Personal Finance Society
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Good Practice Guide

March 2023

A practical guide to Advised Pension Income Drawdown

This March 2023 update replaces the earlier Good Practice Guide of the same name first published in September 2018. This paper is in response to members' requests to provide a summary of good practice within one source document and is based upon the Personal Finance Society's understanding of the regulators rules and current stance. Whilst a summary, it is not intended to be exhaustive and should not be relied upon at the exclusion of other sources of information.

Foreword

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The introduction of pension freedoms revolutionised retirement income advice, and the first cohort to retire under pension freedoms is less than halfway through its retirement journey. As a result, the lessons to be learned from pensions freedoms are still relatively new. Technology, too, is constantly evolving and changing the potential for delivering good outcomes in a more efficient way.

As a result, retirement income remains a pressing priority for clients, advisers and regulators. Analytical approaches, including cash-flow modelling, are developing all the time, as are alternative approaches to investment.

Pensions freedoms were introduced as a way to reinvigorate interest in saving for retirement, by giving people control over their savings in a way that had never been allowed before. Turning that dream into a reality in a well-planned way that produces good outcomes for savers is not straightforward, and usually requires significant amounts of professional advice.

We hope this guide makes a valuable contribution to suitability and the ongoing delivery of consistently good client outcomes.

Adviser Good Practice

1. Understanding why retirement income advice is different

Creating an effective strategy for withdrawing retirement savings requires navigating challenges not present during the wealth accumulation stage. Efficiently overcoming these challenges requires a holistic context which considers the wider financial and personal circumstances of clients. In almost all cases delivering good consumer outcomes involves efficiently managing trade offs between conflicting objectives. Typically, retirement savings used to meet one objective are not also available to meet other objectives. Delivering good outcomes requires a broader approach than balancing the risk vs reward relationship and tax mitigation decisions.

2. Understanding the client's starting position and managing any trade offs

Part of establishing a client's wider financial and personal position involves understanding their aspirations and objectives for later life. Client objectives should be specified, personalised and relate to their individual circumstances. A bespoke approach stemming from establishing a client's starting position is often critical in ensuring a good consumer outcome. This involves identifying and prioritising income and expenditure requirements, including how these may evolve over retirement, personal and family circumstances including health, other assets, including other sources of income as well as their knowledge and experience of retirement income and investing. Once a client's starting position is understood it may become apparent that their objectives and/or needs are in conflict. This will often involve prioritising their objectives based on their overall financial circumstances.

3. Assessing all options

The Taxation of Pensions Act 2014 ('pension freedoms') allows individuals to take as much or as little as they like from their money purchase arrangements on reaching the normal minimum pension age (or earlier in special circumstances). Whilst scheme rules do not have to offer all the flexible options allowable, all available options including a transfer to an alternative arrangement should be considered to arrive at the most suitable client outcome.

To deliver enhanced client outcomes advisers need to consider how to create an efficient strategy from the client's overall assets that meet their clients personalised needs and objectives whilst minimising trade offs. This will often involve considering the entire household balance sheet and efficiently combining the best elements of different solutions into a single holistic plan.

It's unlikely that a single solution will be the most efficient way to meet a client's personalised needs and objectives, with good practice involving an assessment of the suitability of a full spectrum of retirement income solutions. This may include a combination of full drawdown, phased drawdown, partial/tranched annuity purchase, temporary income solutions and lifetime mortgages.

4. Use of Cash Flow Modelling

A good way of understanding the specific needs of a client surface whether they have any concerns about outliving their retirement savings and help them make decisions (especially where trade offs exist) is the regular use of some form of cash flow modelling.

Good practice should include running cash flow modelling beyond average life expectancy and the adviser should have a considered position on what that should be and why. Effective cash flow modelling enables a client to see which combination of solutions is most likely to meet their personalised objectives helping to evidence the suitability of recommendation made.

