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INVESCO RETIREMENT SERIES – PART 3

Spotlight on the Retirement Income Advice Review

The direction of regulatory change is clear

Strategies used in the accumulation phase of retirement are unlikely to be appropriate for the decumulation stage. The Retirement Income Advice Review is another step towards encouraging advisers to build a more robust process for suitability specifically aimed at the drawdown stage of an individual's retirement journey.

Here we ask two of our experts – Graham Hook and Georgina Taylor – to discuss the important aspects and outcomes of the review.

Our regulatory expert Graham Hook gives his views on the Retirement Income Advice Review and the elements that advisors should be focused on.

Graham Hook
Head of UK Government Relations and Public Policy

Q: Why is the Retirement Income Advice Review such a key milestone for the retirement industry?
The Thematic Review was published almost exactly a decade after the Government first announced the pension freedoms in March 2014 that introduced greater flexibility and complexity into retirement planning.

It builds on the 2015 Retirement Income Market Study, the 2018 Retirement Outcomes Review (ROR) and parts of the FCA's 2021 Consumer Investments Strategy in seeking to ensure that advised consumers are appropriately supported in accessing their pension savings and meeting their future financial needs.

Having paused the workstream during the pandemic, the Thematic Review provides the first in-depth snapshot since the ROR of the way in which retirement advice market has adapted to pensions freedoms and equips advisers with knowledge of the FCA's supervisory focus for the years ahead.

Q: What is the FCA primarily focused on as part of this review?
The FCA focused on three key areas:
a) whether the retirement income advice market as a whole is functioning well;
b) whether firms' advice models consider the specific needs of consumers in decumulation; and c) whether consumers are being provided with suitable retirement income advice when accessing their pension savings.

In addition, the FCA wanted to explore how firms were preparing to comply with the Consumer Duty when it came into force for existing products and services at the end of July 2023.

The Thematic Review... equips advisers with knowledge of the FCA's supervisory focus for the years ahead.

Q: What are the key findings?
Overall, the FCA found examples of both good and bad practice. The review of advice models "revealed a mixed picture": some firms had successfully evolved their approaches to the post-freedoms landscape but others hadn't sufficiently considered the needs of their customers or set out their advice model in a way likely to lead to good outcomes.

Areas identified for improvement by the FCA include:

- **Income withdrawal strategy**
  More consistent use of cashflow modelling to estimate sustainable levels of retirement income, tailored to individual circumstances;
- **Risk profiling**
  Reassessing consumers' attitude to risk and capacity for loss when moving from accumulation to decumulation to ensure solutions are appropriately designed; and
- **Advice Suitability**
  Ensuring comprehensive consumer fact finds, including quantifying income needs and exploring future lifestyle changes.

The FCA highlights that retirement income advice will remain an area of ongoing focus.

This is likely to translate into a heightened focus on ensuring there is a difference between centralised retirement propositions and the centralised investment propositions that have driven advice in accumulation.

Q: What is the overlap with Consumer Duty?
Despite the fact that the Consumer Duty only came into force after advice firms had submitted survey returns to the FCA, there's clearly a great deal of overlap between the Review's objectives and the Duty. The Duty requires firms providing retirement advice to act to deliver good outcomes for retail customers, to avoid causing foreseeable harm and to enable their customers to pursue their financial objectives.

It also requires firms to specify their target market, record how their services have been designed to meet the needs, characteristics and objectives of their customers, to ensure their services provide fair value and that their communications meet customers' information needs.

The FCA found that some firms surveyed hadn't defined clearly the composition of their target market, while others held insufficient customer records to enable them to monitor customer outcomes. On this basis, the FCA concluded that not all firms were adequately prepared for the Duty and, now that the Duty is in force, ongoing compliance is likely to be a key supervisory focus in the coming year.

Q: Were pension freedoms a good idea?
Changes were clearly needed to reflect the shift in pension provision from DB to DC and the changing nature of retirement – with more people both living longer and choosing to work for longer on either a full or part-time basis. However, the freedoms – still in their relative infancy – have injected considerable complexity into the decisions people face when they consider accessing their pension savings. For many, it will be the most complex financial decision they will take in their lives.

