The foundations of retirement planning – ten pitfalls to avoid

Pension decumulation

Adviser Solutions

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Introduction

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Today's financial advisers are well qualified, highly regulated professionals. They operate under intense scrutiny and are held accountable to the highest standards.

This expertise is important when clients start the decumulation process. At this stage in their life, they have probably accumulated more wealth than at any other period. When fully retired, they'll no longer add to their wealth (inheritance aside) and will usually live off their savings.

However, they won't know how long their money has to last. This uncertainty is compounded by other unknowns: Inflation, investment returns and long-term care needs, for example. All of which place significant responsibility on advisers.

The FCA's recent thematic review of the retirement income advice market expressed concern that the needs of clients moving from accumulation to decumulation may not adequately be recognised by some firms[1]. This report will explore some of the issues raised in the review, together with other potential pitfalls, to ensure that your retirement planning processes are robust.

For many advisers, this will be nothing more than an aide memoire; perhaps a checklist against which to validate their practices and processes. But none of us are infallible. It's important that, collectively, we do all we can to prepare and protect clients at this critical stage of their life.

1. Retirement income advice thematic review, FCA, March 2024.

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Ten retirement pitfalls to avoid

I never made a mistake in my life. I thought I did once, but I was wrong

Charles M. Shulz

Such unerring confidence in one's ability to always get things right is rare. Most of us make mistakes and learn from them. Financial advisers must meet exacting standards before they can exercise their skill and experience. This includes acquiring the right qualifications, keeping abreast of developments through continuous professional development and adhering to a strict regulatory regime. This means clients can have confidence in the quality of the advice they are given.

Nevertheless, the FCA concluded in its thematic review of the retirement income advice market that 'the review of advice models revealed a mixed picture'[2]. The review identified several areas for improvement. This report is independent of the review, but there is an overlap with many of the issues highlighted by the FCA:

1. **Accumulation vs decumulation.** Some advice firms may not sufficiently differentiate between the accumulation and decumulation phase in their advice models.

2. **Retirement is not a 'one and done' event.** The path though retirement is unlikely to align with the assumptions made at outset. There is so much that can change during the retirement journey.

3. **Retirement is about more than private pensions.** Advisers should take a holistic view of their clients' financial assets as people increasingly use a number of vehicles to fund their later life.

4. **Spending too much or too little.** One of the key challenges facing advisers is to make sure their clients' funds last as long as they do. The FCA review identified over reliance on a single withdrawal rate as a potential issue.

5. **Assessing risk during retirement.** There is evidence that attitudes to risk change during retirement and capacity for loss becomes much more significant during the decumulation phase.

2. Retirement income advice thematic review, FCA, March 2024.

6 **Understanding behavioural economics.** It's important that advisers recognise the impact behavioural economics can have on decision making in retirement planning and accommodate this in their dealings with clients.

7 **Identifying vulnerability.** A 2017 FCA study found that 50% of UK consumers showed one or more characteristics of potential vulnerability. This increased to 69% among those aged 75 and over and 77% of those aged 85 and over[3].

8 **Investing too much or too little in high-risk investments.** With retirement lasting 20-30 years, exposure to equities is critical to ensure funds last for the long haul, but sequencing risk can be fatal for retirees in the early years.

9 **Making binary product judgements.** The option to buy an annuity or choose drawdown often seems to be characterised as a binary decision. In fact, there are significant benefits to combining a degree of annuitisation within drawdown.

10 **Clear, concise communications.** Customer Duty places a responsibility on advisers to ensure their communications 'meet the information needs of retail customers, are likely to be understood by them, and equip them to make effective, timely and properly informed decisions'[4].

3. Understanding the financial lives of UK adults, Findings from the FCA's Financial Lives Survey 2017, October 2017 (updated January 2020).
4. Retirement income advice thematic review, FCA, March 2024.

1. Accumulation and decumulation are different

The accumulation phase is about converting income into capital over a fixed term and investing for growth; as opposed to converting capital into income over an unknown time horizon and investing for income during the decumulation phase.

Chart 1: Accumulation and decumulation are often polar opposites

Accumulation	Decumulation
Converting income into capital	Converting capital into income
Fixed time horizon	Unknown time horizon
Investing for growth	Investing for income
Increasing capital	Reducing capital
Post cost averaging	Post cost ravaging

The differences in these two phases means that many advisers are now using a distinct, separate process to deal with clients when they approach retirement. Centralised Investment Propositions (CIPs) have given way to Centralised Retirement Propositions (CRPs). It's not a universally held view that there needs to be a distinct separation between the two phases. According to a recent Parameters survey by Professional Paraplanner, 60% of paraplanners say decumulating clients need different advice, 25% said they do not require a different approach and 14% were unsure[5].

Whatever your views, there are a range of issues specific to the decumulation phase. Many of these are explored in this report:

- **Investment strategy.** With retirement lasting 20-30 years or more, it usually makes sense to still invest in high-risk assets, like equities, but the threat of sequencing risk means investment strategies should be modified to combat this in the early years of retirement.
- **Income withdrawal.** Most people need their pension savings to provide an income for life. Where a withdrawal rate guide is used, the FCA review stated that it should be appropriate to the client's circumstances[6]. Where cash flow models are deployed, the assumptions should be regularly reviewed and stress tested to cover a range of outcomes.
- **Aggregation of assets.** It's important to take a holistic view covering all of a client's assets including property equity. Not only will this provide a complete picture of a client's wealth, but it can lead to different recommendations depending on the client's objectives.
- **Product selection.** Once a client decides to take benefits, advisers must decide which products to use and how much tax-free cash to take (if any). Annuities, drawdown and UFPLS all come into play and a hybrid approach can offer significant benefits too.

