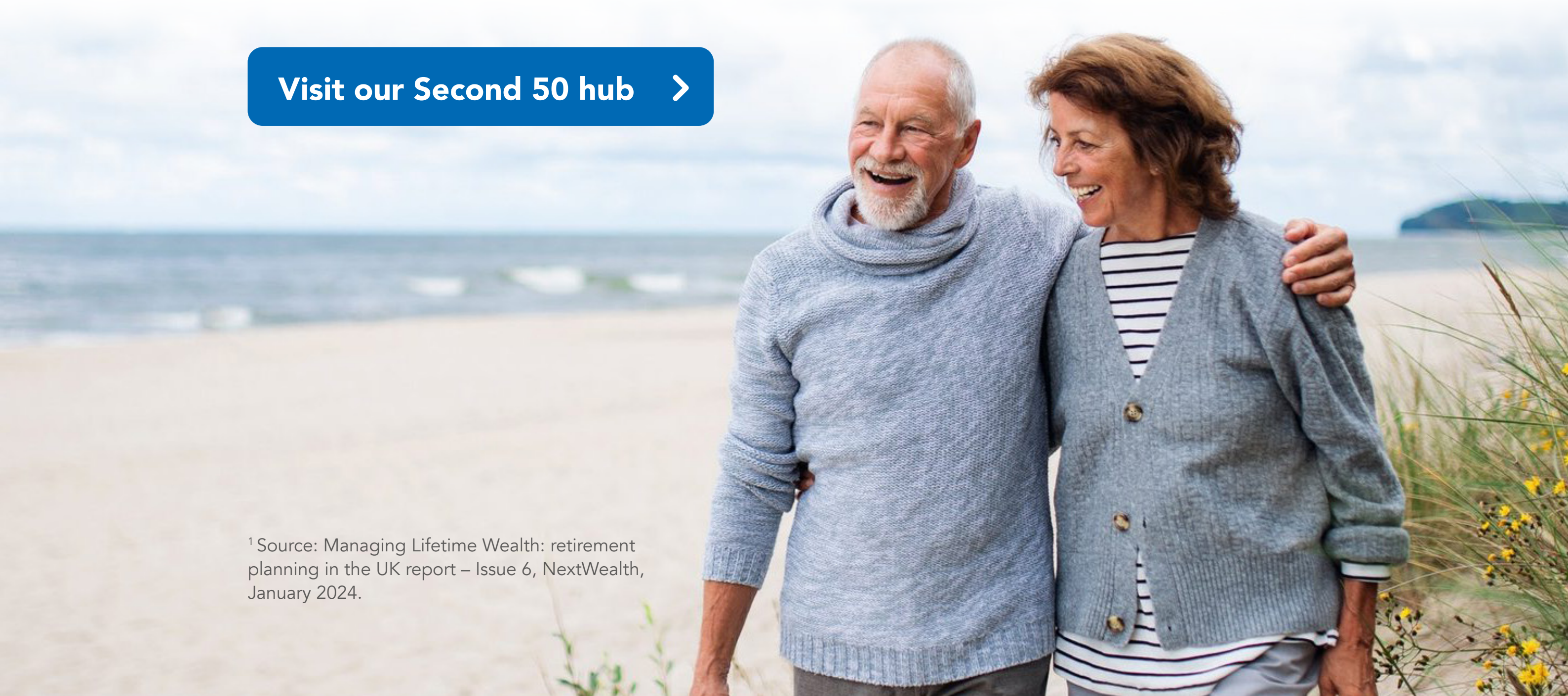
Retirement advice is a cornerstone of financial planning, with advisers estimating that **53%** of the assets they advise on personally are for clients receiving retirement advice[1]. An ageing population, accompanied by a cost-of-living crisis mean sound financial advice could make the difference between an inadequate, modest or more comfortable standard of living at retirement.

With retirement income advice likely to grow even further in importance as the move from defined benefit to defined contribution plays out, it was gratifying to see the FCA highlighting many areas of good practice in their thematic review of Retirement Income Advice. As with any regulatory review, the FCA found areas for improvement – some quite specific and others with potentially wider ranging application. Looking across the industry, the overall outcome will be a 'levelling up' of this advice sector offering a consistently high-quality service to this vital market.

Through improvements in life expectancy, new ways of working and evolving social norms, the way we experience later life and 'retirement' is changing – that's why at Aegon, we're exploring life after 50, or what we're calling the Second 50. In our new report, The Second 50 - Navigating a multi-stage life, we explore the changing nature of later life and its many possibilities. Our research suggests a longer life will fundamentally change what people should expect when it comes to moving through education, work, and retirement in a much less linear way. This means your clients approaching or in their 'Second 50' may be thinking differently about their future, how they reach their life and financial goals, and in finding meaning in their lives. Advisers play a vital and unique role, helping clients prepare financially and mentally for a longer, more enjoyable, multi-stage life.

Take a look at our resources to discover the changing nature of later life and its many advice opportunities.

Visit our Second 50 hub



[1] Source: Managing Lifetime Wealth: retirement planning in the UK report – Issue 6, NextWealth, January 2024.

Fidelity Adviser Solutions – navigating the retirement maze

Post pension freedoms, individuals nearing or in retirement now face much more complex decisions – how to fund their retirement, what income to draw and, where applicable, which investments to hold. There are lots of variables to consider and to help advisers keep on top of some of the key retirement issues, Fidelity has produced a series of insightful reports. These explore topics such as:

- How much does a comfortable retirement cost?
- The variables that determine a sustainable withdrawal rate
- The impact of inflation on retirement planning.

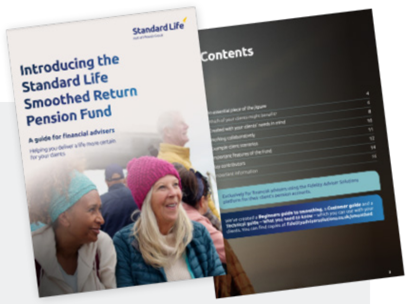
View the full range of reports

The FCA recognises advisers have a key role to play in helping individuals make decisions for the decumulation phase of their lives. However, their thematic review of the retirement income advice market highlighted some key concerns it has in this area. Fidelity recently hosted a webinar where a panel of experts explored the review's key findings and the implications for advice firms. They considered key questions such as:

- Why is the FCA so focused on the role and delivery of retirement income advice?
- What are the key risks to firms of providing retirement income advice and what actions they should take?
- Do firms need to have a different advice proposition and charging structure for clients in the decumulation phase?