As such, being able to access tailored, professional financial advice and a range of retirement solutions was always going to be important. The speed with which the freedoms were introduced has meant that both regulation and market practice have struggled to keep up. But through the industry and regulator's work on retirement advice, combined with the availability of a growing range of retirement solutions, savers accessing their pension in the coming years should feel far more confident relative to their peers of a decade ago.

Q: How do investment pathways fit into all of this?
Introduced in February 2021, the FCA now required drawdown providers to offer four prescribed Investment Pathways to non-advised savers, with the objective of aligning a saver's retirement objectives over a five-year horizon with their drawdown investment.

While a step in the right direction, the pathways are relatively inflexible and don't facilitate up front planning of the different phases and components of retirement. The forthcoming duty on trustees and pension providers to provide a suite of decumulation options to non-advised customers is a great opportunity to reflect better the greater complexity of many individuals' retirement plans and to build mass-personalised solutions to meet them.

Q: In our view what needs to develop further? Any other insights from work being done by the FCA outside of the thematic review or read across from other studies/reviews?
As government and regulators continue to develop their approaches to decumulation, it's vital they give retirement solutions providers the scope to continue innovating in both product and solution design. One-size-fits-all approaches will fail to capture adequately individual needs – or indeed the needs of the Consumer Duty! Regulators should therefore focus on creating flexible frameworks that enable advisers and providers to take a building blocks approach, drawing on different components (e.g. cash, guaranteed income and future investment growth) to tailor solutions to customers' needs.

The outcome of a joint HM Treasury – FCA review of the advice/guidance boundary could bring significant benefits if it enables pension providers to take a more proactive approach to recommending suitable products for a non-advised client's target market, without having to engage in full financial advice. As such, it should considerably benefit those consumers who don't currently access financial advice and for whom provision through existing mass market services, such as MAPS, is currently inadequate.

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Georgina Taylor
Head of Multi-Asset Strategies, UK

Next Georgina Taylor, Invesco's Head of Multi-Asset Strategies, UK, shares her thoughts on how the advice review is filtering into Invesco's thought processes of how to approach decumulation strategies.

Q: What have been the barriers to advisers taking a different approach to decumulation relative to accumulation?
A lot of people entering retirement have had access to a defined benefit pension, which has reduced the uncertainty and level of planning required by retirees as they embark upon their post-retirement journey. At the same time, up until 2022, traditional multi-asset portfolios provided an effective way of funding a drawdown strategy given the very good investment returns achieved from both bond and equity markets.

But things look very different going forward. Defined Benefit schemes are gradually disappearing, and 2022 served as a reminder that portfolios that de-risked into bonds did not provide a lower risk outcome for investors and potentially provided a huge problem for individuals entering retirement, who believed they had a certain level of savings to fund their requirements in retirement.

While it is always difficult to embrace change, the review does lay out the key areas for advisers to focus on: a more robust process needs to be in place to determine income withdrawals which accounts for the specific needs of the individual entering drawdown, evidence of risk profiling needs to be shown in the context of capacity for loss, suitability of advice needs to be evidenced and advisers need to improve record keeping related to periodic reviews and ongoing suitability of products.

In our view the only way advisers can do all of this effectively is by building a specific and targeted approach to having conversations with clients entering drawdown. This approach needs to include a reassessment of how suitable products are for drawdown, but also demonstrate why combining different products together will help satisfy the needs and personal wants of the individual who is planning for their future.

Q: How do we even start to think about how appropriate a product is for a retiree?
If advisers are going to develop a new approach to building investment strategies for decumulation, we need to change the way we look at products and assess their suitability. The regulatory guidance is clear – products that have served savers well through the savings phase of their retirement journey are unlikely to all be appropriate for the drawdown phase.
The complication is that one size does not fit all in retirement and therefore no one product will serve everyone appropriately as they start planning for their future.
There is a degree of complexity in assessing how appropriate products are for retirement, but regulation now states that advisers need to provide clear evidence of why a product is appropriate and so we need to deal with this complexity head on to ensure we are helping retirees as best we can.

Firstly, timing is difficult. Talking about pre- and post-retirement solutions is possibly misleading. An individual may retire from their main career, but they may go on to work part-time, or receive income from other sources. The age from which the state pension starts also changes what income is required from a pension pot, versus what is covered through state pension payments.

