Retirement income advice

A high-level summary of the FCA’s thematic review TR24/1

In this document, we briefly summarise the key points from the FCA’s thematic review of the retirement income advice market, although we recommend firms read the full text in order to see how the regulator’s conclusions may affect how they work.

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Background to the review

Following the introduction of the pension freedoms in 2015, consumers now have much more flexibility about how and when they access their pension savings. As a result, many more individuals now rely on retirement income solutions where their pension remains exposed to investment and mortality risk, such as income drawdown or uncrystallised funds pension lump sums (UFPLS). Indeed, FCA data shows that only 10% of pension pots accessed for the first time in 2021/22 were used to purchase an annuity. Before the introduction of the pension freedoms, 90% of pension pots were moved into annuities.

Therefore, consumers approaching or in retirement now face much more complex decisions – they need to decide how to fund their retirements, what level of income to draw and, where their pensions remain invested, which underlying investments to hold. Consumers may also have other objectives in addition to generating an income, such as passing on an inheritance to loved ones.

The regulator recognises that financial advisers have a key role to play in helping consumers make decisions about meeting their income needs sustainably in the decumulation phase of their lives. However, the FCA state that the harm caused by poor advice may have a particular detrimental impact on these consumers. Therefore, this review supports their work to improve standards across the consumer investment market.

Proportion of pension pots used to purchase an annuity

Source: FCA Retirement Income Market Data and Retirement Outcomes Interim Report July 2017.

Aims of the FCA's review

- To gain detailed insights into how the retirement income advice market is functioning.
- To understand whether firms' advice models consider the specific needs of consumers in decumulation.
- To consider whether consumers are being provided with suitable retirement income advice when accessing benefits, and take appropriate action to tackle any harms identified.
- To inform the regulator's future areas of focus.

Key findings of the FCA

- The review of advice models revealed a mixed picture across the firms within the review. Some firms had evolved their approaches and adapted to the post-freedoms landscape.
- In several areas, not all firms were taking account of the differing needs of their customers in decumulation, as opposed to accumulation.
- The regulator identified considerable differences between firms in advice file record keeping:

- Unsuitable retirement income advice can potentially result in significant harm, such as:
  - Consumers suffering a reduction in their level of income or their funds running out too soon.
  - Potentially paying higher charges than necessary.
  - Investing in complex solutions they don't understand or not aligned with their risk profile.
- Many consumers may be unable to take the necessary steps to mitigate any losses, such as returning to work to supplement their income. It is crucial firms effectively understand the retirement needs of their customers, including considering whether and what level of sustainable income may be required, and recommend a suitable solution to meet those needs.
- Firms must ensure vulnerable customers are fairly treated. While firms have thought about the needs of vulnerable customers, they were not implementing vulnerable customer processes in an effective or consistent manner in several areas. This risks poor outcomes for these customers.

Areas for improvement

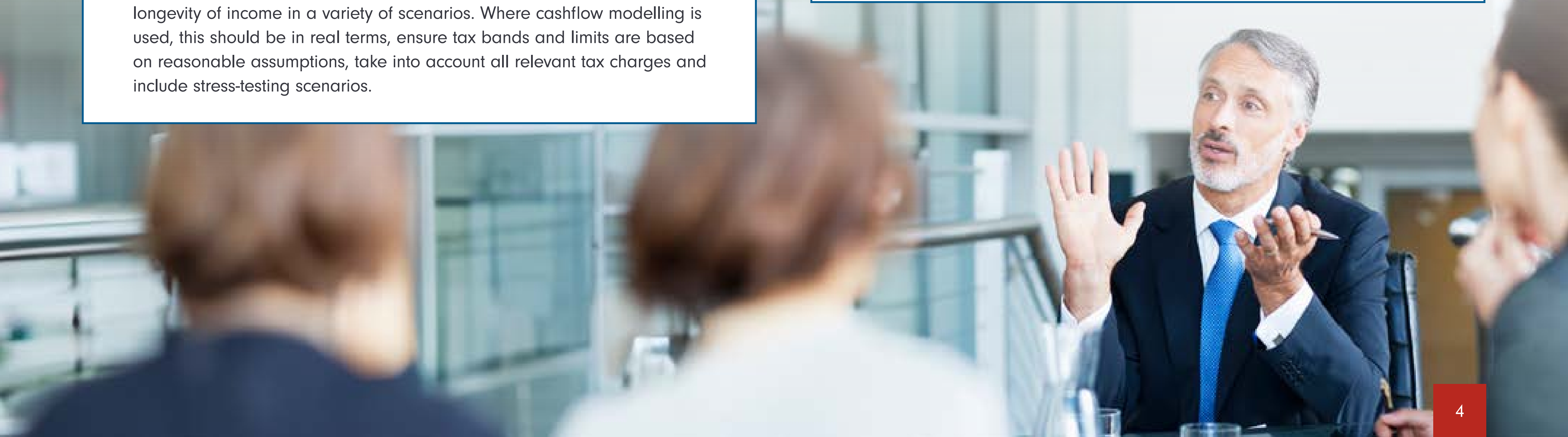
The FCA identified the following key areas for improvement where they expect firms to raise standards.