Robust Cash Flow modelling should stress test different combingations of retirement income solutions across a range of different market conditions, enabling the client to understand the most suitale way to meet their personalised objectives and how they might be affected by certain events such as::

- Periods of increased/decreased market volatility and different sequences of market return
- The need to increase income taken from a portfolio
- The need for any ad hoc withdrawals
- Inflation is higher (or lower) than expected/predicted
- Living longer than expected
- Future returns prove to be lower than expected
- Unpredictable events – a global recession, the need to fund long term care etc..

It is good practice for cash flow modelling to be an integral part of the review process. To ensure good client outcomes it's critical that the underlying assumptions used within cashflow modelling are understood and realistically align to the particular scenario. It's also important to be clear on how the modelled outcomes are arrived at and impact they can have on the recommended solution, for example, whether outcomes are derived on a single scenario deterministic basis or across multiple market conditions on a stochastic basis. This is particularly important to the avoidance of foreseeable harm within the forthcoming Consumer Duty regulations.

5. Considering all the risks

Retirement income advice is almost always a balancing act between efficiently mitigating risk, receiving returns and retaining some flexibility. A successful retirement income strategy involves the ongoing and effective management of any number of client risks following the establishment of attitude to risk and capacity for loss. Essentially this is about helping clients understand the greater risks associated with drawing income from a portfolio of assets, compared with the accumulation stage, including:

- **Sequence of returns risk** (also known as reverse pound cost averaging) – where the order of returns arriving to the portfolio during the early phase of retirement has a disproportionate impact on the outcome experienced by the client.
- **Volatility drag** – the risk inherent where a portfolio falls in value and then needs to work harder to go back to its initial value.
- **Inflation risk** – helping the client appreciate how long their portfolio might need to last and a considered view on the impact of inflation (for example, 5% inflation reduces real income by two thirds over a 20 year period). Even relatively benign rates of inflation can have a huge financial impact over increasing years in later life.
- **Longevity risk** – an assessment of average life expectancy and helping clients understand the probability of living beyond this.

In addition to the above, specific warnings should be given to clients including:

- The capital value of the fund may be eroded
- The investment returns may be less than those shown on the illustrations
- Annuity rates may be better or worse in the future
- High levels of income may not be sustainable.

6. Clarifying all the charges

In the FCA's 2017 Retirement Outcome Review, when commenting on non-advised drawdown the regulator stated:

"Drawdown charges can be complex, opaque and hard to compare..."

It's particularly important that advisers follow good practice in respect of adviser charging and associated disclosure for drawdown, given the added complexity around such things as charges for drawing an income, drawdown set up charges, platform custody charges etc. For further information please see the Personal Finance Society's earlier guide: 'A good practice guide to adviser charging (and associated disclosure)' – March 2015.

7. Establishing an optimal investment strategy

Advisers should consider the need for a different investment approach for clients in the accumulation and decumulation stage. Helping a client to generate regular income from a portfolio of volatile assets, over an unknown time period, represents a very different challenge to supporting them accumulate wealth. To deliver enhanced outcomes to retirement income clients traditional asset allocation often needs to be extended to include a broader range of solutions. This enables more efficient investment strategies to be created that are better positioned to meet this unique challenge.

Retirement income advice needs to carefully balance the need to generate a high enough return to enable a client to meet their personalised objectives whilst managing the increased volatility this exposes the client to. As the potential for higher returns come hand in hand with higher volatility. Counterintuitively, low risk, low volatility solutions can actually expose a client to greater risk in decumulation by not offering the potential for a high enough return to meet their personalised objectives, or the potential for living longer than anticipated.

Overlapping the investment approach should be the overarching withdrawal strategy. This could include total return, cash buffers, bucketing and natural yield. Each approach will have its strengths and weaknesses and each will need to be considered carefully to determine if it's suitable for a meeting client's personalised needs and objectives.

For many clients a holistic plan that utilises the full spectrum of retirement income solutions can enable a client to more confidently take the level of risk they require to meet their personalised objectives.