In our view, the only way we can effectively assess how appropriate products are for retirement is by looking at the retirement dilemma in its entirety, and through assessing how different products interact with each other to satisfy the needs of the individual entering retirement. We think about retirement planning across four different components, and by thinking through each component part we can then more accurately assess how appropriate a product is for a retiree because we know which part of the puzzle a specific product is solving for.

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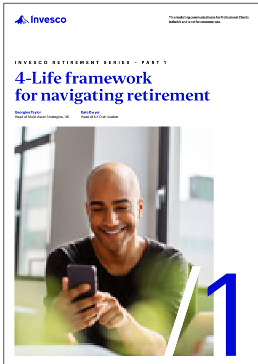
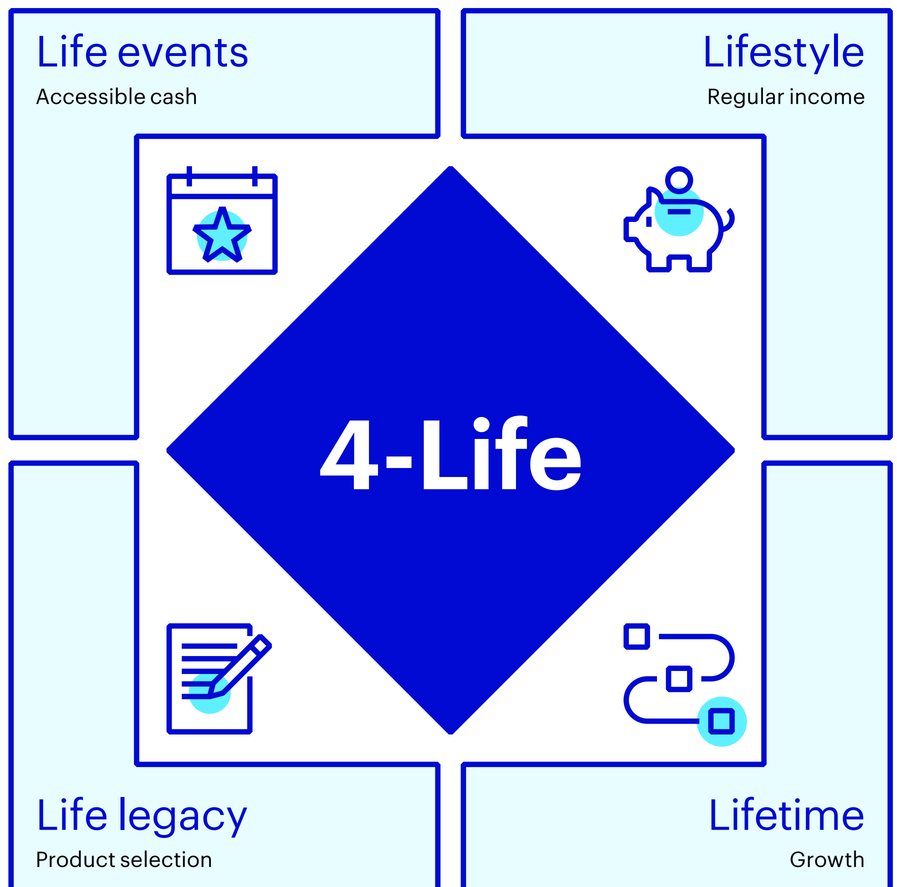
The 4-Life framework for navigating retirement

In our 4-Life framework we outline four considerations for retirement planning – life events, lifestyle, lifetime and life legacy. For each of the four components we can then focus in on appropriate products that specifically solve for life events through cash like instruments, lifestyle which relies on products that deliver a stable level of income, lifetime which is anchored in growth products and life legacy which impacts which products may be more, or less suitable depending on the desire of the individual to pass on a legacy.

We discuss all of this in more detail in a recently released whitepaper.





> **A low capacity for loss does not mean investors have to think about risk in the same way across the whole of their pension portfolio.**

Q: Why is the concept of capacity for loss so important in retirement?

Capacity for loss is an incredibly important measure for individuals who want to take an income from their pensions savings. If individuals have no other income sources, or they have very specific costs that they need to cover, their capacity for loss will be very low and therefore the products that they invest in should be aligned appropriately.

