M&G wealth

The retirement income advice red paper

On 20 March 2024 the FCA published the Retirement Income Advice Thematic Review TR24/1. Alongside the paper it also published a Dear CEO letter which has been sent to financial advice firms asking them to review their processes when providing retirement income advice.

The purpose of this paper is not to provide a deep dive into all of the findings and details contained within the paper, but rather to focus on what actions advisers may need to take, and the support available from M&G Wealth and elsewhere to help them to ensure their processes are appropriate. We would recommend that advisers study the review and associated papers in full.

Executive Summary – Retirement Income Advice Thematic Review TR24/1

The FCA have found evidence of both good and poor practice. For the purpose of this paper, we will concentrate on the findings where processes need to be improved. The FCA findings are 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 non-representative sample of 24 firms.

The findings where concerns were highlighted are as follows:

- lack of necessary client information to demonstrate advice suitability, including expenditure, other income sources and possible changes in objectives in the future
- income withdrawals under drawdown being taken without taking account of individual circumstances or assumptions/methods that were justifiable or recorded on the file
- suitable risk profiling was not evidenced or inconsistent with customer objectives, knowledge and experience
- capacity for loss was not considered
- periodic reviews not taken place that the client was charged for
- inaccurate records to show details of reviews.

Mentioned extensively throughout the thematic review was the importance of process. Processes used throughout the whole advice journey should be consistently used for the same type of clients, and throughout the advice firm by all involved in the advice process. However, it's not just having a robust process, it's also being able to evidence that process and the outcomes that it derives.

The full thematic review can be accessed here:
fca.org.uk/publications/thematic-reviews/thematic-review-retirement-income-advice

The Dear CEO letter can be accessed here:
fca.org.uk/publication/correspondence/dear-ceo-letter-thematic-review-retirement-income-advice.pdf

Cashflow modelling

The FCA also released a separate article on cashflow modelling. The findings highlighted in the article were as follows:

1. Firms relying on information without considering accuracy.
2. Using justifiable rates of return.
3. Planning for uncertainty; using a consistent approach, planning beyond average life expectancy and stress testing models.
4. Consumer understanding; consider consistency of communications.
5. Consider the output; such as ensuring appropriate to objectives, availability of assets modelled for income, impact of tax.

Further information can be accessed here:
fca.org.uk/firms/undertaking-cashflow-modelling-demonstrate-suitability-retirement-related-advice

The Retirement Income Advice Assessment Tool

In a similar manner to the way that the FCA released the Defined Benefit Advice Assessment Tool they have also released a comprehensive Retirement Income Advice Assessment Tool (RIAAT). This is extremely comprehensive and comes with a 92-page instruction guide. It's clear that the FCA have used this tool to review files and will continue to do so. They are encouraging advisers to use the tool to assess their past advice.

Further information can be accessed here:
fca.org.uk/firms/retirement-income-advice-assessment-tool-riaat

The six tabs for the RIAAT spreadsheet are as follows:

- Information
- Suitability
- Insistent Client
- Disclosure
- Consumer Duty
- Results and Feedback

File reviews

The FCA reviewed 100 files. Of these:

- 21 files were out of scope (for reasons such as there only being the Pension Commencement Lump Sum (PCLS) withdrawn).
- 10 files had missing documents, for example, no fact find, suitability report or ceding scheme details and could not be reviewed at all.
- Two files were not reviewed because the FCA had already reviewed an appropriate number of files for the same firm and found the advice to be suitable.
- 67 files were assessed using the RIAAT. Of the 67 files, 45 files (67%) were assessed as suitable, seven files (11%) the FCA had concerns about suitability, 15 files (22%) had Minimum Income Guarantees (MIGs) and could not be fully assessed as firms had not collected the necessary information.

It's also worth noting that there are numerous examples of poor and good practice throughout the document, and these are particularly insightful in helping to identify where gaps may exist in processes.

What should advisers do now?

Given the comprehensive nature of this Thematic Review each firm should analyse all the information thoroughly to sense check their own processes and create a bespoke action plan where necessary. However, based upon the major findings it's possible to create some suggested actions for firms to ensure the most common issues are addressed.

Lack of necessary client information

The key to having a successful retirement income advice process starts with gathering the correct information. In this regard the FCA have given advisers a starting point of the required information for a retirement income client that is required on the first tab of the RIAAT. It's also important to consider all assets that are available to provide income.

How we can help

Here's a comprehensive retirement aims and objectives checklist which can be used to sense check your retirement fact find. This can be accessed here: **mandg.com/dam/pru/shared/documents/en/frpm100580106.pdf** and includes a comprehensive expenditure checklist.

