Retirement Intelligence

Retirement Advice

AN ART OR A SCIENCE?

PRUDENTIAL

Contents

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Retirement Advice – an art or science?

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Retirement Director at Better Retirement and Director at Retirement IQ

I have been advising clients about annuity and drawdown options for over 25 years and during that time I have been searching for the holy grail of the perfect advice process. I have even tried to automate the process. However, I have not succeeded on either front and so I ask myself why has it not been possible to design the perfect advice process and why has it proven so difficult to automate the advice process?

The short answer is retirement advice is both an art and a science. Although it is possible to have structure and automation on the technical side of the advice process it is more difficult to deal with the more nuanced behavioural aspects of retirement. Retirement advice can be complex and time consuming because there are so many different factors to take into consideration. This means advisers need strong technical skills and good soft skills. Although I cannot deliver the perfect advice process, I can show advisers how they can deliver better advice more efficiently and more cost effectively by brushing up on the skills of the trade and following a step by step process.

Although there have been many attempts to extol the value of advisers, the advice gap remains stubbornly wide. Some retirees might be able to navigate their way through the myriad of options themselves, perhaps with the help of Pension Wise, but most people will benefit from taking professional advice given the complexity of retirement.

My challenge to Billy as an experienced adviser was to write a guide which would help other advisers reconsider their own retirement advice processes to see whether they can help more people get better retirement outcomes by developing cost effective advice services.

I think he has succeeded in that challenge and this common sense guide will I am sure be welcomed by fellow practitioners.

Vince Smith-Hughes
Director of Specialist Business Support, Prudential

The uniqueness of retirement income planning

All financial advice is important, and for many older people, advice at retirement is extremely important. Pension freedoms have transformed the way people access their pension pots at retirement, and many people fall into the trap of thinking it is easy and they can make retirement decisions without financial advice. But Retirement advice is complex and unique for the following reasons:

- There are many different pension options and retirement solutions
- It involves more longer-term planning than most other areas of advice
- Clients may have complex needs and objectives when they retire
- Advisers need specialist skills to manage the technical and behavioural aspects of retirement

Retirement advice is also complex and unique because there are many more technical and behavioural factors to take into account than with other areas of financial advice.

Advisers should have a good understanding of the technical matters such as how annuities and drawdown work and the various risks associated with each option and it is important to keep these skills updated. They should also have a good understanding of the behavioural factors they may influence the advice process.

TECHNICAL	BEHAVIOURAL
The advice process must be fully compliant and designed to deliver the best outcomes	Many people procrastinate and have an aversion to making complex decisions
Annuities must be considered and the advantages of mortality cross subsidy explained	If there is information overload and too much choice many people will make no choice at all
The risks of drawdown and the importance of sustainable income must be explained	Poor financial literacy means many people may have difficulty in understanding the key issues
A good adviser will identify the most appropriate solution and make sure the client is not taking undue risks	Some people have an aversion to paying for advice but if they don’t take advice they may make the wrong decisions

Clients who take advice from a competent financial adviser should make the right decisions and obtain good outcomes but those people who don’t take advice risk making the wrong decisions and ending up with poor outcomes.

This guide is designed to help financial advisers improve their retirement advice skills and to help them meet the challenge of advising clients who would not normally take advice either because they do not understand the value of advice or because the cost of advice seems too expensive.

The value of expertise

Three reasons why people need to speak to an expert

- ✓ There is a lot at stake
- ✓ It’s more complex that it seems
- ✓ Most people need some help, guidance or advice

Behavioural biases can affect investment behaviour

Most people are not aware of the behavioural biases that influence their decisions. These include:

- ✓ Overconfidence
- ✓ Loss aversion
- ✓ Hyperbolic discounting
- ✓ Money illusion

Customer segmentation and the advice gap

All clients are equal, but some clients are more equal than others, to coin a quote from George Orwell's Animal Farm. There has been an understandable trend since RDR in 2013 for advisers to concentrate on advising their higher net worth clients and turning away clients with modest financial wealth. Although most advisers I know want to do a good job for all of their clients the financial reality for many firms is that it is not profitable to advise clients with modest pension pots.

This has resulted in the so-called advice gap which has left a significant proportion of the population without access to financial advice. One of the aims of this guide is to show advisers how they can close the advice gap by providing cost effective advice without comprising on the quality of advice and without cutting corners on compliance.

There are many different ways for adviser firms to segment their clients and I think there are three main client segments:

Robo advice

Many firms are developing robo-advice for the mass market but these have yet to gain traction in retirement advice.

One of the reasons is that it is difficult to take account of the many behavioural and emotional aspects of retirement advice without human intervention.