5. Accumulation vs decumulation – the difference in approach, Professional Paraplanner, 6 March 2023.
6. Retirement income advice thematic review, FCA, March 2024.

- **Risk profiling.** Attitude to risk may seem a constant across the accumulation and decumulation stages, but there is evidence to suggest that this is not necessarily the case. What's more, capacity for loss is much more significant during the decumulation process.

2. Retirement isn't a 'one and done' event

There are two aspects to this:

- Firstly, the process of retirement may take several years as more and more people transition gradually from work to retirement.
- Secondly, even when fully retired there are any number of variables that can derail retirement plans.

> **The trend to retire over several years, rather than on a single day, has clear implications for advisers and their clients**

Transitioning to retirement

The trend to retire over several years, rather than on a single day, has clear implications for advisers and their clients. Where clients reduce their working hours or take on a less demanding and less well-paid role, do they need to top up their income? If so, how should they achieve this? This subject is explored in more detail in our report 'Reinventing Retirement', but here's a brief summary of some of the considerations:

- **NI contributions.** NI contributions aren't payable over State Pension age and some costs could reduce, so the gap in income may be less than the difference in earnings.
- **State Pension.** At State Pension age, the State Pension could top up any shortfall in earnings, but this could push someone into a higher tax bracket or provide more income than required (though this could be used to pay further pension contributions).
- **Private pensions.** Meeting any shortfall from private pensions could make sense, but:
  - Leaving aside tax-free cash, income from private pensions is taxable.
  - Taking income could trigger the MPAA.
  - Tax-free cash does not trigger any reduction in the MPAA or increase tax payable (assuming the money isn't recycled in breach of the rules).
  - Income from a lifetime annuity or any defined benefit income would not trigger the MPAA, but is taxable (and can't be varied to precisely meet any shortfall).
- **Other savings and investments.** There are alternative ways to top up any shortfall using tax advantaged products like ISAs. Utilising the CGT allowance, dividend allowance and personal saving allowance may also create additional income tax-free.

Note: Data on tax bands and charges used in cash flow models should be based on realistic assumptions.

Once the decision has been taken to retire outright there is still a need to review the client's needs throughout retirement. There are two key reasons for this: the pattern of expenditure during retirement is likely to change and the timing of any changes is usually unknown.

> **Expenditure needs during retirement will inevitably change, but the shape of any change is difficult to identify in advance**

Patterns of expenditure

Expenditure needs during retirement will inevitably change, but the shape of any change is difficult to identify in advance. There's a common view that expenditure takes on the shape of a smile: High expenditure during the early years when people are healthy and keen to make the most of retirement, followed by a slowing down as health issues emerge leading to a fall in income needs, then an uptick in expenditure as long-term care costs dominate late in life.

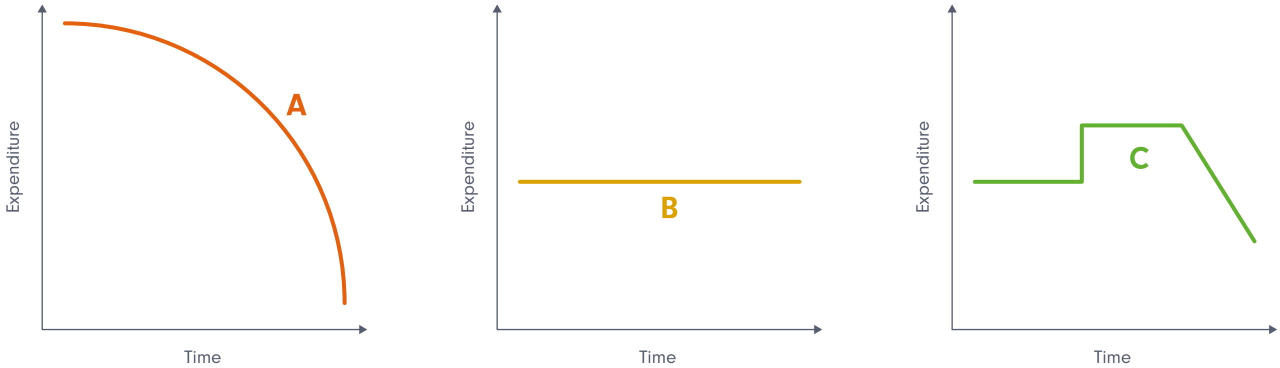
For some people this may be true, but for most people 'smile' isn't the path they'll follow:

- Only 1 in 4 men and 1 in 3 women over 65 will have 'substantial care needs during retirement'[7].
- Some people will need care in the home, but much home care is provided by family and friends. Estimates suggest there are over five million unpaid carers in the UK[8]. In contrast, there are less than one million paid carers[9].

7. Pensions and the funding of long-term care, Institute and Faculty of Actuaries, 2021.
8. Carers UK, 2024.
9. Home care statistics: number of providers, service users and workforce, Homecare.co.uk, June 2024.

In some cases, expenditure may gradually decrease as mobility reduces over time, but without the need for expensive long-term care at the end of life. Care may be needed in the home, but provided by family and friends (see A below). Other people could lead a productive retirement, then die after a short illness or suddenly – perhaps after a heart attack, stroke or accident (see B below). Given the increasing trend to gradually transition to retirement, income needs from retirement savings may be small in the early years to supplement income from employment, then increase when outright retirement occurs, then steadily reduce as health deteriorates (see C below). There are endless permutations.