Risk profiling and capacity for loss

The FCA have previously set out clear requirements for assessing risk in their finalised guidance on assessing suitability: **fca.org.uk/publication/finalised-guidance/fsa-fg11-05.pdf**. However, there were some key points in the review that it's worth covering on the subject of retirement advice:

- Risk profiling to assess attitude to risk (ATR) without taking into account the fact that income is to be drawn from the fund is likely to lead to poor outcomes. The FCA cite an example where a risk profile questionnaire is supplemented by an additional focused 'at retirement objectives questionnaire' as good practice.
- Capacity for loss (CFL) is another aspect of risk profiling and determines the extent to which consumers could cope with a reduction or change to their income (see below for how to assess this using cashflow modelling).
- Secure income options (annuities, fixed term annuities) need to be considered and assessed for suitability.
- ATR and CFL are likely to change when a client enters the decumulation stage.
- The process for assessing ATR and CFL should be consistent across an adviser firm.
- ATR and CFL should be reassessed on a regular basis as part of an ongoing service where it exists, and take into account any change in circumstance.

How we can help

The FCA research showed, unsurprisingly, the majority of firms use risk profiling tools to help assess ATR. Propositions available through M&G Wealth have extensive coverage on most third-party risk profiling systems. Further information can be accessed via the following links:
mandg.com/pru/adviser/en-gb/insights-events/third-party-reports/risk-rating-matrix

mandg.com/wealth/adviser-services/investment-solutions/mps

Cashflow modelling

Ensuring income levels are appropriate

Assessing the client's income requirement having gathered the necessary information is an all-important part of the process. Often it will be necessary to challenge the client as they may choose an aspirational income rather than what is realistically sustainable and required to meet expenditure needs. The checklist mentioned above can help to ascertain the correct figure. More information can be found in the "use correct data for inputs" section under the FCA cashflow modelling page mentioned above. Remember that it's important to determine whether the advice is being given on a single life or joint life basis.

Using justifiable rates of return

Investment growth rates should be reasonable, justifiable and should be based upon a forward-looking view rather than historical returns. They should be linked to the client's attitude to risk and therefore are likely to vary across clients with different risk profiles where asset classes are different in the underlying investment. These should be regularly reviewed and be consistent across different advisers. All charges should also be taken into account, and models should be typically run assuming above average life expectancy. More information can be found in the cashflow modelling link above under "plan beyond average life expectancy".

An important aspect of not only ensuring the strategy is effective but also that the client understands the risks involved is the use of stress testing. This should include:

- considering a feasible fall in asset values at the start of any income withdrawal period
- allowing for inflation
- showing how higher withdrawals will deplete the fund sooner.

How we can help

Detailed examples of how to conduct cashflow modelling can be found on our "on demand" events page and can be accessed here: **mandg.com/wealth/adviser-services/insights-and-events/on-demand-events**

The review found that stochastic and deterministic modelling were both used extensively, with some firms using both. When considering PruFund in cashflow modelling, we have already run thousands of calculations in a deterministic manner to arrive at our Expected Growth Rates (EGRs). As part of the smoothing process, EGRs are the annualised rates your client's investment would normally grow at. They are reviewed every three months, when they could rise or fall.

They are forward looking and set quarterly by the Prudential Directors, having regard to the investment returns expected to be earned on the assets of the funds over the long term (up to 15 years). They are published every quarter for each product. Your client's investment will normally benefit from this growth rate on a daily basis, through an increase in the price of the units held (known as the unit price).

EGRs are able to be used as a guideline when running cashflow models, subject to suitable caveats and stress testing. It should be remembered these are based upon our long-term expected returns and are in no way guaranteed. More information on the EGRs and appropriate building blocks can be accessed via these links: **mandg.com/pru/adviser/en-gb/funds/prufund-range/egr-and-upa**

mandg.com/dam/pru/shared/documents/en/11/quarterly-update-building-blocks-framework.pdf

The value of your investment can go down as well as up so you might not get back the amount you put in.

Ongoing service and fees

Given the FCA focus in this area it was unsurprising to find this was also an area commented on by them.

Key points were as follows:

- The service provided and frequency of review should be clearly documented to the client.
- Reviews should include factors such as income needs, change in circumstances, objectives, risk profile changes, health conditions and the FCA would expect appropriate systems and controls to be put in place to support those customers who are vulnerable.
- Firms should have MI to ensure reviews are completed, and where they are not, have appropriate processes in place to refund clients.
- Reviews should be consistent across an adviser firm for the same level of service.