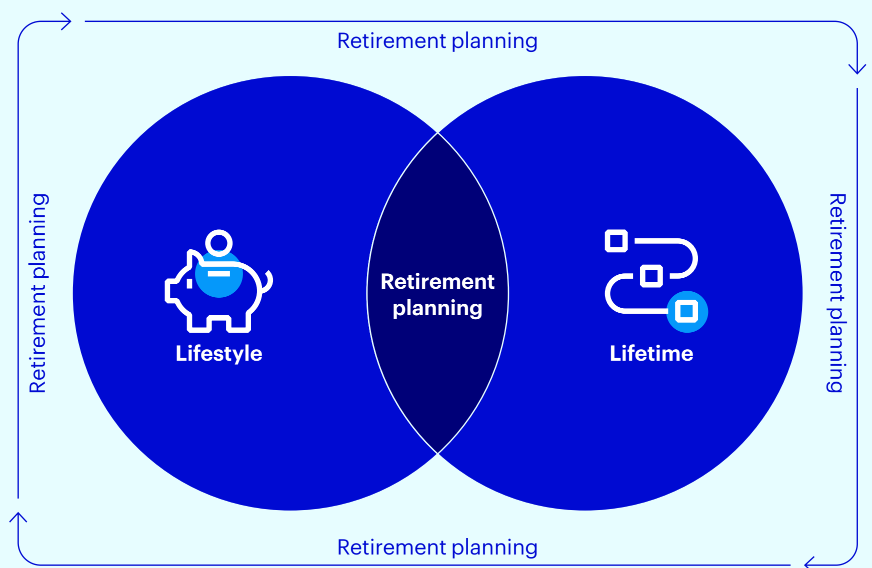
But a low capacity for loss does not mean investors have to think about risk in the same way across the whole of their pension portfolio. Capacity for loss feels more intrinsically linked to the certainty of income nearer term. If individuals can access the income they require, they may be able to set some money aside to invest for the longer term in products that can deliver a good rate of return, which invariably comes with a higher level of risk. If retirees can have one income pot to cover lifestyle as per our 4-Life Framework, and a growth pot alongside it to cover future lifetime flexibility we can help deal with the uncertainty of retirement in a more targeted way.

Q: Should we approach risk profiling differently for retirement products?
The typical anchor for assessing risk appetite is through people's tolerance for volatility. Questions targeting how much people are willing to lose short term, or how quickly they may need their money back tends to lead to an overall risk tolerance assessment for that individual.

However, we would argue that risk tolerance needs to be looked at holistically across a whole retirement portfolio, and not necessarily guide product selection on a product-by-product basis. We need to combine the two elements of retirement planning – an individual's income requirement alongside the need to future proof their retirement portfolio for changing needs over time. We believe this is best done by having a lifestyle pot and a lifetime pot.

For the lifestyle pot, assessing a person's income needs and ensuring that income can be delivered through the products that are selected is important. If an individual has a low capacity for loss, these income products should be low risk and have a high probability of delivering the product's income targets. If there is money left over this can be put in a lifetime pot that would be a growth portfolio to fund future spending or income needs. The products selected for the lifetime pot could be higher risk if the individual's income needs are satisfied through the lifestyle pot. In aggregate the person has exposure to a low risk income portfolio and a higher risk growth portfolio but when added together their overall retirement portfolio is around medium risk. We need to get better at looking at what a combination of products means for an individual rather than selecting products through a one dimensional risk tolerance lens.

Changing needs in retirement calls for a fluid approach between lifestyle and lifetime planning



Lifestyle
Lifestyle captures month-to-month spending based on the lifestyle that each person wants to enjoy in retirement. There are two layers – essential spending and additional spending. Putting a monetary value on this lifestyle component can help with how much of a person's savings need to be allocated for everyday spending and what is left over for other types of spending and future planning.

Lifetime
Lifetime planning is there to help people build longevity into their retirement plan. No-one knows how long they will live for or when they may need to increase their month-to-month spending. This could be because of a change in lifestyle, a change in health or buying a few more luxuries along the way.