Chart 2: There are multiple patterns of expenditure during retirement



Timing

Even if there was one single pattern of expenditure during retirement, it wouldn't address the issue of timing. The timing of changes in expenditure is impossible to predict. For example, how many active years will someone enjoy? When will they start to slow down (and how quickly)? If long term care is required, when will it start – and when will it end?

And while we've explored how health can impact the pattern of expenditure, there are other elements that can derail expenditure in retirement. For example, extraneous influences like investment returns, inflation and changes in tax. Likewise, vulnerability, excessive income withdrawals, shifts in risk appetite or modifications to legacy planning can also require revisions.

The timing and shape of retirement expenditure will be personal to each client and the influence of external factors all point to a need for regular reviews.

3. Retirement is about more than private pensions

Advisers should take a holistic view of their clients' financial assets as people increasingly use a number of vehicles to fund their later life. There are two important reasons for this:

- **People may struggle to provide a comfortable retirement solely relying on their pension savings.** The Retirement Living Standards research suggests that the gross annual income a couple need to fund a comfortable retirement is £67,474[10]. For a couple with maximum state pensions of £23,004, they would still need £44,470. If we assume a 4% withdrawal rate that would require a fund of more than £1m. They could take more than 4%, and this is considered later in this report, but some people will need to explore using other savings and investments (including property equity).
- **'Don't let the tax tail wag the investment dog' is true for decumulation as it is for accumulation, but there is a greater need to be 'tax aware'.** If income is the main objective, tax advantaged products like ISAs can reduce the amount required to provide a given income. Allowances for capital gains tax, dividends and personal savings are also available. Any tax-free lump sum not earmarked can also be used. If leaving a legacy is paramount, then the treatment of pensions, particularly on death before 75, the ability to transfer ISA wealth between spouses and civil partners and the use of business relief qualifying investments on death after two years can all potentially help. What's more, assets owned by the deceased are revalued at the date of death for capital gains purposes.

Property is another potential source of income in retirement. Downsizing or equity release and later life mortgages can create a lump sum or income tax-free (if the home is the principal residence). Rental income from the Rent a Room scheme is tax-free up to £7,500 each year. Buy to let has been popular among some retirees though the tax breaks have been eroded over the years.

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Property is another potential source of income in retirement. Downsizing or equity release and later life mortgages can create a lump sum or income tax-free

10. How to estimate likely Retirement Living Standards, Pensions and Lifetime Savings Association, 2023.

Chart 3: A range of assets are increasingly used in retirement planning

Pensions
- State pensions
- Defined benefits
- Defined contributions

Property
- Downsizing
- Equity release
- Later life mortgages
- Rent a room
- Buy to let

Savings and investments
- Savings
- ISAs
- Bonds (onshore and offshore)
- OEICs
- Other (e.g. business relief)

Other
- Earned income
- Inheritance
- Benefits and allowances

4. Spending too much or too little

One of the challenges facing advisers is to make sure that their clients' funds last as long as they do. The FCA thematic review identified over reliance on a single withdrawal rate as an issue[11]. There are many variables that dictate what a safe withdrawal rate could be for any given client and there is a need to constantly monitor this throughout retirement.

What's more, there is also the risk of clients spending too little during their retirement if a rigid approach to safe withdrawal rates is taken. This could mean denying themselves a better standard of living.

11. Retirement income advice thematic review, FCA, March 2024.

This subject is explored in greater detail in our report 'Sustainable withdrawal rates for drawdown clients'. Key variables include:

- **Age.** Age is an important determinant of how much someone could safely withdraw. The older someone is the more they could take.
- **Longevity.** If life expectancy is compromised, a higher rate could be taken.
- **Access to other assets.** People who have access to other assets to fall back on, like property equity, could decide to take a higher income.
- **Inherited wealth.** Where there is a high degree of confidence of an inheritance a client could choose to take more.
- **Charges and fees.** Morningstar suggests that 1% in charges and fees should lower the safe withdrawal rate by 0.4%[12].
- **Equity weighting.** The optimal asset allocation is a 40% equity weighting (see chart 4), assuming a 90% probability of success over 30 years. There's an explanation of this in the next section.
- **Inflation.** In its 2022 report, Morningstar modelled partial inflation-linking by assuming income was inflation linked by 1% less than the actual rate of inflation. This increased the initial safe withdrawal rate by 0.5%[13].

Chart 4: Safe withdrawal rates based on term and equity weighting

Equity weighting	10 years	15 years	20 years	25 years	30 years	35 years	40 years
100%	8.3	5.8	4.6	3.8	3.3	3.1	2.9
90%	8.6	6.0	4.7	4.0	3.5	3.2	3.0
80%	8.9	6.2	4.8	4.1	3.4	3.3	3.2
70%	9.2	6.4	5.1	4.3	3.8	3.5	3.2
60%	9.4	6.5	5.2	4.4	3.9	3.5	3.3
50%	9.6	6.7	5.4	4.5	3.9	3.6	3.4
40%	9.8	6.8	5.4	4.5	4.0	3.6	3.4
30%	9.9	6.9	5.5	4.6	4.0	3.6	3.4
20%	10.0	6.9	5.5	4.5	4.0	3.6	3.3
10%	9.9	6.9	5.4	4.4	3.9	3.4	3.2
0%	9.7	6.7	4.2	4.3	3.6	3.2	2.9

Source: Morningstar. Data as of September 2023.

Also, firms using cash flow modelling should ensure that the underlying assumptions are appropriate and review the outputs throughout retirement.

12. How Much Can I Take From My Retirement Savings? Allan Roth, AARP, January 2022.
13. The State of retirement Income: Safe Withdrawal Rates, Morningstar, 2022.