View replay

The panel touched upon the role new products have to play in delivering a sustainable income for clients. One such option is the new Standard Life Smoothed Return Pension Fund, which is exclusively available to advisers using the **Fidelity Adviser Solutions** platform for their clients' pension accounts. It's designed to deliver an income in retirement that is likely to be more consistent than that provided by an unsmoothed fund.



Find out more

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INTRODUCTION

Retirement advice is now receiving a huge amount of regulatory attention while, more broadly, policy makers continue to grapple with achieving better outcomes for the wider population of pension scheme members and savers.

Advisers are, effectively, being challenged on the approach and processes they use in the delivery of their retirement advice.

Indeed, it is difficult to imagine an initiative closer to the heart of the matter in terms of what advisers offer to the majority of their clients for whom securing a comfortable and financially secure retirement is one of the primary reasons they seek advice.

Therefore, much of the focus of this guide will be on the FCA Retirement Income Advice Thematic Review.

There is a growing belief among advisers and experts that the FCA initiative represents a significant challenge to current practice. That may have been underplayed in initial reports of the FCA work which focused on the fact it didn't signal a widespread regulatory intervention. Many of the headlines and initial analyses included the words 'mixed bag'. However, it feels as the market now senses that the review could be much more consequential. Indeed, there are warnings for those advisers persisting with 'poor practice' that enforcement could follow.

It would make sense for just about every advice business to consider what they are offering given the FCA's concerns and priorities, even if just to reassure themselves they are doing the right thing.

This guide will not just focus on the regulatory environment, but also seek to consider the important trends beyond regulation, how the market is changing in terms of client needs, briefly touch on the shift in the environment regarding taxation and allowances, and finally provide lots of useful links.

AN OVERVIEW OF THE RETIREMENT INCOME MARKET

The FCA has been assessing the retirement income market periodically since 2015, coinciding with the launch of pension freedoms.

The very latest data, published this year, runs from April 2022 to March 2023. We include the highlights, as identified by the FCA, in the statistics below.

BROAD **STATISTICS**

Total number of pension plans accessed for the first time in 2022/23 increased by **4.8%** to 739,535 compared to 2021/22 (705,666).

UFPLS saw the biggest increase in **pension plans accessed** for the first time from 36,271 in 2021/22 to 41,571 in 2022/23 (**14.6%**).

Sales of annuities decreased from 68,514 in 2021/22 to 59,163 in 2022/23 (**13.6%**).

The overall value of **money being withdrawn** from pension pots fell to £43,199m in 2022/23 from £45,638m in 2021/22, a decrease of **5%**.

32.9% of plans accessed for the first time in 2022/23 were accessed by **plan holders who took regulated advice** (down from 33.4% in 2021/22).

58% of pensions accessed in 2022/23 **did not receive advice or guidance**, compared to 48% in 2018/19. Nearly 429,000 pensions were accessed without professional help compared to 314,000 five years earlier.

Continue

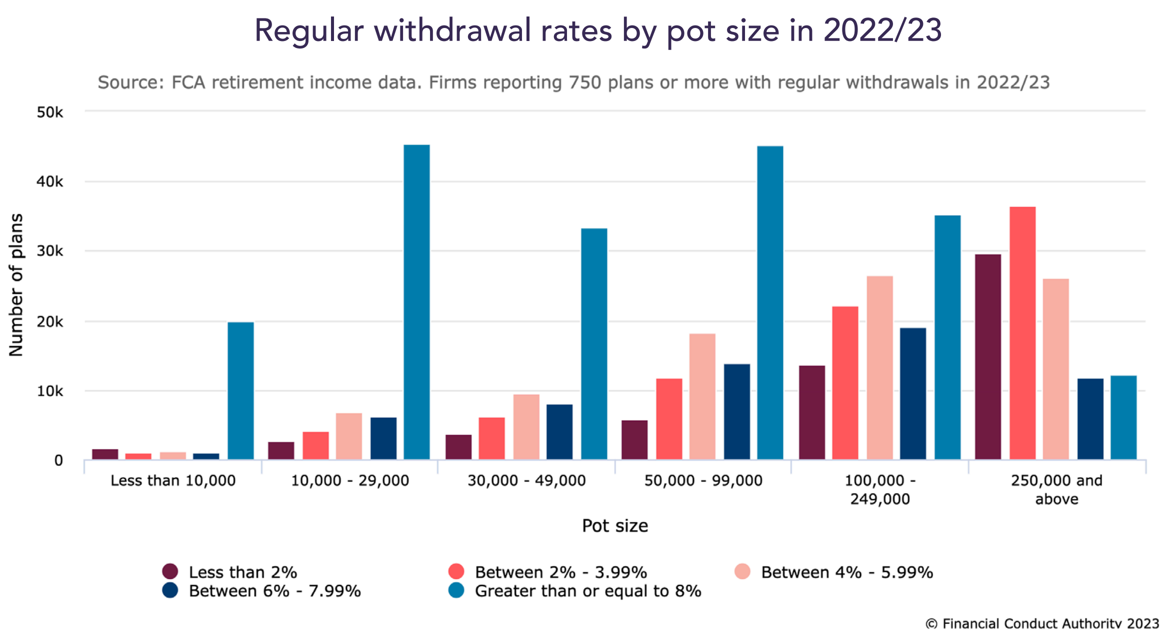
Use of advice or guidance is lower in all categories compared with the 2018/19 survey, but drawdown fell the most from 75% to 61%. Among UFPLS withdrawals it has declined from 56% to 34%.

The number of **DB to DC transfers** continued to fall from 26,619 in 2021/22 to 18,073 in 2022/23.

WITHDRAWAL RATES BY POT SIZE

The table below shows withdrawal rates by pot size. What is striking is that for small to mid-sized pots even up to a pot size of £249,000, withdrawals of eight per cent or more make up by far the most common level of withdrawals.

Only in the £250,000 and above group do we see withdrawal levels that could be argued to be sustainable - with 2% to 3.99% - being the most common choice. (Clearly this appears to be more of an issue for non-advised savers as a read-across to withdrawal rates used by firms, surveyed in the FCA's thematic review demonstrates).



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We look at drawdown and annuities below, taken with advice (blue), after having consulted PensionWise (yellow) and without advice in any form (grey). The trends do not look particularly striking although there is some falling off for those seeking annuities with advice.