	MASS AFFLUENT	UPPER MIDDLE INCOME	HIGH NET-WORTH
Typical profiles	May be 'just getting by' and need as much money as possible • Funds too small to justify full advice • Generally little understanding of pensions	Often financially astute and value financial advice • Usually technology savvy and may use online tools • However, some may not engage with their pensions	• May be financially rich but time poor • Usually recognise the value of experts and advisers • However, some may be self-select investors
Overview	Many will be attracted to taking lump sums, but others will need guaranteed income	Drawdown may have become the new default but the importance of income guarantees shouldn't be underestimated	Will benefit from holistic financial planning including, sophisticated investments, tax and inheritance planning
Value of pension pot	< £ 100K	£ 100K – £ 500K	> £ 500K

The advice gap exists between those who have pension pots that are probably too big to just take as a cash sum and those who have pension pots larger enough to benefit from specialist financial advice. I think that everybody will benefit from advice but the elephant in the room is the cost and complexity of advice.

I know from practical experience that the borders between these segments are fluid. For instance, someone with a pension pot of £100K may think of themselves as an affluent client and someone with a £500k pension pot may not want a complex solution. Generally, it is not the size of the pension pot that matters, but the client's overall financial situation. But in many cases, the size of pension pot is a good proxy for the complexity.

Don't forget that just because someone has a large pension fund it does not follow that they will not be interested in annuities. Even after pension freedoms I am being approached by high net worth individuals for information and advice about annuities.

The rest of this guide will help advisers to close the advice gap by looking at ways to make advice more accessible without compromising on the quality of advice.

Filling the advice gap

I maintain that it is possible to provide advice to those people who fall into the advice gap by doing the following:

- Explaining the benefits and value of advice
- Making the advice process more engaging and client friendly
- Delivering a more efficient and cost effectively advice process

The retirement advice process

In the introduction I said it is difficult to automate the advice process because there are so many moving parts, but this doesn't mean it is not possible to use technology to make the advice process more efficient. Before we take a detailed look at the retirement advice process it will be helpful to consider why it is different is to other types of advice.

As advisers and their clients are involved in the advice process they will both have to be:

- ✓ Good listeners
- ✓ Have confidence to make their views known
- ✓ Diplomatic and have patience

WHY IS RETIREMENT ADVICE DIFFERENT TO OTHER TYPES OF ADVICE?

Investment advice for people with modest assets and uncomplicated circumstances is often a two-step process; the client explains what they want and completes a questionnaire and then the adviser uses their knowledge and judgement to recommend a solution. Retirement advice is more complicated and often involves additional steps because there are more factors and solutions to take into account.

These extra steps include educating clients about their options and the key issues, encouraging them to think about their longer-term objectives and equipping them with the tools to compare and contrast the options presented to them.

Another reason why retirement advice differs from many other areas of advice is that clients are generally more engaged and involved with the advice process because this is one of the most financial decisions, other than buying their house, they will ever make. Therefore, advisers need to make sure clients understand the key issues so they can play their part in the advice process.

A TYPICAL ADVICE PROCESS

The graphic below sets out the six stages of a typical advice process and shows the role of the adviser and how clients should get involved:

		WHAT ADVISERS SHOULD DO	HOW CLIENTS CAN GET INVOLVED
1	Initial meeting	Explain the key issues and options and gain the confidence and trust of client	Start gathering information about their pensions and personal finances
2	The Retirement questionnaire	Get to know their client's circumstances and help them set out their objectives	Must answer as many questions as they can, especially about attitude to risk
3	The analysis, planning and risk profiling	Adviers will use a range of financial tools such as cash flow and stochastic modelling to produce a retirement strategy	The more information provided about retirement objectives, the better the analysis
4	Researching the market	They will research the market for the most suitable retirement solutions	This is best left to advisers as they have the information and tools to research the market
5	Present solutions and agree advice recommendation	Present a range of relevant options which will meet the client's retirement objectives and produce good outcomes	Must understand the choices and options presented and should be involved in the decision process
6	Confirm advice and product solution as well as any investment advice	Produce a suitability letter and regulatory information. Then arrange to implement advice and review regularly	Ensure they are comfortable with the advice given and understand the risks to be taken

Not every client will need or want this level of engagement and different advisers may guide their clients through the process in a different way. This process is based on my personal experience and style, so advisers may want to adapt this to meet their own particular way of advising clients.

In practice, some of the steps may be merged into one, especially when dealing with less complicated situations, but I think it is helpful to consider each step individually as it will help show what adviser skills, resources and client involvement are needed at each step.

INITIAL MEETING

How the advice process starts will depend whether it is an existing client or a new client. For existing clients, much of the preparatory work will have be done as the client's circumstances will be known and hopefully a retirement plan (even if it is high level) will be in place. For new clients, the initial stage is very important because this is where trust and confidence can be won or lost.