5. Investing too much or too little in high-risk investments

With retirement lasting 20-30 years, exposure to equities is critical to ensure funds last for the long haul. Market downturns in the early years have relatively little impact during the accumulation phase – savers often haven't saved much – but they can be fatal for retirees. Advisers need to mitigate the potential impact of this occurring. However, over reliance on risk free or defensive, low risk, investments may mean that retirees' funds simply won't last long enough whatever the economic environment.

> **Over reliance on risk free or defensive, low risk, investments may mean that retirees' funds simply won't last long enough whatever the economic environment**

Combating sequencing risk

There are various strategies to mitigate sequencing risk such as holding cash buckets of fund payments over 1-3 years to allow for markets to recover. This can prevent the devastating impact of sequencing risk, but it does come at a price. Over most time periods markets are rising. That means holding more than a nominal amount in cash will impact returns.

An alternative strategy is 'dynamic spending'. In other words, to reduce spending when markets fall significantly during the early years of retirement. A further solution is to only live off the natural income or yield on investments. This means income isn't taken from capital, so while capital values may fall, they should subsequently recover. The flaw with both of these options is that income will vary each year which won't work for everyone.

Partial annuitisation can also offer a way to mitigate sequencing risk. A level annuity will generally pay a higher income than bonds, which means less needs to be withdrawn from the rest of the fund to provide a given rate of income. A level annuity will not protect against inflation, but people usually spend less as they age and the balance still invested in drawdown should provide a degree of protection.

Optimal investment strategies

Generally, once action has been taken to mitigate sequencing risk the prevailing wisdom is that a diversified portfolio with a high exposure to equities will probably provide the highest returns over the long term. Yet, if you look at chart 4 the sweet spot for sustainable withdrawal rates over a 30 year term with a 90% probability of success is 40% equity allocation.

This may seem counter-intuitive, but the answer lies in choosing a 90% probability of success. The volatility of equities means that this will favour bonds and cash. For example, chart 5 shows that if the probability of success is pitched at 50-70%, then the higher the equity weighting, the higher the safe withdrawal rate.

> **"The prevailing wisdom is that a diversified portfolio with a high exposure to equities will probably provide the highest returns over the long term**

Chart 5: Withdrawal rates by probability of success and equity weighting

Equity weighting	50%	60%	70%	80%	90%	100%
100%	6.2	5.6	5.0	4.3	3.3	0.9
90%	6.0	5.5	5.0	4.4	3.5	1.1
80%	5.9	5.5	5.0	4.4	3.7	1.4
70%	5.8	5.4	5.0	4.5	3.8	1.6
60%	5.6	5.3	4.9	4.5	3.9	1.9
50%	5.5	5.2	4.9	4.5	3.9	2.2
40%	5.3	5.0	4.8	4.5	4.0	2.4
30%	5.1	4.9	4.7	4.4	4.0	2.6
20%	4.9	4.7	4.5	4.3	4.0	2.8
10%	4.6	4.5	4.3	4.2	3.9	2.8
0%	4.4	4.2	4.1	3.9	3.6	2.6

Source: Morningstar. Data as of September 2023.

6. Assessing risk during retirement

There is evidence to suggest that attitude to risk and capacity for loss change as a direct result of the act of retirement: The absence of a regular salary each month and the psychological effect of drawing down savings built up over many years may be just some of the reasons.

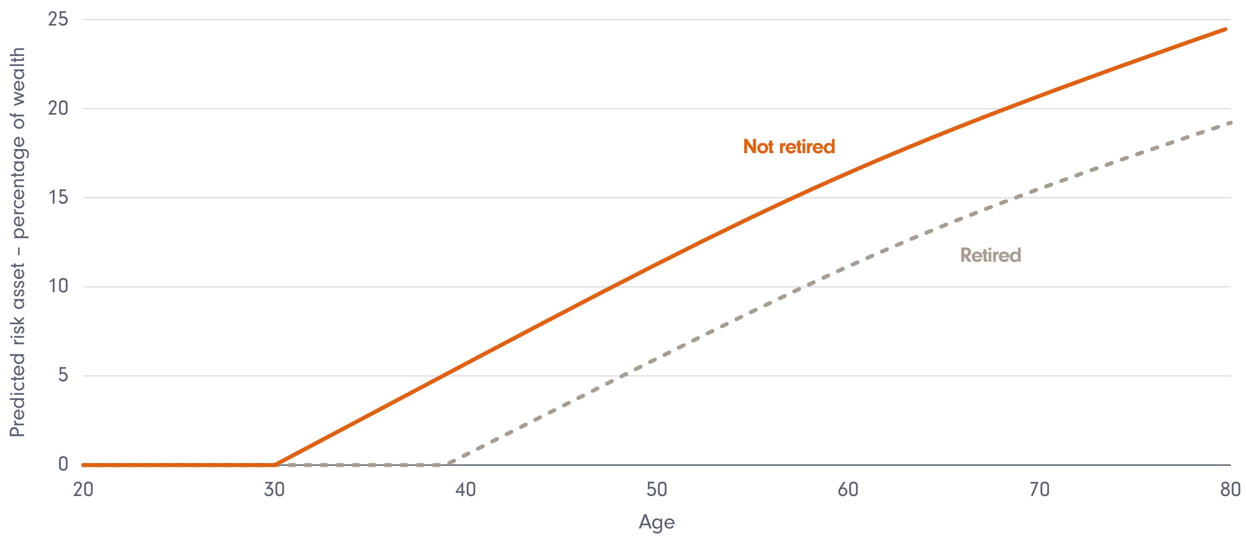
A 1997 US study of the proportion of net wealth invested in 'risky assets' compared retired and non-retired people of the same age. It revealed both an overall change in risk aversion with age and a marked difference between those in retirement and the non-retired (see chart 6).