Income withdrawal strategy and methodology

- Firms generally use cashflow modelling or a specific percentage withdrawal 'guide' rate to help show customers the income they might be able to draw sustainably throughout their life. The withdrawal rate firms use to help calculate sustainable income varies across the market.
- Not all firms were effectively considering sustainability of income withdrawal. The lack of, or inconsistent use of, cashflow modelling or a withdrawal guide rate to estimate a sustainable income means consumers risk making poor decisions about how and when to withdraw funds.
- Firms need to consider their customers' current and future income needs in retirement. Whether this is through using cashflow modelling or a withdrawal guide rate, they should adopt a reasonable approach tailored to the customer's circumstances and objectives. Firms should illustrate the longevity of income in a variety of scenarios. Where cashflow modelling is used, this should be in real terms, ensure tax bands and limits are based on reasonable assumptions, take into account all relevant tax charges and include stress-testing scenarios.

Risk profiling

- The FCA has set out clear requirements for risk profiling which firms must follow, and has published final guidance on how to establish the risk a customer is willing and able to take in making a suitable investment selection. Firms should assess capacity for loss consistently, in addition to attitude to risk, to help identify suitable solutions for their customers.
- Attitude to risk (ATR) and capacity for loss (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.
- Some firms were not assessing capacity for loss (CFL) for customers. Failure to consider CFL in decumulation means firms may not be correctly identifying suitable income or investment-based solutions.



Areas for improvement

Advice suitability

- Firms are required to get the necessary information about the customer to assess suitability before making a personal recommendation. Fact finding should be complete, with no gaps, inconsistencies or missing relevant information.
- The FCA had particular concerns around the suitability of the advice given in some files. The issues identified included loss of guarantees and features, penalties incurred and unnecessary charges or tax. Some customers were also not given information about relevant options.
- Some files showed firms had failed to get the necessary information from customers, specifically around vulnerability, their knowledge and experience of investments and understanding of risk, expenditure analysis, their wider financial circumstances and future lifestyle changes. It was also unclear whether information relating to the risk of capital erosion, the potential for future annuity rates to be worse, or that income levels might not be sustainable had been disclosed.
- Firms must collate the necessary information and maintain proper records about their fact finding, recommendation, communications with their customers, and required disclosures.
- Firms must keep orderly records of their business, including their services and transactions, in order to show suitability of recommendations.

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.
- The regulator expects firms to track and monitor when review meetings are due and identify whether any are missed. For customers in decumulation, there is a higher likelihood that they have characteristics of vulnerability so it is important that firms have a plan to ensure services are proactively delivered.

Control framework

- Firms must take reasonable care to establish and maintain appropriate systems and controls over their business.
- Some firms found it difficult to provide the requested information for the FCA's data survey while some firms had difficulty providing fully completed advice registers.
- Firms must show they have robust systems and controls and consider appropriate information to monitor customer outcomes. This includes having a comprehensive advice register.

Action for firms

- The FCA's review identified multiple areas for improvement and their full report sets out the findings and expectations under existing rules and guidance, which the Consumer Duty now supplements. This includes examples of good and poor practice. All firms that provide retirement income advice should consider and use this information to review and update how they work.
- Firms should refer to the questions in the FCA's data survey and take immediate steps to review whether they have appropriate MI and update their data collation processes and records accordingly.
- The FCA has published the Retirement Income Advice Assessment Tool, developed for the review to assess the suitability of advice files. This will help firms understand the regulator's methodology for assessing advice files. This is supported by an article on cashflow modelling, which sets out points for firms to consider when preparing and using a cashflow model.

Further supervisory work

The FCA have stated that retirement income advice will remain an ongoing focus for them and that they will be carrying out further supervisory work in this area to explore the scale of the issues identified and tackle any harms. They have emphasised that they will take further action if firms do not address the areas of poor practice highlighted by the review.

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Important information

This document provides information and is only intended to provide an overview of the current law in this area and does not constitute financial advice, tax advice or legal advice, or provide any recommendations. This document represents a summary of our understanding of the relevant regulations at the date of its last review (April 2024). Regulations and guidance are often subject to change and may change in future. Individuals should check that rules and regulations have not changed. Tax treatment depends on individual circumstances and all tax rules may change in the future. You cannot normally access your pension savings until age 55 (57 from 2028). Different options may have different effects for tax purposes, different implications for pension provision and different impacts on other assets and financial planning.