Retirement income market data 2022/23 | FCA →

OTHER SOURCES OF INSIGHT

OVERALL **ANNUITY SALES**

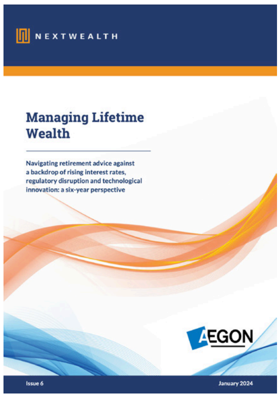
Although the FCA figures above show **a decrease in annuity sales** from 2021/22 to 2022/23, the Association of British Insurers' figures suggest a different story or at least a suggestion that the market may, to some degree, be interest-rate and price sensitive.

As it reported in February 2024, annuity sales jumped in 2023 with a total sales value of £5.2 billion, a 46% increase on 2022 and a record for the years since pension freedoms.

2023 sets new post-pension freedoms record for annuity sales I ABI →

SURVEY OF ADVISERS REGARDING **RETIREMENT ADVICE**

The NextWealth report Managing Lifetime Wealth Retirement Planning in the UK, sponsored by **Aegon**, surveyed 200 advisers for its 2024 edition (researched in 2023).



Some key figures include the fact that only 6% of financial advisers say they never recommend guaranteed income products to retirement advice clients.

76% recommend them sometimes. The proportion that always or often recommend these products fell back slightly this year to 18% from 24% last year.

Advisers estimated that 53% of the assets they advise on are for clients receiving retirement advice.

Those seeking to use drawdown to take a sustainable income, while preserving all or part of their capital was 83% in 2023, a steady downward shift from 96% in the report published five years ago.

The report also found advisers suggesting that when asked about clients' retirement aspirations, 76% were hoping to maintain the same standard of living, 65% assisting the next generation and 45% hoping to travel or live overseas.

Retirement advice in the UK I Adviser I Aegon →

AEGON

Continue

ATTITUDES OF CONSUMERS APPROACHING RETIREMENT

A survey by Retirement Review and iPipeline found that of 2,000 40 to 66 years olds with pension savings, the average target pot was £223,503, while on average the total value of personal pension pots across all schemes was £167,891. This might indicate that for those building reasonably sized pots, consumer expectations are not widely divergent from reality, bearing in mind the age range of respondents.

Retirement Review | Building a Better Retirement →

RETURN TO WORK/PHASED RETIREMENT

14% of retirees aged over 55 have gone back into work, according to research from Standard Life's Retirement Voice report, as their living costs have increased, and their pension is not sufficient to fund retirement. A further 4% are also considering returning to work.

Almost two-thirds (64%) of over 55s who have unretired say that income issues have been the driving force behind this. A third (32%) have found their living costs have increased more than they'd expected, meaning they've needed to return to work, and 24% have realised their pension is not providing enough income to live on. Meanwhile, three in ten (31%) want to earn more money so they can treat themselves more in retirement.

The study surveyed 6,350 adults in August 2023.

14% of retirees have returned to work →

REGARDING **SUFFICIENT INCOME**

The Pensions and Lifetime Savings Association has updated and increased the three levels of retirement income deemed necessary for a minimum, moderate and comfortable retirement.

Roughly speaking, a single person will need to be able to spend £14,400 a year to achieve the minimum living standard or £22,400 for a couple, require £31,300 a year for a moderate living standard or £43,100 for a couple, and £43,100 a year for a comfortable living standard or £59,000 for a couple.

Home - PLSA - Retirement Living Standards →

KEY REGULATORY EVENTS

PENSION **FREEDOMS** AND **ALLOWANCES**

The Pension Freedom reform, which came into effect in April 2015, radically liberalised retirement decisions and cut annuity sales from around 350,000 a year by around 80% and arguably increased the need for advice at a time when the numbers were falling.

For the public, it meant that from the age of 55, you could access your pension in many different ways, when previously, especially for those with smaller and mid-sized pension pots, there was close to a de facto requirement to buy an annuity to secure an income.

Many of those approaching retirement who did seek advice were in somewhat more restrictive drawdown arrangements known as capped drawdown.

Since 2015, the public can access the whole pension pot as one lump sum; 25% will be tax-free with the remainder added to your annual income and potentially taxed at the marginal rate, one hazard being that accessing a large sum can move someone into a higher tax band that tax year.

Taking an income from a flexi-access drawdown fund or an uncrystallised funds pension lump sum does restrict the amount you can place back into your pension with a limit of £10,000 now applying as part of the Money Purchase Annual Allowance (though it has been as low as £4,000).

The rules around tax free cash relating to the abolition of the Lifetime Allowance (LTA) from April 2024 (the LTA was set to zero for 2023/2024) have changed some of the calculations around tax free cash. The tax-free element is now limited to the value that could have been paid on 5 April 2023 which suggests it will get less generous in real terms over time.

Consultations are ongoing on finalising the rules around LTA abolition with extensive newsletters and Q&As from HMRC, final legislation still due, and with political uncertainty regarding Labour's plans also continuing. At time of writing, Labour were reported to not be bringing back the LTA but this wasn't in their manifesto.

The most recent and extensive HMRC Q&A dates to April 2024 - Lifetime allowance (LTA) abolition - frequently asked questions - GOV.UK (www.gov.uk).

HM Revenue & Customs

Continue

REGULATORY INITIATIVES WITH AN IMPORTANT IF INDIRECT INFLUENCE

Two other regulatory initiatives are very likely to have a bearing on what firms are doing. These are the coming into force of Consumer Duty with finalised guidance published in July 2022. Much of the current regulatory work makes reference to the Duty. It is also likely that the advice and guidance boundary review DP23/5: Advice Guidance Boundary Review – proposals for closing the advice gap l FCA could have implications for retirement guidance if not advice and this review again makes reference to it.

RECENT REGULATION AS IT RELATES TO THE SUPERVISION OF ADVISERS AND ADVICE

While it can be argued that Pension Freedoms has led to lots more scrutiny of advisers' retirement advice, the two obvious forerunners of this examination of retirement, are widely held to be the Assessing Suitability Review - Assessing Suitability Review l FCA - from 2017 and the various work on Defined Benefit (DB) transfers ranging for regulatory work on poor advice and misselling regarding the British Steel Pension Scheme to tightening up a host of FCA work on transfer advice culminating in Final Guidance FG21/3: Advising on pension transfers l FCA. The DB work also saw the FCA produce a regulatory tool the Defined Benefit Advice Assessment Tool (DBAAT) for assessing previous advice on DB transfers, an approach now emulated in the current work as we will see below.