More recently, a 2020 study concluded that 'risk aversion concerning financial decisions increases in older cohorts'[14], while a 2011 study came to a similar conclusion that 'age has a negative effect on the willingness to take financial risks'[15]. The authors suggest that there could be many reasons for this: Among them the observation that 'each additional year of life represents a shortened time horizon for recouping market losses' and that people may become concerned about preserving capital to fund future consumption.

What's more, capacity for loss comes very much to the fore during retirement. Defined as 'the customer's ability to absorb falls in the value of their investment', capacity for loss is a critical element of retirement planning. It requires a deep understanding of the client's resources and their expenditure to be able to stress test how much risk clients can take without exposing themselves to peril.

Regular reviews of attitude to risk and capacity for loss should be carried out throughout retirement.

Chart 6: Retirement appears correlated with an increase in risk aversion



Source: Wang Hui, Hanna Sherman 'Does risk Tolerance Decrease with Age?', Financial Counselling and Planning Education c.1997.

14. Mónika Kuti – Zoltán Schepp, Aging Society and Attitude to Risk, Public Finance Quarterly, 2020/4.
15. Yao, R., Sharpe, D. L., and Wang, F. (2011). Decomposing the age effect on risk tolerance. Journal of Socio-Economics, 40(6), 879-887.

7. Understanding behavioural economics

It's important that advisers recognise the impact behavioural economics can have on decision making in retirement planning. Behavioural economics is the study of how emotional, social and cognitive factors influence economic decision-making. It explains why people sometimes act irrationally.

These irrational behaviours can play a key role in influencing the decisions people make when they approach retirement and beyond. Given that some decisions made at retirement are irreversible, it's essential that advisers provide clarity and objectivity to guide their clients. Here are some common examples of behaviours that advisers should consider in their discussions with clients:

- **Availability bias.** This refers to the tendency to make judgements based on an example or instance that comes easily to mind. These mental shortcuts or heuristics can be damaging. For example, George Osborn's remark that 'no one will have to buy an annuity' is a classic example of 'availability bias'. This can lead to people dismissing annuities out of hand. It's not about recommending annuities over drawdown, but shaking prejudices that could lead to poor decisions.
- **Hyperbolic discounting.** This is the preference for a smaller reward sooner rather than a larger reward later; the classic issue of immediate v deferred gratification. It can impact retirement planning in many ways. For example, taking too much income or choosing a single life annuity with no or little protection for dependants. These examples could be appropriate in certain circumstances, but advisers should consider if decisions are being made emotionally.
- **Loss aversion.** Generally, a loss is more painful to people than an equivalent gain is rewarding. Game theory suggests that most people won't bet to win £1 if they could lose £1[16]. The upside needs to be around 2.5 times the downside to attract people. This asymmetric view of risk is evident in retirement (see chart 6). Where clients choose drawdown, advisers should guard against taking too little investment risk, while safeguarding against sequencing risk.
- **Optimism bias.** This is our tendency to overestimate the probability of positive events, while underestimating the probability of negative events. A positive attitude to life helps people get through when things aren't going their way, but it can lead to issues. For example, underestimating the impact of inflation or life expectancy. Alternatively, overestimating investment returns.

> **"**
>
> **Behavioural economics is the study of how emotional, social and cognitive factors influence economic decision-making**

16. Kahneman D, Tversky A, 1979, Prospect Theory: An Analysis of Decision Making Under Risk cited in Lessons from Behavioural Finance for Retirement Plan Design, Pensions Research Council 2003.

- **Framing.** How a choice is presented affects the decision consumers will make. An example is the positioning of annuities. FCA research revealed that when presented as a form of insurance, 66% of consumers preferred an annuity to a savings account. When presented as an investment product only 17% chose the annuity[17]. Again, this is not about promoting annuities, but simple ensuring that clients have the opportunity to assess solutions objectively.

Chart 7: Common examples of behavioural biases

Availability bias
The tendency to make judgements based on an example or instance that comes easily to mind

Hyperbolic discounting
A preference for a smaller reward sooner rather than a larger reward later

Loss aversion
A loss is more painful to people than an equivalent gain is rewarding

Optimism bias
Overestimating the probability of positive events and underestimating the probability of negative events

Framing
How a choice is presented affects the decision consumers make

17. Does the framing of retirement income options matter?, 2014, FCA.

8. Identifying vulnerability

A 2017 FCA study found that 50% of UK consumers showed one or more characteristics of potential vulnerability. This increased to 69% among those aged 75 and over and 77% of those aged 85 and over[18]. The FCA's final guidance on Customer Duty has a strong emphasis on vulnerability: The term 'vulnerability' is mentioned more than 100 times[19]. The introduction to the FCA's final guidance explains that [20]:

'We expect consumers with characteristics of vulnerability to benefit from the overall improvements in outcomes delivered as a result of the new Duty.'

The causes of vulnerability are many and varied. The FCA gives examples of the types of circumstances and characteristics which can lead to consumers being classified as 'vulnerable' [21]:

- **Health.** This covers physical and mental health issues and includes impaired hearing and loss of sight. Addiction can also be an issue.
- **Life events.** This could include bereavement, a relationship breakdown and even retirement itself.
- **Resilience.** Inability to withstand financial shocks, inadequate income and over indebtedness would all fall into this category.
- **Capability.** This identifies impediments to comprehension. For example, lack of knowledge or confidence in financial matters, literacy or language problems, learning difficulties and poor digital skills.