Q: What is the role of an asset manager in building retirement portfolios?
Asset managers are only one part of the retirement supply chain. But the industry can only build products that are appropriate for retirement if every single part of the supply chain understands the full retirement journey and acknowledges the complexity of drawdown versus accumulation. Significant innovation is needed by the asset management industry because the investment challenge of drawdown is very different to the requirements in accumulation. The industry cannot launch single products to address decumulation but needs to offer a suite of product options so that the building blocks can be combined to satisfy the more personal requirements that dictate success in the drawdown phase of an individual's retirement, relative to the accumulation phase.

Q. What is Invesco doing to address the challenges of investing in decumulation?
We are very directly taking the outcome of the Retirement Income Advice Review and building products and solutions that will help advisers to build more effective retirement portfolios for their clients.

Historically there has been a relatively extreme view taken in retirement. Either use an annuity for those with a very low risk tolerance, or alternatively use a drawdown strategy based on taking income from a growth portfolio. We believe we can do better. If individuals need income, then targeted income products should be used to satisfy that income requirement.

The decision of what is best for that person's individual circumstances can be based on whether the individual has full sight of how they want their retirement plan to be on day one or whether they need more flexibility.

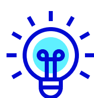
As a firm, we believe the work we have been carrying out can help address some of the challenges of investing in decumulation across three dimensions:

Assessment of investor's needs in retirement
Invesco has developed the 4-Life framework to help navigate the world of retirement. By thinking about retirement planning across four different components, retirees can better identify their true needs and more accurately assess how appropriate a product is for their retirement. By leveraging this framework, advisers may be in a better position to provide guidance to their clients, in line with the latest regulatory review.

Investment solutions for retirement
We believe combining different income products together works well to build a combination of certainty and flexibility into a retirement portfolio, tailored to individual needs. Using a combination of cash, guaranteed income, and target income funds helps personalise the experience for the individual.

Testament to this philosophy is Invesco's launch of a new retirement solution for advised clients together with Just Group. The partnership will bring together the expertise of Invesco's Model Portfolio Service (MPS) and Just Group's pioneering Secured Lifetime Income (SLI) product, a guaranteed income producing asset to help advisers mitigate key retirement risks, such as longevity, sequencing risk and unknown life events.

In addition, Invesco's Multi-Asset Strategies team has just launched Invesco Summit Income, a multi-asset income fund that aims to pay a specified level of monthly income to investors which can be used in conjunction with cash and guaranteed income products or in isolation depending on the cashflow requirements of the individual. The fund builds on and complements the successful launch of Invesco's Summit Growth and Summit Responsible risk-targeted fund of fund ranges by adding an income solution to the existing range of five multi-asset growth funds. In essence, this will provide investors with a consistent journey from accumulation to decumulation.



A knowledge centre for retirement related topics
Saving for retirement is complex and we believe we will deliver better outcomes for individuals if we all work together. We are keen to share our insights on how different communication styles can directly influence decision making in retirement, share our portfolio analysis tools to help clients blend different investment solutions together, and directly talk through our investment propositions specifically targeting drawdown. We also encourage clients to reach out to our industry experts, such as Graham, who can provide guidance on the latest regulatory trends.

> **The industry cannot launch single products to address decumulation but needs to offer a suite of product options.**

Investment risks

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and you may not get back the full amount invested. Over time, inflation may erode the value of investments.

As one of the key objectives of the product is to provide income, the ongoing charge is taken from capital rather than income. This can erode capital and reduce the potential for capital growth.

The product's use of financial derivatives may result in the product being leveraged, that is, the economic exposure created by using a derivative may be greater than the amount invested. The product, therefore, has the potential to lose more than it paid. If a counterparty becomes insolvent this will also result in a loss. The use of certain derivatives may also impair the product's liquidity which may mean the product has to close positions at an unfavourable price.

The issuers of the debt securities to which the product is exposed may not always make interest and other payments due to financial difficulties or insolvency. The value of the debt securities may fall due to poor market conditions, such as a decrease in market liquidity, and/or variations in interest rates. These risks increase where the product invests in high yield, or lower credit quality, bonds.

The product may be exposed to securities of emerging and developing markets, where difficulties in relation to market liquidity, dealing, settlement and custody problems could arise which could result in losses.

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For the most up to date information on our funds, please refer to the relevant fund and share class-specific Key Information Documents, the Supplementary Information Document, the Annual or Interim Reports and the Prospectus, which are available on our website.

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