FCA FINANCIAL CONDUCT AUTHORITY

The FCA itself says that current review evolved from Assessing Suitability Review II, a second look at suitability shelved due to the pandemic. But now, the market view is that between the first suitability review and the emerging DB transfer problems, the regulator decided it needed to subject retirement advice to much more scrutiny as indeed, we shall see soon.

THE MAIN REVIEW IN DETAIL

The latest regulatory intervention follows the FCA's thematic review of retirement income - [Thematic review of Retirement Income Advice | FCA] which was published in March 2024.

It was accompanied by a Dear CEO letter setting out expectations of advice firms in light of the review and an accompanying article on cash flow modelling setting out some concerns about how firms were using such modelling in their advice to clients.

It does feel as if the regulator envisages a lot of change if not for the whole advice market around retirement, then certainly for those who are not meeting the required standards following its review.

Those not doing what the regulator wants, represent a minority of the sample, but a worrying one and, certainly for this group, the FCA is demanding change.

It intends to effect this change with the Dear CEO letter summarising several areas of concern and an article outlining specific concerns about cash flow modelling. More details are then spelled out in the review documents including suggestions of good practice and poor practice. The FCA makes great use of links to other work and regulatory requirements.

The review covers a range of issues – again – including broad risk calculations, variable approaches to retirement advice, poor record keeping and indeed not making enough effort to conduct reviews that have been promised and are paid for.

It also includes what might be called an interesting 'call-back' from the regulator regarding failings it previously found in pensions transfer advice.

We look at the letter first, then the CFM article and then summarise the review. Our intention is to give a strong feel for what the FCA wants, but, of course, if advisers have concerns, they should read the documents in full themselves. We have focused on the criticisms unfortunately. (Comments in the 'voice' of this guide are in brackets with all the rest being the FCA's words or at least abridged versions of them.)

DEAR CEO LETTER - SUMMARY

"Our review found examples of both good and poor practice across the market. Some firms showed they had considered their customers' needs and had designed their advice model in a way likely to lead to good outcomes."

Continue

"However, we saw that some firms may not be meeting the needs of their customers, potentially leading to poor outcomes. We ask all firms to ensure their advice process complies with FCA requirements on information collection, suitability and disclosures. They must also ensure they have adequate systems and controls and monitor customer outcomes."

Areas for improvement (listed in the letter)

→ The approach to determining income withdrawals was applied without taking account of individual circumstances, or based on methods and assumptions that were not justified or recorded

→ Risk profiling was not evidenced, was inconsistent with objectives and customer knowledge and experience, or lacked consideration of capacity for loss

→ Failure to get necessary information about customers to demonstrate advice suitability, including expenditure or other financial provision, or not exploring future objectives or circumstances, including income needs or lifestyle changes

→ Periodic review of suitability, where relevant, was not always delivered to customers that had paid for ongoing advice

→ Inaccurate or insufficient records held as the control framework to enable customer outcomes to be assessed and track whether periodic review services were delivered

The letter also sets out actions it wants to see firms take, listed below:

1 Take steps to address the review's findings within your firm

You should consider our findings and take appropriate steps to meet our requirements on retirement income advice, including the Consumer Duty, and document how you have done so. You should also refer to the questions in the data survey to identify what improvements could be made to your management information to monitor customer outcomes and respond to regulatory information requests.

Continue

2 The Retirement Income Advice Assessment Tool (RIAAT)

We have also published the RIAAT and accompanying instructions, developed for the purpose of the review to assess the suitability of advice files. This tool will help firms providing retirement income advice understand our methodology.

3 Refer to our article on Cashflow modelling (CFM)

In addition to the review's findings, we have published an article which sets out how firms can improve the way they use CFM. It outlines points to consider when undertaking modelling to help firms deliver suitable advice and aid consumer understanding. You should also refer to our rules for defined benefit transfers which set out requirements for how CFM should be used in similar scenarios. In line with ongoing obligations under Principle 11 and the notification requirements in SUP 15 of our Handbook, please let us know if you identify any matters which you consider we would reasonably expect notice.

ARTICLE ON CASH FLOW MODELLING - SUMMARY

The structure of the letter revolves around identifying foreseeable harm and then a set of 'findings' from poorly delivered cash flow modelling, again with lots of links. We quote the FCA directly as far as possible. Words in the 'voice' of this guide are in brackets once again.

Foreseeable harm can be caused if firms:

- do not consider how clients will interpret the output
- project forward using returns that are unjustified and don't result in realistic outcomes
- do not consider the inputs and outputs objectively

Continue

1 Finding 1: Firms relying on information without considering accuracy

A firm is entitled to rely on information provided by clients unless it knows the information is clearly out of date, inaccurate or incomplete.

What we found

- Not challenging clients on figures provided: for example, where income and expenditure indicate savings are available, but the client has no savings
- Not thinking about future lump sum needs: for example, to replace cars or carry out home maintenance

How can firms improve?

Use correct data for inputs

2 Finding 2: Using justifiable rates of return

The returns used within cashflow modelling are one of the most important parts of the model. We expect firms to have a reasonable and justifiable basis for all assumptions they use in the model.

If the firm's modelling is based on incorrect assumptions, there is a higher risk of poor consumer outcomes. The client is not likely to understand the risk that they will not achieve the returns they need to achieve their objective and so will not be in an informed position.

What we found

- High returns assumed for cautious assets, without explanation
- Projections based entirely on past performance, without considering if this provides an appropriate expectation of the future potential
- Not taking tax into account in any withdrawals
- Not considering how charges will affect the future potential returns, or failing to account for all product and adviser charges

How can firms improve?

Consider the potential investments
Use justifiable future rates of return
Include all charges

Continue

Finding 3: Planning for uncertainty

Cashflow modelling is based on assumptions, and in our work we have seen firms explain this poorly to clients.

If the firm does not explain cashflow modelling clearly its recommendation may not align with the customer's risk tolerance and capacity for loss. Customers could be misled about the sustainability of their pension.

What we found

Examples we have seen of this are firms:

- Mixing real and nominal terms in their cashflow modelling
- Only planning for average life expectancy, when 50% of people will live longer than this
- Failing to properly stress test outcomes in line with the potential investments

How can firms improve?

Use real terms consistently
Plan beyond average life expectancy
Undertake stress testing

Finding 4: Consumer understanding

When they get advice, clients may receive a number of communications from firms that refer to future outcomes.

Using multiple growth rates across different communications is likely to confuse clients and lead to misunderstanding if not explained.