8. Establishing a 'prudent' withdrawal rate

Linked to the above, advisers should have a robust framework in place when it comes to advising clients on what commentators often refer to as a Safe Withdrawal Rate (SWR). There is no such thing as a universal safe withdrawal rate, as every client is different and has different circumstances and objectives. Good practice should also extend to the use of more accurate words such as 'personalised', 'prudent' or 'reasonable' withdrawal rates. Any withdrawal rate should be established and supported by robust modelling and stress testing across a range of market scenarios. Taking into account the clients personal and financial circumstances..

9. Minimising Tax

One of the key ways advisers can demonstrate value (and increase sustainability of income) is in respect of limiting tax on withdrawals. Tax rules on pensions are constantly changing, and the impact of these rules on retirement income advice is a subject that is beyond the scope of this guide. The PFS regularly hosts events (such as its investment, retirement and later life roadshows) which provide expert commentary on tax rules as they evolve and are an excellent source of up-to-date information on this subject.

10. Consideration of other opportunities

Where appropriate, adviser should consider other planning opportunities related to drawdown, including for example, the use of spousal bypass trusts, the recycling of income and the use of excess income to fund pension contributions (e.g. for children or spouse).

11. Creating a defined, repeatable process

Scoping out, documenting and following a defined process that is flexible enough to accommodate all types of clients' current and evolving needs, as well as predictable and unpredictable events will help ensure advice remains suitable and compliant. Such processes should cover onboarding both new clients and a robust review for existing clients.

12. Building a robust review process

Successful retirement income strategies require ongoing monitoring to help ensure they meet changing and evolving client circumstances. This requires a consistent drawdown review process across all clients, regardless of the provider. Best practice would include a withdrawal policy statement which ensures there is a pre-agreed framework for managing these ongoing decisions.

Critical questions include:

1. Is it meeting the personalised objectives, priorities and expectations of the client?
2. Is the chosen level of income sustainable over the long term?
3. Is the investment strategy still suitable?

Other important questions to be asked include amongst others:

- How will a client's health affect the review and outcomes?
- How do you assess whether the clients' objectives are still realistic?
- Has their capacity for loss/attitude to risk changed?
- How are any changes to strategy and investment portfolio identified and actioned?
- How do you decide if the time has come to consider a partial annuity purchase or if this is the right time to add another tranche of annuity?
- Is it clear the clients' minimum income requirements are still being met?
- Has the client's cognitive abilities deteriorated?
- Does the client have a Power of Attorney in place? Or, is the client a Power of Attorney for someone else?
- Advisers should hardwire a review of the nomination/expression of wish into every annual review and following each key life event.
- Changes in relevant legislation?

13. Frequency of Review

It has always been important to review retirement income strategies with clients on a regular basis but following pension freedoms, and the facility to take large ad hoc withdrawals at any time, reviews have become even more important. Frequency of review should reflect the complexity of any given clients' circumstances, but good practice would suggest this should be at least annually and, in some cases, more frequently.

14. Building Contingency

It's good practice to make sure there is a contingency built in to all retirement planning, and to make sure there is significant provision to cover unforeseen problems (such as a major stock market crash, significant unexpected capital expenditure or the death of a partner). Agreeing to a plan of action in advance will enable action to be taken quickly.

15. Understanding of the impact on Welfare and Social Care Support

It is important that the adviser understands the impact of different choices on drawing down pension funds on current and future entitlement to welfare and social care support. This is especially relevant for those who draw down their pension pot quickly as they may be deemed by authorities to have deliberately deprived themselves of income/assets and in so doing reduce or disqualify entitlement to such support at some future point.

16. Powers of Attorney

As well as increased longevity, the UK will have increasing numbers of people with illnesses, both physical and mental, ranging from mild cognitive decline to dementia. Good practice involves highlighting the possibility of loss of a client's own ability; for instance if they lose mental capacity, what are the issues that present in terms of the ongoing management of a drawdown strategy. Evidencing that the client has the ongoing capacity to make decisions and outsource decisions to third parties, such as discretionary fund managers and their adviser is increasingly important.