It's also important to bear in mind that vulnerability can be brought on suddenly, bereavement for example, or develop gradually like dementia. Where it leads to a financial shock, loss of income following bereavement, divorce or job loss this can exacerbate people's vulnerability.

Vulnerability isn't always a constant or permanent state. For some, it will be, but others may move in and out of vulnerability. The impact of vulnerability can also fluctuate and may be multi layered. Someone caring for an elderly relative may find that they need to reduce their working hours or give up work altogether. The loss of income means they may need to start to dip into savings. Eventually, money saved has been spent and debts accumulate. It's not difficult in this example to see how vulnerability can escalate.

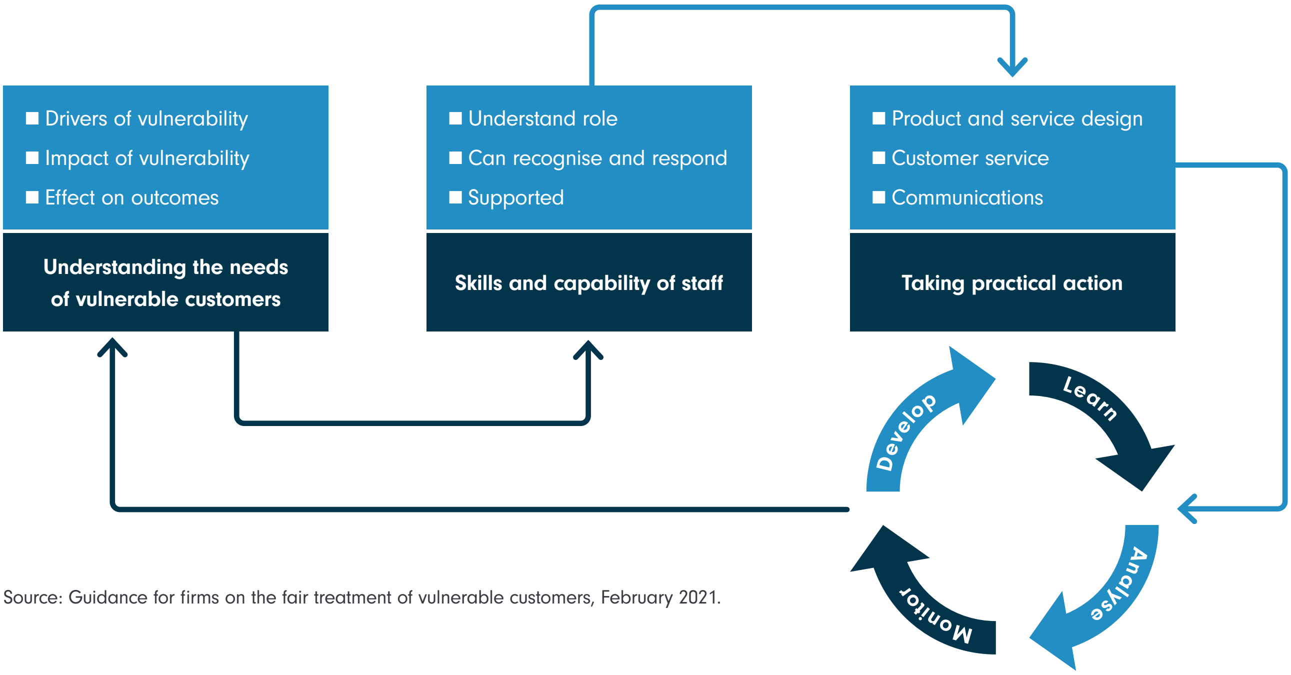
"It's also important to bear in mind that vulnerability can be brought on suddenly, bereavement for example, or develop gradually like dementia

18. Understanding the financial lives of UK adults, Findings from the FCA's Financial Lives Survey 2017, October 2017 (updated January 2020).
19. Vulnerable Customers and the Consumer Duty, Parmenion, February 2023.
20. FG22/5 Final non-Handbook Guidance for firms on the Consumer Duty, July 2022.
21. FG21/1 Guidance for firms on the fair treatment of vulnerable customers, FCA, February 2021.

In February 2021, the FCA published guidance for regulated firms on the fair treatment of vulnerable consumers. This builds on their 'Approach to Consumers', published in 2018. It comprises four main sections covering the approach to achieve good outcomes for vulnerable customers and how to comply with the FCA's Principles for Businesses:

- Understanding the needs of your target market or client base.
- Ensuring staff have the skills and capabilities needed.
- Taking practical action on how to respond to a vulnerable consumer's needs.
- Monitoring and evaluation.

Chart 8: FCA guidance on fair treatment of vulnerable consumers



Source: Guidance for firms on the fair treatment of vulnerable customers, February 2021.

9. Making binary product judgements

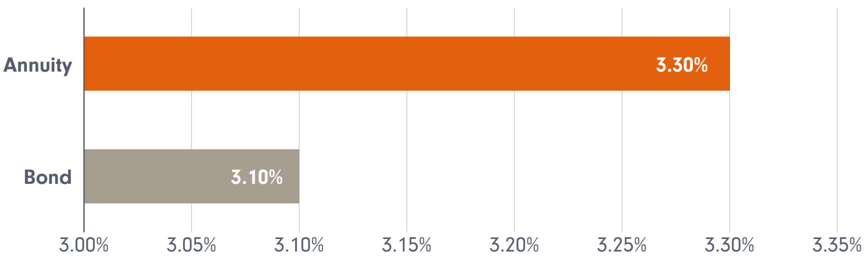
Buying an annuity or choosing drawdown is often treated as a binary decision. The FCA expressed concern in their thematic review that annuities weren't always considered adequately in retirement planning[22]. As well as considering annuities in their own right, there are significant benefits to combining a degree of annuitisation within drawdown. Not only can annuity income cover essential expenditure, but replacing part or all of the bond element can provide better outcomes.