What we found

- Risk profiling tools often refer to the potential returns of the selected risk profile or the percentage fall a client may be willing to accept
- Key features illustrations will show projections where the pension provider has selected a rate of return which is aligned with the underlying assets
- Cashflow models will have their own assumed growth rates, which could be different from the above

How can firms improve?

Consider consistency of communications

Continue

Finding 5: Consider the output

Firms need to review the cashflow modelling outputs to draw conclusions about the client's potential financial position before and during retirement. These outputs are key factors to consider in the firm's suitability assessment.

If the firm fails to review the outputs:

- The cashflow model given to the customer may be factually incorrect or misleading
- It may recommend a solution that is not suitable for the customer's needs or objectives
- There is a higher risk that the financial plan will not work out as intended.

What we found

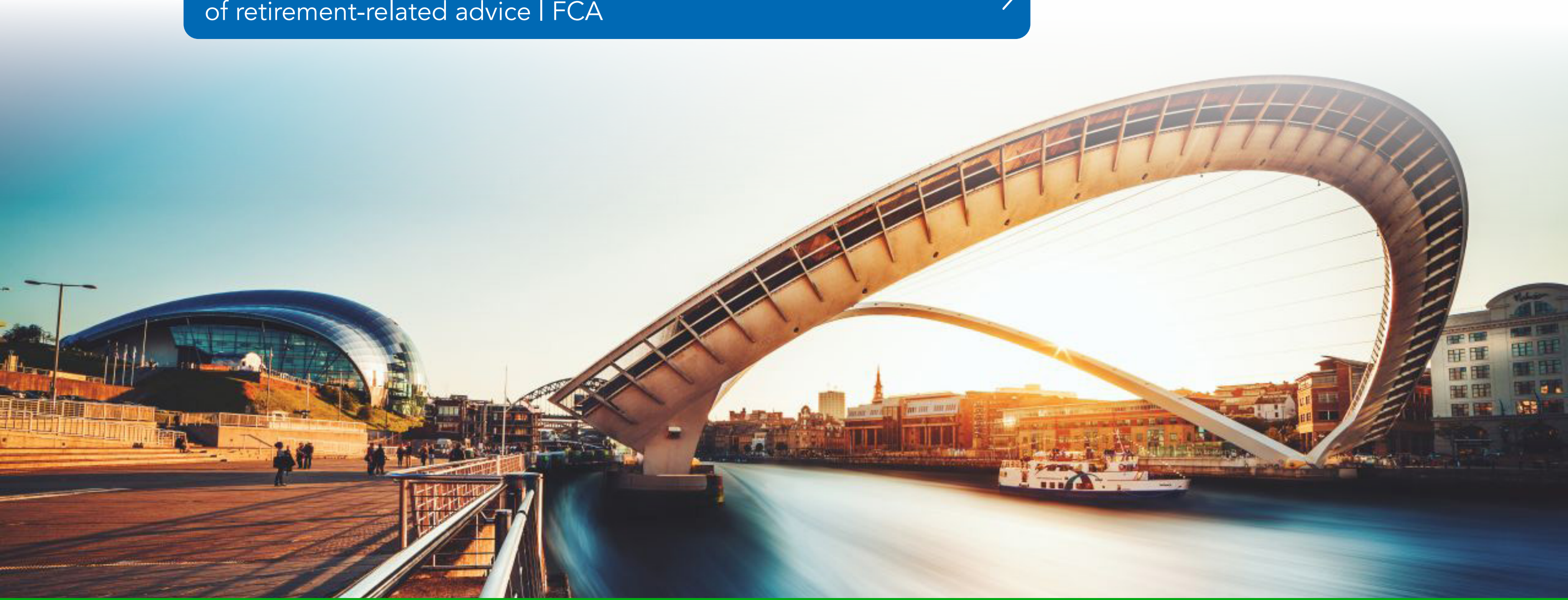
Examples we have seen of this are that the firm may fail to:

- Realise that the model relies on pensions being accessed before the minimum pension age
- Identify where the cashflow model relies on illiquid assets, such as the client's main residence or non-rental property, for lifestyle expenditure
- Consider the impact of tax on the client's proposed withdrawals, with the consequence the client needs to take more from the fund than is projected and could run out of money sooner

How can firms improve?

Review cashflow modelling outputs

Undertaking cashflow modelling to demonstrate suitability of retirement-related advice I FCA



RETIREMENT INCOME REVIEW HIGHLIGHTS

The full review refers to various in force regulations which the FCA strongly implies some advisers could be in breach of, some of which stretch back to 2011. We list those below.

FCA FINANCIAL CONDUCT AUTHORITY

List of regulation of relevance to the review (FCA's own view)

FG11/05:'Assessing suitability: establishing the risk a customer is willing and able to take and making a suitable investment selection'

FG12/16: 'Assessing suitability: replacement business and centralised investment propositions'

TR16/1: 'Assessing suitability: research and due diligence of products and services'

Regulatory Guide: 'The Responsibilities of Providers and Distributors for the Fair Treatment of Customers' (RPPD)

FG21/1: 'Guidance for firms on the fair treatment of vulnerable customers' • FG21/3: 'Advising on pension transfers'

The review also makes frequent reference to the newer initiatives in other words **Consumer Duty** and **the Advice Guidance boundary review** as noted previously.

The sample and statistics

Findings were drawn from a representative sample of 977 firms who responded to a data survey, and a desk-based review of the advice models and advice files of a sample of 24 firms.

The FCA requested advice files from the 24 firms including a desk based review. It noted 10 files (10%) were missing key documents, so could not be assessed. Of the files the FCA were able to review, 45 files (67%) were found to be suitable. However, it found 7 files (11%) where we had concerns about suitability and 15 files (22%) had material information gaps (MIGs).

Continue

Specific areas of concern (quoting the FCA directly again)

Income withdrawal strategy/methodology

The withdrawal guide rate firms used to help calculate sustainable income varies across the market. Firms may have referred to industry research when deciding what withdrawal guide rate to use as the standard basis for income drawdown advice within their firm.

Not all firms were effectively considering sustainability of income withdrawal. For example, many firms were not using CFM or were not using it in a consistent or appropriate manner.

We expect firms to illustrate the longevity of income in a variety of scenarios.

Risk profiling

Firms should assess capacity for loss (CFL) consistently, in addition to attitude to risk (ATR), to help identify suitable solutions for their customers. ATR is a subjective measurement of an individual's willingness to accept risk while CFL relates to their ability to absorb losses. ATR and CFL are both key elements of risk profiling. When moving from accumulation to decumulation it is likely that the ATR and CFL for many customers will change so needs to be reassessed.