Clearly the time to set up a Lasting Power of Attorney is well before it is needed and adviser firms should highlight this to their clients. Consideration should also be given to a disclaimer being signed at the outset if the client chooses not to elect an LPA.

17. Drawdown legacy planning

Pension freedoms introduced the concept of nominee and successor flexi-access drawdown, which amongst other things allows for pension wealth to be passed down through family generations. Apart from being good practice, it is important that a member nominates and keeps their nominated beneficiaries up to date if they want them to have access to all death benefit options available under drawdown. Advisers should hardwire a review of the nomination/expression of wish into every annual review and following each key life event.

Further consideration to involve family and/or loved ones in drawdown legacy planning can mean the whole experience on death goes smoothly and promptly, often resulting in a far better outcome at what is almost always an emotionally difficult time for family members.

Appendix – The Rules and regulatory source material

Recent FCA communications

Recent Communications	Relevant dates	Content commentary/link
FCA PS 19/21 – 'Retirement Outcomes Review: Feedback on CP 19/5 and our final rules and guidance'	Issued 30/7/2019	This statement sets out the FCA's proposed package of remedies from their **Retirement Outcomes Review**. Drawdown is where the majority of the review's focus and concern lies. Between October 2015 and September 2017, nearly 350,000 pension pots went into drawdown, and almost a third of these did so without the benefit of any financial advice. The key elements of the proposals are:: • are requiring providers to send information to their customers in drawdown annually, whether or not they are currently drawing an income from their pot. **https://www.fca.org.uk/publication/policy/ps19-21.pdf** This consultation sets out the FCA's proposed package of remedies from their Retirement Outcomes Review. Drawdown is where the majority of the review's focus and concern lies. Between October 2015 and September 2017, nearly 350,000 pension pots went into drawdown, and almost a third of these did so without the benefit of any financial advice. In respect of drawdown, the FCA are seeking feedback from stakeholders on proposals that: • providers should offer ready-made drawdown investment solutions, within a simple choice architecture ('investment pathways'), which reflect standardised consumer objectives • new consumers accessing drawdown will have to make an active choice to be in cash. The FCA expects firms to have a strategy for dealing with consumers who have already been defaulted into cash,and who are unlikely to be best served by this investment strategy Once a consumer has entered drawdown the FCA suggest they still need information and support, and... • are consulting on a proposal that providers should send information to their customers in drawdown annually, whether or not they are currently drawing an income from their pot. • are seeking feedback from stakeholders on whether firms should remind their customers annually of their chosen investment pathway and their ability to switch. **www.fca.org.uk/publications/consultation-papers/cp18-17retirement-outcomes-review**
FCA Non-advised drawdown pension sales review: summary of findings	Issued 28/3/2018	The FCA assessed whether firms are providing necessary information in a way that helps customers make informed decisions when accessing retirement benefits and when reviewing whether their drawdown pension continues to meet their needs. **www.fca.org.uk/publication/multi-firm-reviews/non-advised-drawdown-pension-sales-review.pdf**

Appendix – The Rules and regulatory source material

Further reading

Defaqto: *Professionals' guide to drawdown 2018–19*
The document is accredited by the CII/PFS and CISI for up to 60 minutes of structured CPD.
https://www.defaqto.com/advisers/publications/professionals-guide-to-drawdown-201819/ or https://www.pruadviser.co.uk/pdf/GENM416404.pdf

The Pension Advice Service – *Spotlight on Income Drawdown*
file:///C:/Users/apfstonm/Downloads/https___www.pensionsadvisoryservice.org.uk_content_spotlights-files_uploads_Income_Drawdown_SPOT001_v1.6_Dec_2017_.pdf

Money Advice Service - *What is income drawdown?*
https://www.moneyadviceservice.org.uk/en/articles/income-drawdown

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