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Retirement Income, foreseeable harms and Consumer Duty

With the introduction of pension freedoms many people have turned to drawdown as their retirement income vehicle of choice. Annuity rates have increased recently but there are still many billions of pounds in drawdown arrangements and it remains a very popular option for clients looking to draw benefits.

Many of these customers will of course be advised. But what about the Consumer Duty? How does that affect income drawdown? All regulated firms should by now have considered these new rules in detail. This is particularly relevant when you consider the finding of the thematic review of retirement income advice. The FCA themselves have confirmed the results will also be an important indicator of how firms are implementing the Consumer Duty.

Let's remind ourselves of what the Consumer Duty has introduced

- act in good faith
- avoid foreseeable harm, and
- enable and support retail customers to pursue their financial objectives

Pretty much all advice firms would say that's already business as usual, but let's have a look specifically at drawdown clients.

No adviser can say categorically that a drawdown strategy is going to work 100%. Volatility over recent months and years caused by unpredictable events has shown us that.

So it naturally follows to avoid foreseeable harm the risks of drawdown need to be identified and a plan created to deal with them.

So what are the risks? This is not an exhaustive list but the key ones include:

- Longevity risk
- Inflation risk
- Investment shortfall risk
- Sequencing of return risk
- Change in circumstances

These are all generally well known so I will not elaborate on these further. Many firms will have these included within a centralised retirement proposition (CRP) as risks, and should also document how these risks are managed.

There is a requirement for a report to be produced and signed off by a firm's board on an annual basis. The report would be an assessment of whether the firm is delivering good outcomes for its clients which are consistent with the Consumer Duty. This assessment should include:

- The results of the monitoring that the firm has undertaken to assess whether their products and services are delivering expected outcomes in line with the Consumer Duty;
- New and emerging risks to good outcomes for clients;
- Any evidence of poor outcomes and an evaluation of the impact and the root cause;
- Actions taken to address any risks or issues; and
- How the firm's future business strategy is consistent with acting to deliver good outcomes under the Consumer Duty.

This assessment will be part of the evidence the FCA use to assess a firm's compliance with the Consumer Duty and they will expect it to be provided on request.

So, what might need to be considered in respect of income drawdown for the assessment? Let's not forget a big part of the Consumer Duty is avoiding foreseeable harm. Looking back over recent years we can see that there has been extreme volatility as well as significantly rising inflation. Although it is impossible to predict the occurrence of such events, we can identify the potential risks of these and also put a plan in place to deal with them.

It might look something like this, drawing information from the firms CRP and client management information (MI). This is not supposed to be 'all encompassing' as many advisers will have additional strategies, plans etc in their CRP. They should also review the thematic review findings to ensure that any other relevant aspects of their CRP are adapted as appropriate.

However an analysis of the key risks, the plans for dealing with those risks and then an assessment of what was done to provide good customer outcomes feels like a good place to start. Once the 'tactics' have been established, it should be relatively straightforward to analyse what's happened in practice to include as MI for the report.

Below is an example of the type of information an advice firm might produce based upon the identifiable risks of drawdown. This also doesn't take account of wider MI which it would be prudent to consider, such as for example how many clients are falling outside of a firms initial and ongoing fee ranges, though this could be picked up separately as part of a wider piece concentrating on more macro issues.

CRP table – dealing with risks of drawdown

Key Risks	**How risk is assessed at outset**	**Strategy(ies) for dealing with risk**	**Flag to identify risk crystallising/potentially crystallising**	**Strategy (ies) for dealing if risk crystallises (as prepared and planned for and identified under SR)**
Longevity risk	CM to include longevity modelling based upon market data	SR to highlight need for regular reviews using CM	Annual review with CM to show risk of fund exhaustion using current market data	Reduce income Consider purchase of annuity Take money from cash buffer outside of portfolio
Inflation risk	CM to include multiple projections of future growth and suitably stress tested	Use of bucket system to target when funds should be drawn on Use of multi asset fund to help ensure consistency of return Adjustment made to income based upon stress tested model reflecting current market experience	Funds underachieving target growth rate for defined period of time	CM at review to identify reduced income level, which may need to be supplemented by available funds outside of DD
Sequencing of return risk	CM to include potential for market falls	SR to include cash buffer held within portfolio to take income from over short term SR to identify any sources of funds that could be used to draw income from in short term SR to include recommendation for fund/part of fund to be invested via smoothed fund to reduce fund volatility SR to include recommendation for natural income to provide all/part client income Use of bucket strategy to reduce volatility from fund paying income Evaluation of fund's sequencing risk profile	Market falls by a predetermined amount Volatility of portfolio exceeds expected boundary	Conduct client review immediately with updated CM Take money from cash buffer in portfolio Take money from cash buffer outside of DD
Change in circumstances	Any future changes to be notified by client	Client contact or identified at review time or client contact in interim	Revised CM to determine effect of new requirement (for example lump sum taken or increased income requirement)	Determined by new need or objective

Key: Drawdown = DD   Cashflow model = CM   Suitability report = SR

Having established and identified where the key risks lay, the data can then be collated to provide information for the annual assessment report. Below is an example of some of the information this could contain.

Number of clients in drawdown	Number of clients where client objectives not met as per SR	Reason(s) for client objectives not being met	How remedied and any change required to CRP?	Number of clients where risk highlighted in CRP/SR crystallised	Number of clients where strategy in CRP/SR was used	Number of client complaints received for drawdown clients	Reason(s) for complaint	How complaint dealt with
xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx

Most advice firms will already have robust processes in place to deal with the risks a client may face, in order to ensure they have good understanding and achieve a good outcome. The challenge going forward will be how to marry these processes with the Consumer Duty, whilst also capturing and presenting the relevant MI under the new rules and guidance.

The clock is now ticking until the first Consumer Duty annual assessment will need to be completed. Advice firms need processes in place to collect the relevant data, and to react accordingly to any required actions.

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