Deficiencies with firms' fact finding and records:

- Potential vulnerability was not identified, recorded or explored even where information on file suggested vulnerability may have been present
- Knowledge and experience of investments and understanding of risk was either recorded at a high level, inconsistently or not supported by the information on file
- Expenditure analysis was not recorded or completed so it was not clear what the minimum income need was or what proportion of this was for essential expenditure
- Information about wider financial circumstances, for example, other pension provision and the state pension was missing
- Income, including any lump sum capital needs were not quantified or the timeframe for which income was required was not stated
- Future lifestyle changes were not explored or recorded, for example, when a partner would retire/receive a pension or how objectives or income needs were likely to change
- It was unclear whether information relating to the risk of capital erosion, the potential for annuity rates to be worse in future, or that income levels might not be sustainable had been disclosed

Periodic review of suitability

Where customers are paying for ongoing advice, firms should clearly confirm the details of the ongoing service, its associated charges, and how customers can cancel the service and stop payment of associated charges.

Firms should not charge customers for services that are not delivered. In the data survey, some firms indicated that some of their customers had paid for but did not receive an annual/ongoing review.

Continue

Centralised retirement proposition (CRP)

Not all firms in the market have a CRP. Some firms have a centralised investment proposition (CIP) which focuses primarily on the investment-based solutions and does not cover annuities. And some firms do not have either.

Whether firms have a CRP, CIP or use some other approach, they are more likely to be able to deliver consistent and suitable advice where they have designed their advice model to meet the needs of their customers.

CRP governance structures

From the CRP reviews, we saw 20 of the 24 firms (83%) had a governance structure that had clear reporting lines and designated individuals accountable for key areas of the business. For 4 firms, however, their documentation did not clearly explain how oversight worked in practice, with gaps in the documents or no organisational charts to explain this.

Use of withdrawal guide rates

The data survey indicated firms use a range of different withdrawal guide rates to help calculate sustainable income. While some firms had a standard rate (house view) to use as a guide for income withdrawal advice, others did not and used CFM instead:

→ 276 out of 962 firms stated they had a standard rate and of these:

- 45 firms used 3%
- 199 firms used 4%
- 32 firms used 5%
- 686 firms stated they had no standard rate
- 810 firms stated they used some form of CFM
- 111 firms stated they did not use CFM or have a standard rate

We do not have room to cover all the instances of good and bad practice discussed in the review, but we want to give one example from the document sadly of bad practice. We have decided to include an FCA focus on the loss of a retirement income guarantee below.

Continue

Example of poor practice around guarantees (quoted in full below)

A customer switched 3 plans to take income using drawdown. Of the 3 plans, 1 had a guaranteed annuity and 2 had Guaranteed Annuity Rates (GARs). Plans with these types of guarantees are referred to as safeguarded benefits. The guaranteed annuity plan provided a minimum level of income at the age of 65. The GARs provided a guaranteed rate of income at any retirement age (when starting to take the GAR income) from 65 up to 75. The firm compared the income available from the GAR and guaranteed annuity against that from a current annuity rate (CAR). Advice to switch was based on the CAR income being slightly higher at the time of advice than the guaranteed annuity and GARs. However, giving up guarantees on the GAR plans may not have been in the customer's best interests. The firm did not show they had considered all possible scenarios. While the CAR was higher (at time of advice), it would be liable to fluctuate up or down in future in line with market changes. However, the GAR would not be affected by market rates but would increase based on the customer's age. So, the income available from the GAR plans would be higher in future. The GAR policy terms showed the rate of income available depended on the age the customer started to take the GAR income, with the rate increasing for each year retirement was deferred, up to age 75. So, if income was taken from the GAR at the age of 66, there would be a higher rate than would be available if taking income at 65. 28 Further, only 1 of the 3 plans needed to be switched to achieve the customer's income objectives. Retaining the other 2 plans with the ceding scheme would have provided the customer with the flexibility to take advantage of the GARs in the future.

TR24/1: Retirement income advice thematic review (fca.org.uk) →

EXPERT AND ADVISER VIEWS ON THE REVIEWS

The experts and advisers we have spoken to believe that almost all advisers need to check their processes in light of this review. There is some frustration that the review has highlighted issues that some deem should have been dealt with by the regulator previously. Indeed, the FCA itself makes reference to more than a decade of final guidance and research. However, to some extent advisers could be excused for some frustration that there is still something of a need to read between the lines in terms of what the FCA wants to see happen.

The review in context

Fidelity's head of retirement and savings development **Paul Squirrell** says:

Paul Squirrell

Head of Retirement and Savings Development

"

Reviewing retirement outcomes is not a new thing. The Retirement outcome reviews have been going on since pension freedoms were introduced some nine years' ago, and many changes have been introduced, including stronger nudges to pension guidance and investment pathways.

However, more recently the focus has switched to retirement income advice and the FCA have issued a 53 page report of their findings. As they did with the DB advice review, this included examples of good practice and poor practice… the fact they have organised this review – and included a whole list of findings of good practice, bad practice, areas for improvement and a Retirement Income Advice Assessment Tool, suggests the least advisers need to do is avail themselves of these documents and be aware of it all. I would also recommend that advisers read the documentation with Consumer Duty in the forefront of their minds and be honest with themselves when reviewing their approach to Retirement Income Advice.

Financial Life Planning founder **Kate Shaw** says:

"Because I am a pensions person anyway this is one of the most depressing ones as we have heard all this before. It is quite an exciting market to be working in. In many ways, you should be at the fun stage and not have the regulator saying you are not accessing risk or capacity for loss properly. That is fundamental when you get to retirement. I have to ask for how long this is going to go on for?

Continue

"This isn't new. It comes up in every review that involves process. And not doing this is a double harm. In accumulation, if something goes a bit wonky or the ATR isn't quite right, you have a long time to put that right. But if a client is stopping work, and the adviser hasn't put a decent process in, the risk of harm is far greater. No matter how good we think we are we should check our processes all the time. But we are not talking about little tweaks here. These are fundamental problems."

Phil Young, managing partner at Zero Support, says:

"The majority of the market has focussed almost entirely on investment and accumulation processes since RDR and done reasonably well with this. Mainly because the free training and CPD on it comes from investment managers, platforms who are all interested in accumulation. Retirement has had less attention, and it probably deserves more, mainly because different advisers in the same firm have different ways of doing it. It's a drier, academic area with less free support on offer. Some use safe withdrawal rates, many don't, and regardless of whether it's bad advice or not, it isn't well documented as a process. It's definitely inconsistently applied within the same firm as a result. I have seen some really good work on this of late which has been prompted by a regulatory kick up the backside, which is no bad thing. I don't think it would have been done without it."

