Drawdown Response

FCA policy statement

Grabbing ROR, running with it and securing a big win

In June last year, the Financial Conduct Authority (FCA) published the Retirement Outcomes Review (ROR) final report, in which it set out its findings and proposed a package of remedies for addressing the issues arising from the introduction of pension freedoms.

On the 30th July this year, following consultation, it published its final rules on the second tranche of ROR remedies in policy statement 19/21. These rules will be in force by 1st August 2020.

Here, we explore what this policy statement means for the industry at large, what it may mean for your business, and, crucially, how we can support you to help your customers make better informed decisions and ensure they remain engaged with their investments through drawdown.

A brief re-cap

The FCA tasked NatCen Social Research, supported by the Pensions Policy Institute, to gather evidence on non-advised consumers' engagement with their drawdown investment decisions before publishing the final rules. Tellingly, though perhaps unsurprisingly, the study found that most of the study group had moved into drawdown to get access to a Pension Commencement Lump Sum (PCLS) and not because they were interested in the product its own right. It seems Drawdown for the non-advised has become an inadvertent by-product of getting access to tax-free cash before retirement.

With this second tranche of remedies the regulator therefore is primarily looking to:

- Prompt the significant number of non-advised consumers entering drawdown (currently accounting for approx. 30% of all drawdown) to think about their objectives for their pension fund, **by presenting different investment pathways;**
- **Point non-advised consumers entering drawdown in the right direction** towards more appropriate investment strategies that match their objectives rather than defaulting to cash; and
- **Improve the quality of the information all consumers in decumulation receive.** Providers will be required to disclose clearly charges in pounds and pence, to set out the amount held in the drawdown account, and to remind the consumer about how it is invested and the other options available to them.

A growing problem

Human nature being what it is, and the appeal of accessing tax-free cash top-trumping all other considerations, the numbers entering drawdown without advice is likely to increase over time. Currently accounting for 30%, we expect that number to be swelled by retirees who only take advice at the point of retirement and those who cease to receive advice in retirement. Indeed, the cost of ongoing advice may deter many retirees from seeking regular advice during retirement.

PS19/21 is a klaxon sounding for the industry to step up, take action, and innovate to ensure the needs of the consumer are being met in the run up to, at, and through retirement. Top of the list must surely be new asset allocation strategies for the drawdown market as well as adequate guidance and tools.

The role of providers

The FCA is very clear that drawdown providers must help consumers understand their attitude to risk and capacity for loss and how this compares to the riskiness of the investment pathways but recognises the problem of drawdown providers inadvertently giving personal recommendations. **The FCA proposes the use of guidance and tools** to help consumers decide whether a pathway is right for them.

However, the FCA offers no concrete ideas on how this can be achieved without risking being judged to have given advice. One way would be to provide forecasts of the potential outcomes from a pathway compared to other options so that consumers can see whether a pathway or another investment option is right for them. The forecasts should clearly show how a pathway or other options might affect their retirement objectives. Consumers need to be given realistic expectations of the potential outcomes from the pathways and this is essential if consumers are to understand the risk and reward associated with a pathway.

Without adequate help, as the NatCen study shows, it is hard to see how consumers can make the right decisions and manage their drawdown plans effectively in retirement.

Providing and enhancing cost effective advice and guidance

The FCA's proposals are a "band aid" for the non-advised who need, at the very least, access to excellent guidance and tools. Ideally, the real answer is access to advice but, for most consumers, this is currently too expensive. **Digital advice is both cost effective and scalable** so that it can be delivered to meet the needs of mass market consumers. Digital advice can be made available in the run up to, at, and during retirement. The advice can be holistic covering all wealth not just pensions and can include advice on tax efficient withdrawals in retirement.

Guidance and tools to help with the selection of the right pathway or other investment options are essential to set realistic expectations for outcomes. Guidance and tools should continue to be provided in retirement to help consumers manage their drawdown plans. This is particularly important for those consumers drawing income. They need to know what level of income is sustainable for life and, if and when, it might be in their interest to buy an annuity.

A considerable upgrade to the tools available to advisers should also be on the agenda. **Most of the current tools are systematically flawed because they use deterministic projections.** Deterministic projections (including some using stochastic models) systematically over-estimate sustainable income because they ignore sequencing risk (a run of poor returns in the early years of drawdown which can deplete retirement capital rapidly and irreversibly) and the negative effects of volatility i.e. pound cost ravaging (the reverse of pound cost averaging for accumulation). The use of a quality stochastic model is key to being able to show the likelihood of a customer achieving their goals, which in turn also helps provide a capacity for loss check.

A typical consumer will move through various life phases:

- Receiving guidance and accessing modellers in the workplace in the run up to retirement;
- At-retirement either receiving guidance, digital advice or (for the wealthy few) traditional advice possibly arranged by the employer; and
- In retirement using a combination of guidance and modellers, digital advice and traditional advice and potentially switching between these options depending on price and perceived need from time to time.

Where all these options are provided by the same pension provider, **consistency in the guidance given, the modelling and the presentation of results will greatly improve consumer understanding.** A consistent and seamless approach, which meets the different needs of consumers from time to time, will also aid their retention and loyalty as they move through different life phases.

The FCA's Policy Statement and requirement for investment pathways should be the stimulus for developing new asset allocation strategies for the drawdown market. Asset strategies designed for accumulation will not be suitable and new investment solutions are needed for different decumulation patterns and optimised for different target durations and risk capacity. For example, a fund, specifically designed for drawdown, with a dynamically optimised asset allocation, could increase retirement income substantially or ensure that a required income lasts longer.

Doing more than "tick box" compliance offers the prospect of a big win

Let's see how we can work together to run with ROR for the benefit of consumers and to advance the industry. There is a lot to be gained. From a very conservative analysis, we estimate revenues from retirees using drawdown could be increased by at least 11% and profits by 20% after 5 years rising to 27% and 31% after 10 years. This is simply the difference between a "tick box" response and using technology to deliver a consumer-focused guidance and advice proposition for consumers using drawdown. By doing this, retention rates can be improved and the non-advised transformed into long term satisfied customers. The above enhanced figures for revenues and profits are based on a very modest increase in the average size of pension assets due to a small amount of consolidation and slowing down the depletion of assets in drawdown by providing access to enhanced guidance, modellers and digital advice so that retirees can better achieve their retirement objectives.

It's been four years since the introduction of pension freedom, it's time to innovate and lead. And we're here to help you do that.

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