THE RETIREMENT QUESTIONNAIRE

Talking to advisers about fact finds is like teaching mother to suck eggs, however there are some important questions about retirement objectives that may not be asked on a standard client questionnaire. Some firms have an additional questionnaire which asks specific and focused questions which enable the adviser to get a more in-depth understanding of the client's income requirements and longer-term objectives.

THE ANALYSIS, PLANNING AND RISK PROFILING

One of the many skills a good retirement adviser will have is to convert the information objectives set out in the client questionnaire into a coherent retirement plan. There are a wide range of financial tools such as cash flow modelling software to establish future income needs. There are investment planning programmes which use sophisticated stochastic modelling techniques to identify appropriate investment strategies.

RESEARCHING THE MARKET

One of the many ways in which advisers add value in the advice process is by identifying the most appropriate product solutions because they continually research the market to identify the most appropriate retirement solutions with the most competitive terms. In some cases, the best advice may not be a single solution but a combination of guaranteed income and drawdown.

PRESENT SOLUTIONS AND AGREE ADVICE RECOMMENDATION

If retirement planning was a science, there would be a right answer and a single solution but often there are no right or wrong answers because retirement involves making subjective choices. Therefore, a good adviser will be prepared to consider and discuss a range of relevant options before deciding which is solution is most suitable for individual circumstances.

CONFIRM ADVICE AND PRODUCT SOLUTION AS WELL AS ANY INVESTMENT ADVICE

The suitability letter is one of the most important aspects of the advice process because it sets out the advice recommendation and explains the rationale for the advice given. The suitability letter not only confirms the product solution but also explains how the chosen investments match the client's attitude to risk.

TOP TIPS

Remember the well-known Chinese Proverb; *Tell me and I will forget, show me and I may remember; involve me and I will understand.*

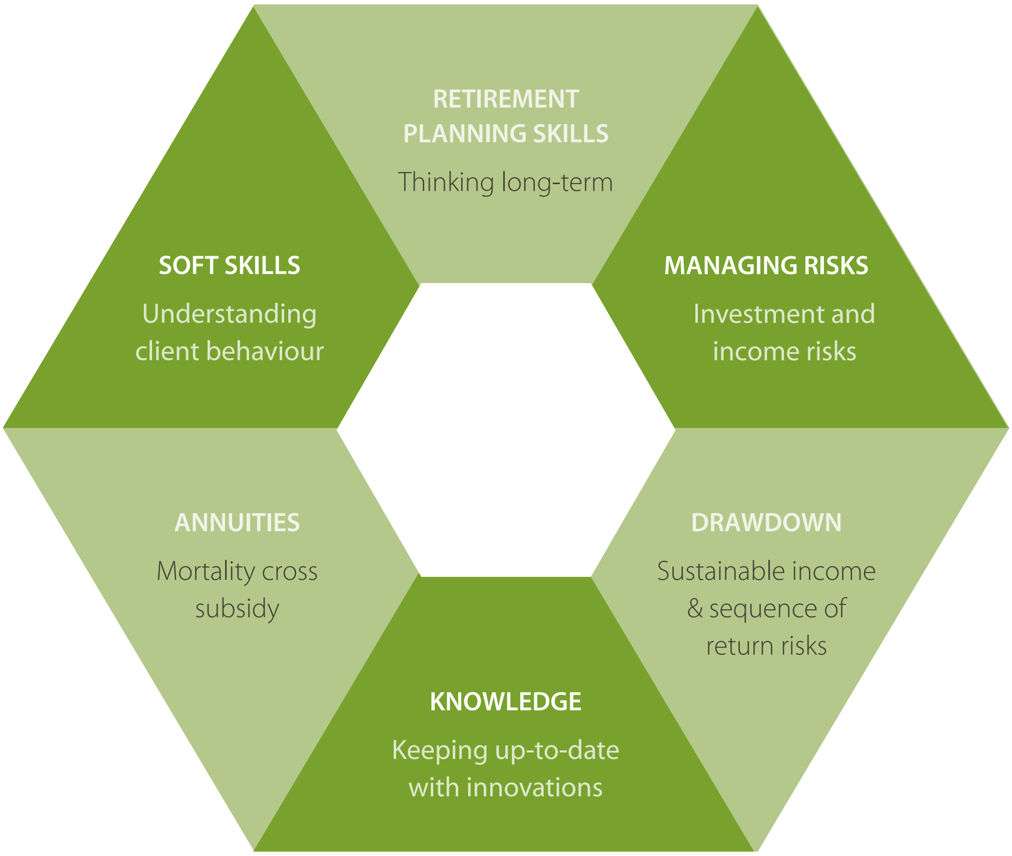
The key to make good decisions is to ***involve*** clients in the advice process.