A 2018 study by actuarial consultants, Milliman, showed that an annuity-equity strategy could, in the right circumstances, produce a higher withdrawal rate. The example below shows how an annuity-equity strategy could produce a sustainable withdrawal rate of 3.3% (increasing with inflation), compared with a bond-equity strategy withdrawal rate of 3.1% over a 30 year period (see chart 9).

Buying an annuity or choosing drawdown is often treated as a binary decision. The FCA expressed concern in their thematic review that annuities weren't always considered adequately in retirement planning

Chart 9: Sustainable withdrawal rate (increasing with inflation)

For healthy 65 year old female, fund: 55% equity, 5% cash, 40% bond or annuity.



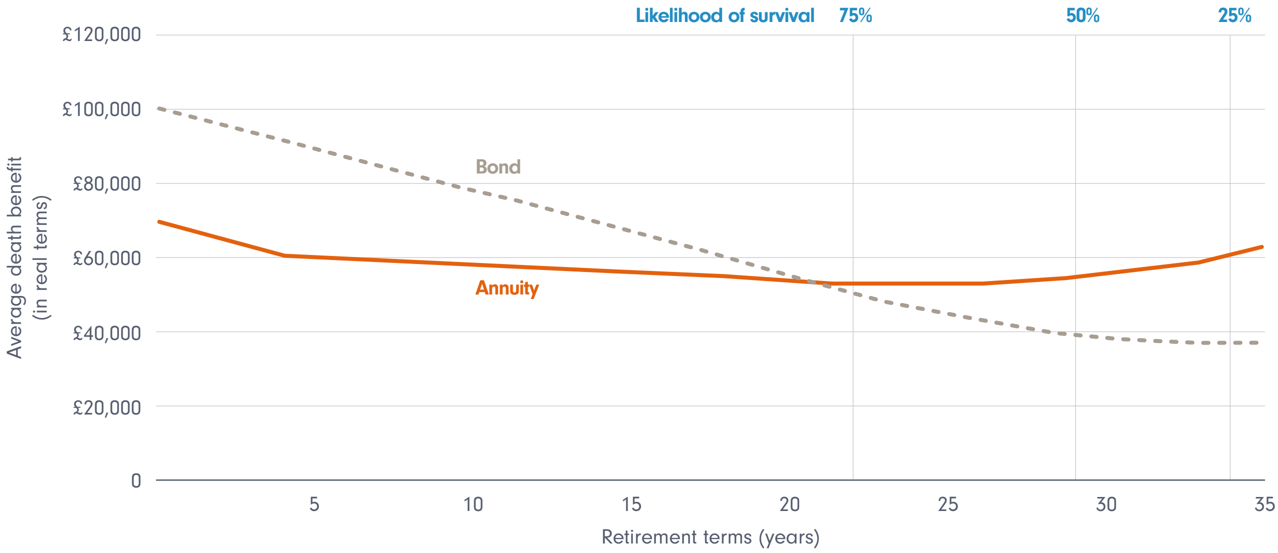
Source: 'Annuities reinvented: Are annuities the missing asset class for sustainable drawdown solutions?', Milliman, 2018.

It's also interesting to note that the annuity-equity and bond-equity strategy differ in terms of the level of death benefit they could provide. Chart 10 shows the average death benefit (adjusted for inflation) at different points. Over the long term, the annuity-equity strategy provides a higher death benefit.

22. Retirement income advice thematic review, FCA, March 2024.

Chart 10: Average death benefit (increasing with inflation)

For healthy 65 year old female, target income of £4,000 a year, fund: 55% equity, 5% cash, 40% bond or annuity (5 year guaranteed period).



Source: 'Annuities reinvented: Are annuities the missing asset class for sustainable drawdown solutions?', Milliman, 2018.

This may seem counter intuitive, but there are reasons for this. Firstly, the higher income from an annuity means less needs to be withdrawn from the drawdown fund to provide a given amount of income. Secondly, the bond-equity strategy is rebalanced each year, but as annuities cannot be bought and sold the annuity-equity strategy is not rebalanced. It should be noted that while annuities cannot be sold, further annuities could be bought during retirement. Given annuity rates are higher at older ages, this could boost sustainable withdrawal rates further (though this is likely to have a negative impact on death benefits long term).

This is not the only study to support the view that including a degree of annuitisation within drawdown can lead to better outcomes in many instances. The Institute and Faculty of Actuaries modelled a range of strategies involving drawdown and annuitisation and concluded that by adopting an integrated strategy 'consumers can potentially generate a larger overall income from their pension pot'[23].

Annuities should be considered not only as an alternative to drawdown in the right circumstances, but also as part of an integrated solution, where it may deliver better client outcomes.

23. Can we help consumers avoid running out of money in retirement?, Institute and Faculty of Actuaries, March 2018.

10. Clear, concise communications

Customer Duty places a responsibility on advisers to ensure their communications 'meet the information needs of retail customers, are likely to be understood by them, and equip them to make effective, timely and properly informed decisions'[24].