The overall approach for advisers to take to the review

Aegon's pensions director **Steven Cameron** says:

Steven Cameron

Pensions Director

Some of the focus of the document is on whether advisers use cash flow modelling or a withdrawal guide rate. Here, there has to be a focus on an individual's age and health situation in terms of how long the money has to last as a simple cap for withdrawals does not fit all clients.

Independent compliance expert **Adam Samuel** says:

"Advisers need to go back to basics. There shouldn't be problems with the ATR assessment. When your client stops working and stops making money, their attitude to risk goes down."

Continue

Samuel notes a little exasperatedly the repeat of problems with the pension transfers.

"We are still seeing transfers not properly backed up by TVA and by not understanding the guaranteed benefits. Unless advisers get their heads around that, we are never going to see this improve."

"You have to see risk from two points of view – one the objective. What can the customer actually afford? Also from the subjective side, what do they aspire to?"

"It has always been the adviser's job to match the two up. It's been around a very long time."

Cash flow modelling / Attitude to Risk / Capacity for loss

There is a lot of discussion about whether the FCA is essentially demanding firms do certain things in terms of their processes. Some experts believe that is effectively what is happening.

Samuel says:

"The big message from the paper is almost that if you can't do cash flow modelling, you can't do retirement advice. Certainly, the regulator has got that idea. Whether they are right to say it, is a very difficult question."

He says a look back to what we thought were critical yields would show the limits of predictions.

"To be fair, the FCA says customers have to be told the risk of this when predicting future rates. But above all else before you do an important transaction give your compliance adviser a ring."

Squirrell says:

Paul Squirrell

Head of Retirement and Savings Development

There was a question posed [in the review] that if you are not using CFM or withdrawal rate guides, then how are you assessing sustainability of income in retirement? The regulator does not say that advisers have to use either, but they are asking if you don't, then how will you work this out? When using CFM, they also mention that you cannot just use one deterministic result. In other words, if we are using CFM, are we stress testing it?

Continue

Paul Squirrell

Head of Retirement and Savings Development

Fidelity INTERNATIONAL

> The implication was about certainty of income. When you consider this, and the references to the use of CFM, there is a lot of commonality between the DB advice review and this.
>
> There were also findings of inconsistency within firms that use CFM tools that didn't have controls to make sure these were used in a consistent manner to ensure consistency of approach.

Tom McPhail. the director of public affairs at the Lang Cat says:

"It feels like the FCA are playing quite a long game on this patiently building a case. They did the review and sent out the Dear CEO letters and did the commentary and have made it clear what their expectations are. On all of it, the Attitude to Risk, Capacity for Loss and the cash flow modelling, they are not saying this is exactly what we are looking for but this is the evidence we are looking for and the process we are looking for and the review mechanisms in place and if you are not doing that, you are going to have to have some pretty robust arguments to persuade us you are doing your job properly.

"They are still not telling IFAs how to do it, but they are asking how you justify the rate of income you recommend for your client? Is it 4%, what is your rationale. CFM. Which model did you choose? Did you review it? How can you make sure your team of advisers are all using the same process? What is your control process? It is relentlessly professionalising what you are doing for your customers"

Regarding annuities

William Burrows, an adviser with Eadon & Co and founder of the Retirement Planning Project says:

"People who are taking more out of their drawdown have to look at annuities now, because rates have increased. In the space of a couple of years, annuities have turned from a low-income product into a high-income product, and they should be considered for anybody who is taking income out of their pension pots. Annuities are a hard act to beat in terms of income at the moment."

Syndaxi Financial Planning director **Robert Reid** suggests that annuities were brought back into vogue for many clients by the economic turmoil during the brief Liz Truss premiership.

He says:

"It triggered a change in the marketplace and put something back into place that was always there. There's an intrinsic value in having a guarantee. People who cashed in and paid the tax will rue the day they didn't buy an annuity."

Continue

Not either/or but some worries about the regulator

Reid adds:

"Annuity rates shift all the time, and they will shift again. People have always seen them as an either/or situation when they should be asking what's the right mix. It is not an alternative, it a combination. That part can be played by an annuity or another form of fixed income – DB, state pension, so it is controlled and gives you certainty with your expenses.

That takes you to having the ability to construct the mix. Again it is not either/or should you buy inflation proofing? We have to get away from default choices."

Inflation proofing, could, for example cost 30% of a pot, so perhaps setting money aside from a non-inflation linked annuity might work better than taking out inflation-proofing.

"If the regulator starts to see it as a choice between two products, then they have totally lost their way. It is a question of combinations not either/or."

He calls into question the current standard of the examinations around these issues.

Concerning records and charging

Samuel says:

"There is another issue that a lot of firms are charging ongoing adviser charges and not delivering the reviews they promised. A lot of firms are just not very good of keeping track of what people are actually paying them.

"Trail rules are different from adviser charging rules. But I would now go through every customer giving you revenue and make sure you have written to them with a report that updates this stuff. If they do get in touch have a proper review."

Cameron notes:

Steven Cameron

Pensions Director

AEGON

The FCA absolutely expect that if a service is being paid for, it is delivered, and in particular here if you're charging for ongoing advice for periodic reviews, you absolutely must be delivering on these." He says the regulator also emphasised that advisers must be proactively reaching out to clients who are entitled to this service, making clear what it costs and that it can be cancelled.

Continue

Squirrell says:

Paul Squirrell

Head of Retirement and Savings Development

Fidelity International

"There is a strong mention of managing conflict of interest, which was also a theme in the DB advice review. As a result of the DB advice review Contingent charging (fees based on outcome) is generally not permitted. While they have not said this for Retirement Income Advice, if you look through section four in this latest review, there are concerns raised about how advisers are remunerated, and whether this is directly linked to fee income based on assets under management. For instance, if your remuneration is heavily influenced by assets under management, how does that affect your decisions around annuitisation? Do you have controls in place to manage conflicts of interest, and does the adviser remuneration package include KPIs based on suitability of advice and not just on fees received?

Burrows, an adviser with Eadon & Co and founder of the Retirement Planning Project says:

"The challenge to advisers now is to demonstrate the value they are adding for their ongoing fees especially if portfolio rebalancing is done by the adviser. In previous days, if you were the adviser and picking funds you could perhaps justify the fee. The point I would make is that the challenge is to justify or to show the value that they are adding and that could include securing income."

