For financial intermediary use only. Not for use with customers.

JUST.

THE RETIREMENT SPECIALIST

RETIREMENT INCOME

WHAT DO NILS BOHLIN AND THE FCA HAVE IN COMMON?

Guy Anderson, Director of Retirement Income Distribution at Just, discusses how a misalignment between consumer requirements and adviser understanding of client retirement income needs may lead to foreseeable harm... And how a fresh look at the annuity vs drawdown question could be the answer.

Nils Bohlin's claim to fame was the invention of the three-point safety belt, which was fitted to Volvo cars from 1959. So important was this now ubiquitous device that it was recognised by the German Patents Register as one of the eight patents to have had the greatest significance for humanity during the 100 years from 1885 – 1985.

What Nils did was find a way to avoid the foreseeable harm Volvo could cause to their customers by the ever-increasing performance of their products. This brings me nicely on to the topical subject of the FCA Consumer Duty.

At a high level, this trailblazing regulatory requirement is made up of one overarching principle, three cross-cutting rules and four outcomes. Many would look at these simple statements and see similarities with long standing regulatory initiatives such as Treating Customers Fairly. However, I believe one of the cross-cutting rules is a little different: 2. Avoid foreseeable harm to retail customers. Let me explain why I've arrived at this judgement.

Increases in gilt yields

With the current economic and market turmoil, plenty of column inches in the weekend papers are being given over to the financial impact this could have on their readers. The increases in gilt yields drive increases in guaranteed income rates, and much media commentary is revisiting the hackneyed annuity versus drawdown debate. This is an outdated and overly simplistic comparison which I'll return to later. So, now guaranteed income is in vogue, it was interesting to see the results of a recent customer and adviser retirement income survey, undertaken by H/Advisors Cicero on behalf of one of our platform partners, 7IM.

Amongst the survey data, one thing stood out to me in the context of that cross-cutting rule — Avoid foreseeable harm to retail customers.

While 75% of the retirees who responded to the survey either agreed or strongly agreed that they would like guaranteed income in retirement, only 12% of advisers agreed or strongly agreed that their clients want guaranteed income.

It could be argued that this level of misalignment between consumer preferences and adviser understanding of client preferences may lead to foreseeable harm, especially if solutions recommended fail to provide the outcomes consumers are expecting, which for many retirees, is an investment performance risk-free, sustainable income.

I don't think it's difficult to foresee how harm could be caused when retirees are recommended to rely on the markets to provide a sustainable income over a lengthy period, but let's take a look anyway.

Relying on the markets to provide sustainable income

Here's a very simplistic hypothetical client who started living off their £1m portfolio a year ago. We'll use the commonly cited 4% amount for the first year's withdrawal, which was taken upfront. Their adviser talked enthusiastically last year about how they could enjoy an inflation protected income and be able to pass money on to their children and grandchildren when the time came. This was evidenced using a simple deterministic cashflow plan showing everything would be good. All they needed was what sounded like a very reasonable 5% portfolio return every year.

One year on in our simplified example, at the first annual review:

- The client's portfolio has dropped by 20% due to all asset classes being impacted by market turmoil.
- Because of double digit inflation they now need to withdraw £44,000 this year rather than the £40,000 last year.
- The £1m the client had a year ago is now only worth £725,000 after their second withdrawal. So a quarter of it has disappeared in just one year.
- This is not what that cashflow plan showed, as based on that 5% growth the capital was staying largely intact for some years to come.
- The second year's withdrawal rate, now 5.7%, is above the assumed 5% per annum investment growth rate and to get back to that nice round £1m number would now require a 38% return ignoring future withdrawals.
- And, this is before consideration of all charges and costs.

Is this painting an unfair and unrealistic picture?

Now you might think that this paints an unfair and unrealistic picture, but let's return to those weekend papers. In a recent Saturday edition, there was an article where an adviser from a large financial planning and asset management business dismissed any consideration of guaranteed income for a 65 year old individual with a £500,000 portfolio. This was on the basis that they could enjoy the same starting amount of income as a level annuity, with modest inflation protection, assuming a 5% pa portfolio return. That sounds OK doesn't it, until you read that on those assumptions the £500,000 could run out at age 84! An age at which our current 65 year old has a 79% likelihood of surviving to and beyond.

> **"Surely, suggesting a plan for someone to run out of money at a point in time before even their average life expectancy is irresponsible..."**

Surely, suggesting a plan for someone to run out of money at a point in time before their average life expectancy is irresponsible, as is suggesting investment markets increase year in, year out at a constant 5% pa. How does this sit with 'avoid foreseeable harm to retail customers'?

Now, the above might be a good example of what some would suggest was a lack of impartiality and unconscious bias entering into the advice process. But I think it's also a good example of the old hackneyed binary mindset that is proving difficult to shift when it comes to retirement income provision. Do I buy an annuity versus using drawdown? When is the optimal age to annuitise? These are no longer relevant questions in my opinion, not for the vast majority of retirees who rely on professionals to guide them.

Both. Not either or. That's the intelligent response.

What should be recognised and given fair and impartial consideration is how allocating 15%-20% of a retirement portfolio into guaranteed income can optimise the durability of the overall portfolio, dampen sequence risk and help avoid foreseeable harm. Just as Nils Bohlin did for Volvo 60 odd years ago, incorporating guaranteed income into a retirement income portfolio will also become a ubiquitous decision.

If you'd like to hear more, we'd love to share impartial evidence that shows how incorporating guaranteed income into drawdown SIPP portfolios could deliver improved client outcomes. Please get in touch with us, either by phone on 0345 302 2287 or via email at support@wearejust.co.uk

FOR MORE INFORMATION

Call: **0345 302 2287**
Lines are open Monday to Friday, 8.30am to 5.30pm

Email: **support@wearejust.co.uk**
Or visit: **justadviser.com**

Please contact us if you would like this document in an alternative format.

Please note your call may be monitored and recorded and call charges may apply.