This can be challenging. How can you ensure that client communications hit the right mark? Here are some thoughts to help improve your communications:

> **This is a widespread view among professional communicators and it makes sense. Giving too much information can obscure the key take outs**

Remove complicated language

The financial services industry is riddled with jargon like 'flexi access drawdown' and acronyms (UFPLS, PCLS, for example). There's also excessive use of Latinate words like 'Consolidation'. This can make communications seem impenetrable to many investors. The industry has improved immeasurably over the years – changing 'consolidation' to 'bringing together' for example, but there is no room for complacency.

Less is more

This is a widespread view among professional communicators and it makes sense. Giving too much information can obscure the key take outs. Having said that, financial services regulation often prescribes what the client should be told or made aware of to help them make informed decisions. This can constrain how easily this mantra can be applied. While meeting regulatory requirements is paramount, this is a useful guiding principle.

External software

Pre-Internet there was the 'Fog index'. This was a scale that showed how educated your audience needs to be to understand your communications. These days software like Hemmingway Editor or Grammarly can assess copy across a number of measures like 'difficult to read', 'use of passive voice' and 'number of adverbs'. The decision to accept changes is yours. If your clients are university educated you may decide to ignore some or all of the comments. There are free versions, but for a fee extra functionality is available.

24. Retirement income advice thematic review, FCA, March 2024.

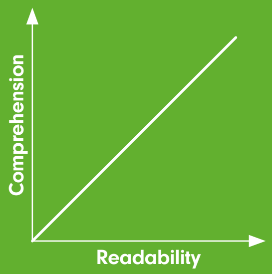
Formatting

The layout of your text can also make a difference (see chart 11). Images and icons can break up chunks of copy, short paragraphs and short sentences usually work better, headings and sub-headings make copy more engaging.

Chart 11: The same copy can be more engaging if formatted effectively

No matter how good your copy is, or how much effort you've put into it, if it looks like a wall of text it may seem impenetrable to people. That means they are less likely to read it, even though it contains valuable information they need to know. So how can you make your copy easier on the eye and more inviting to readers? Try using enticing headings and sub-headings to draw attention, inject bullet point lists where it's appropriate to do so and consider adding images to break up copy. Make sure paragraphs that aren't overly long – short sentences can help too.

No matter how good your copy is, or how much effort you've put into it, if it looks like a wall of text it may seem impenetrable to people.



Make it easier on the eye

- Use enticing headings and sub-headings.
- Inject bullet point lists where appropriate.
- Add images to break up copy.
- Make sure paragraphs aren't overly long.
- Short sentences help too.

Summary

- The move from accumulation to decumulation is significant; switching the emphasis from building capital over many years of working to using that capital over many years in retirement. The challenge of planning for the decumulation phase is exacerbated by the increasing popularity of drawdown where certainty of income throughout retirement is no longer guaranteed.
- The FCA thematic review expressed concerns that while some firms provided examples of good practice, it was apparent that in other cases the needs of customers in decumulation were not being appropriately recognised.
- Advisers need to use their technical expertise and skills to identify optimal investment strategies, ensure the full range of products is considered – including hybrid solutions, define withdrawal rates for each customer (or review the assumptions underpinning cash flow models) and take a holistic view of a clients' assets.
- Firms should recognise that retirement strategies should be reviewed regularly throughout retirement as neither the pattern of expenditure nor the timing of any changes in expenditure can be known with certainty at the outset of the retirement journey.
- Advisers also need to use their broader skill set to recognise where behavioural biases may be in evidence, assess clients for vulnerability and regularly test for changes in attitude to risk and capacity for loss. Adviser firms need to constantly evaluate the quality of their communications to help clients understand their choices and make sound decisions.
- Today's adviser is a highly skilled professional fully equipped to support clients through the complex transition from work to retirement. The opportunity to help people provide for a comfortable retirement should be a fulfilling and rewarding experience for advisers and of immense value to their clients.

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. The value of benefits depends on individual circumstances. The minimum age clients can normally access their pension savings is currently 55, and is due to rise to 57 on 6 April 2028, unless they have a lower protected pension age. Different options may have different effects for tax purposes, different implications for pension provision and different impacts on other assets and financial planning.

Past performance is not a guide to future returns. The value of the fund and the income from it can go down as well as up so you may get back less than you invested.

More insights on tax and pensions

We're committed to providing you with technical support to help you keep pace with the latest rules and legislation. Our range of practitioner material is designed to help you keep on top of all aspects of retirement planning. Themes covered include death benefits, pensions and divorce, the State Pension, pension withdrawals taxation and much more.

Visit the Technical matters hub on our website
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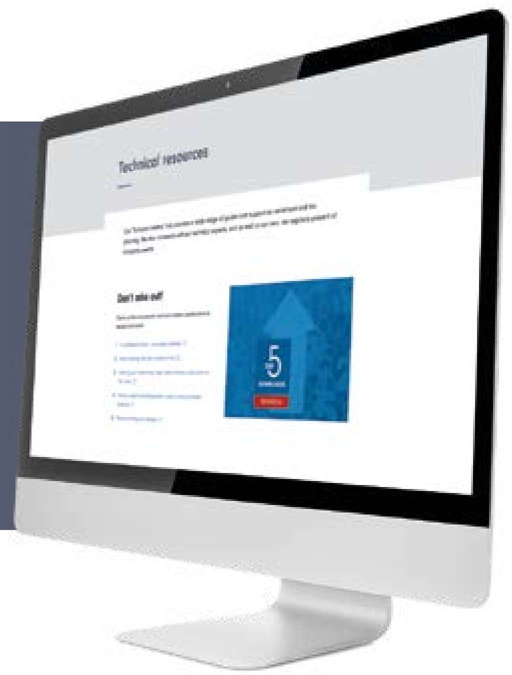

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