McPhail says:

"The other side of the squeeze is what are you charging for all of this and did your customers actually get that. There is more to a relationship than reviews but if you haven't documented what you have done for your customers how can you possibly justify charging for it? I think they have laid the groundwork for some uncomfortable conversations. There are good IFAs doing it the right way but if you haven't got it on file, you are going to be in trouble next time you get a visit."

Cameron adds:

Steven Cameron

Pensions Director

AEGON

"It's not good enough to be delivering good outcomes, avoiding foreseeable harm and helping your client meet their financial objectives. You've got to prove that you've done it. You need the data to prove those good outcomes. So again, revisiting your Management Information and your control framework is important." He says that you should have a log of every time you've offered advice, what type of advice that was and what you charged for that.

Safeguarded benefits (as per the previous example of poor practice)

Samuel says:

"Firms are terribly vulnerable to one particular piece advice going wrong. That is safeguarded benefits – these things are terribly important."

The Centralised Retirement Proposition

Squirrell says:

Paul Squirrell

Head of Retirement and Savings Development

We often talk about Centralised Investment Proposition and/or the Centralised Retirement Proposition – but what is the difference? Many firms have a CIP, but that doesn't automatically include the use of annuities. Can you use a CIP for your CRP if you are not considering different ways of generating income? How does your CRP deal with the need for short term income and/or sequential risk? When the regulator talks about CRP it doesn't solely mean a different set of model portfolios based on dividends, but a firm's overall approach to retirement income. For instance, does the CRP ensure a consistent approach to clients' retirement income needs? Do you have a robust risk questionnaire that includes ATR/capacity for loss considerations that specifically looks at the potential impact in retirement?

What I also read into this is that advisers need to be clear that the individual understands the difference between guarantees and non-guaranteed and the risks associated with both.

Vulnerability

Cameron says that some of the numbers are encouraging. He adds:

Steven Cameron

Pensions Director

AEGON

> Although the survey looked at experiences and practices ahead of the consumer duty, it was great to see that a very strong 952 out of 958 firms had implemented identification policies for vulnerable customers. On the other hand, they found that for half of firms, it wasn't clear how they would then monitor the outcomes for vulnerable customers compared to other customers. Are they making sure advice is suitable and the outcomes are as good for vulnerable customers as for others?

CASE STUDY
Greg Neall, Chartered Financial Planner at Wake up your Wealth

> I've certainly had to make some improvements to our processes and our due diligence. I believe our changes are probably smaller than most, as we were using some of the good practices referred to.
>
> This largely stems from our profile as a small community IFA with a fairly large average pot size (funds under advice) per client.
>
> We have around 110 households and we conduct reviews on fixed dates in the year; this helps us chase up responses to review invitations and it makes follow up tasks, such as reducing withdrawals at state pension age, easier to manage through reminders in outlook and our CRM.
>
> Since our average pot size is a bit higher than is typical (c.£350K), many of our investors draw an income which is enough for them and is comfortably within a sustainable range (4-6%pa).
>
> I suspect the IFAs with most problems are those with a tail of smaller value investors, who 1) are less profitable to engage with, and 2) are more likely to need to draw a higher percentage.
>
> We already operated a policy of reducing investment risk as investors near retirement (they can opt out), and re-risking in the early years, as a protection against sequence risk. There are technical arguments against this, but I think it's best to be sure of a good investor experience.

“ My process for setting withdrawal rates was largely discretionary, driven by deterministic cash flow models built individually by me on excel; I relied on memory for consistency in these. I now have to formalise this in a due diligence document and note if I have moved away from my core assumption model, and why. I concur that inflation must be taken account of in CFMs but I am reluctant to always show outputs in real terms: in my experience investors understand their drawdown income has to go up better than they understand that a level annuity has a decreasing real value.

Owning my own business also means I have nowhere to hide; if I say to an investor: “In three years, you must reduce your income or you will run out of money”. I have a heavy burden of responsibility to make sure that happens. If I were an employed adviser looking to move on to pastures new, would I care too much if that actually happened or not?

With annuity rates returning, we are now talking to clients more often about converting to a guaranteed income. This is challenging to the moral integrity of the firm, as it can be to the detriment of our ongoing turnover and our sale price.

I’m also confident that our pricing model (0.5%pa with a fixed cap) is not in the sights of the FCA on the basis of price and value, but again this comes back to our higher average pot size. If all firms have to move to our level of average pot size, the advice gap will widen considerably, and automated advice and/or guidance is not ready to pick up the fall out.

Overall, I welcome the improvements the FCA said they hope to see in the Dear CEO letter from March: better researched withdrawal rates, understanding risks specific to income drawdown and ensuring ongoing service is provided and references the original advice. As ever with any new regulatory focus, my fear is that firms will react with additional processes intended for self-protection, which will cause service delays and higher costs, instead of improving their due diligence and standards of advice by giving the advice staff the training they need.

TEN QUICK TAKEAWAYS (IN THE VIEW OF THIS GUIDE)

1. The regulator is getting increasingly frustrated with poor practice and whether that is a minority or not it is clearly determined to effect change especially post-Consumer Duty.

2. The problems include long term concerns around assessment of risk and particularly how that changes in the transition from accumulation into decumulation.

3. The regulator is worried about a failure to have adequate governance structures around the use of important components of retirement advice that can see different approaches within Centralised Retirement Propositions or the deployment of what may be inadequate Centralised Investment Propositions.

4. Standards and governance in the use of cash flow modelling need addressed as a matter of urgency.

5. The regulator strongly suggests that attitude to risk not only changes in retirement but that capacity for loss has to become a much greater concern and be incorporated into advice and processes.

6. There is no move to require more annuitisation but security of income and indeed client understanding of the differences between guaranteed and non-guaranteed income is essential.

7. The retirement advice process needs to pay much more heed to client vulnerability but also to act on it and to record the process.

8. Promised reviews need to be delivered or at very least clients properly notified of the ability to review and the ability to cancel if they decide they don’t need this service.

9. Advisers doing DB pension transfers are still making some mistakes and that really needs to stop.

10. Advisers need to be very careful around the treatment of safeguarded benefits.

Guide author

John Lappin

John Lappin is a financial journalist who reports and commentates on financial services, financial advice and sustainability. Among other things, he is the former editor of Money Marketing, consumer investment title Mindful Money and specialist investment website Global Investment Megatrends.

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