How we can help

Given the importance and focus of ongoing fees and service we have a comprehensive article dedicated to this subject, which can be accessed here:
mandg.com/dam/pru/shared/documents/en/cd100758401.pdf

As indicated in the article, this can be used in conjunction with the PFS fair value statement for ongoing advice to help create a bespoke document for an adviser firm.

Reviewing the RIAAT

The FCA recommend that firms use the updated RIAAT to assess the suitability of Retirement Income advice and the adequacy of client disclosure for advice given after 1 November 2007.

For advisers very active in the 'at retirement' market it would be extremely time consuming to review every single case since 2007, but it would be practical as a starting point to use a sample size of past advice cases and also use it for assessment of clients going into decumulation now. This should give a firm an overall idea of how both their past advice and current advice processes meet the requirements. Though it's impossible to 'reinvent history' a past review may also have the advantage of identifying where gaps in information could be, and allow them to be closed at future reviews.

Disclosure requirements

These will be well known to advisers but there are several aspects that the research drew out. These are:

- The Initial Disclosure Document (IDD) being given too late in the advice process, for example just before advice was given or at the same time as the suitability letter. As the IDD sets out the service and the charges for the firm it should be provided at outset.
- Appropriate disclosure information about the funds used had not been given to clients.
- The potential for capital erosion or annuity rates changing in future had not been explained to the client.
- The benefits of guaranteed annuity rates (GARs) or other guarantees had not been fully explained to the client.
- The implications of tax on a proposed solution had not been fully explained to the client.

How we can help

What is required?

mandg.com/pru/adviser/en-gb/adviser-support/mifid-ii-disclosure

ISA cost and charges calculator

mandg.com/pru/adviser/en-gb/tools-calculators/isa-costs-calculator

PIA disclosure of costs and charges

mandg.com/pru/adviser/en-je/adviser-support/prudential-international-assurance-plc

Access to KIDs and IODs

mandg.com/pru/customer/en-gb/funds/productlibrary

Due diligence

All third-party tools, software, platforms, etc used as part of the advice/suitability process should be researched and reviewed regularly (annually is cited as good practice) to ensure they remain fit for purpose for use.

How we can help

Check out the range of tools and calculators available through us. Each tool gives comprehensive information as to what the purpose of the tool is and how to use it:
mandg.com/pru/adviser/en-gb/tools-calculators

The following link will take you to the due diligence document in relation to the M&G Wealth Platform:
mandg.com/wealth/platform/your-platform/platform-factsheet

FCA data survey and reviewing existing processes

To help ascertain if there are any gaps in advice processes, the Dear CEO letter the FCA have advised referral to the questions in the data survey to identify what improvements could be made to management information to monitor customer outcomes and respond to regulatory information requests:
fca.org.uk/publication/corporate/retirement-income-advice-survey.pdf

Other useful information

Given the comprehensive nature of the thematic review, it's impossible to cover all related subjects in detail. However, the following topics and links may prove useful for further information on this topic.

Personal Finance Society guide on income drawdown

The PFS have produced a comprehensive guide on advised pension income drawdown covering many of the topics raised in the thematic review:
thepfs.org/media/10129449/good-practice-guide-advised-pension-income-drawdown-c1.pdf

Personal Finance Society consumer duty toolkit

The PFS toolkit provides templates across the wider subject of consumer duty, many/all of which though will be relevant to retirement income clients:
thepfs.org/news-insight/consumer-duty/

University of York paper

This thought-provoking paper covers sequencing risk, safe withdrawal rates and smoothing of returns:
york.ac.uk/media/economics/documents/discussionpapers/2017/1706.pdf

Retirement income, foreseeable harms and consumer duty article

In this article we look at what may be required for income drawdown customers for the annual consumer duty board attestation, covering off the key risks of drawdown, strategies for mitigating them and what MI could be captured to help evidence compliance with consumer duty requirement:
mandg.com/dam/pru/shared/documents/en/cd100644506.pdf

Sequencing of return risk video

In this video we explain sequencing of return risk and different strategies for mitigating them:
mandg.com/pru/adviser/en-gb/insights-events/insights-library/sequencing-of-risk-return

Working together

Most of our business at M&G Wealth is conducted by professional financial advisers, and we are always keen to champion the advice market and support it in any way we can. We believe we have some compelling propositions, but we rely on you, our adviser partners to recommend them to your clients.

We hope you found this red paper useful. Should there be anything else we can help with then your account manager will be pleased to discuss further.

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