- Don't overload them with information – only give what is relevant
- Make it easy to compare and contrast different options
- Go the extra mile to make sure they understand all the risks

Don't be frightened of making things easy to understand and remind clients that in order to make things simple you must have a deep understanding of the subject in the first place

What advisers need to know – the skills of the trade

There are a number of specialist skills advisers need to have to be able to give the best possible advice to their clients:



Skills of the trade

For more information about these skills please refer to my other guide 'Retirement is a journey not an event – questions and answers' which can be downloaded at:
www.williamburrows.co.uk
www.pruadviser.co.uk

RETIREMENT PLANNING SKILLS

You may need to encourage your clients to take a longer-term view of their retirement objectives and help them plan for the future. This can become complicated and may involve using cashflow modelling tools.

You should know the difference between 'deterministic' and 'stochastic' models. Deterministic models calculate a single static solution from a number of inputs assuming a number of linear assumptions, while stochastic models use dynamic calculations to produce a range of options with the probability of various outcomes.

SOFT SKILLS

It is easy to dismiss the importance of soft skills but in my experience they are often just as important as the hard knowledge skills. This is because retirement advice is more nuanced than many people realise as there are a number of behavioural factors to be taken into account.

Important soft skills include:

- Listening and empathy
- Non-verbal communication
- Persuasiveness adaptability.

MANAGING RETIREMENT AND INVESTMENT RISKS

Explaining and managing investment risk is one of the most important skills advisers must have. They should have good processes for assessing attitude to risk and capacity for loss, and need to be aware of risks such as:

- Inflation risk
- Longevity risk
- Risk of running out of income

If things don't go according to plan, advisers will have to demonstrate they explained all the risks adequately, and their clients really did understand the risks they were taking.

TECHNICAL SKILLS - DRAWDOWN

Drawdown may be a simple concept but it is a complicated plan to manage properly. The specialist skills which advisers must polish up on include:

- Working out the appropriate level of sustainable income or safe withdrawal rate
- Advising the appropriate investment strategy
- Managing sequence of return risk
- How to regularly review a drawdown plan.

While annual reviews are a must for drawdown, advisers should also keep a watchful eye on their client's drawdown plans at more regular intervals and look for any early warning signs of potential trouble ahead.

This can be more difficult in practice than it sounds but from my practical experience clients really value regular contact between annual reviews.

TECHNICAL SKILLS - ANNUITY

Annuities may be less popular but that doesn't mean they should be ignored and responsible advisers should always keep an eye on the annuity market. This is especially important in later retirement as the benefit form mortality cross subsidy increases and the effects of mortality drag become more significant.

It is good practice to look for times when the value of a drawdown plan has increased and annuity rates have also increased. This may be the time to consider locking into an annuity.

PRODUCT KNOWLEDGE

Annuities have an important role to play in retirement planning so it is important that advisers understand all the different annuity policies and options.

There has been some important developments in the drawdown market with some companies offering specialist investment solutions and phased income options. It is also important to understand fixed term income plans which offer annuity style income for a fixed period.

MIFID II AND PROD RULES

Advisers must be familiar with the new Mifid II product governance rules, the so-called PROD rules. PROD is the short-hand term for product intervention and product governance. The intention is that good product governance should result in products that:

- Meet the needs of one or more identifiable target markets
- Are recommended to clients in the target markets by appropriate distribution channels
- Deliver appropriate client outcomes'

This means adviser firms will need to understand their client bank better and make sure they offer investment solutions and advice propositions that are appropriate for different types of clients.

IMPROVING YOUR SKILLS OF THE TRADE

Retirement advice is not static because good advice will take into account changes in market conditions and personal circumstances as well as new product innovation and regulatory updates. This means that advisers should constantly look to improve their skills.

There are some obvious ways to keep your skills up-to-date. For instance, most providers run seminars and there are several industry reports. It is also important to study for the relevant exams as these improve technical skills.

The best retirement advisers have superior technical skills and outstanding soft skills. It may be relatively easy to brush up on the technical skills but improving soft skills is much harder.

Behavioural Biases

Most people probably think they are sensible and can make rational decisions. But often they don't realise they are influenced by a number of behavioural biases which can result in poor decision making.

Poor numeracy skills and lack of understanding have a negative influence on client behaviour. Advisers can help their clients overcome some of the common biases by presenting facts and figures in a clear and concise way.

Some of the most common behavioural biases are as follows:

- **Overconfidence –** Many people over estimate their ability to make the right decisions
- **Information bias –** Watch out for fake or misleading news
- **Loss aversion –** Fear about short term losses may result in being over cautious
- **Hyperbolic discounting –** Avoid short-termism and take a longer-term view

OVERCONFIDENCE

If I had a pound for every client who bravely said "I don't mind taking risks" but then became anxious when there was a downturn in the financial markets, I would be rich. It is easy to be confident when things are going well way but if things start going badly there is a tendency to become worried and sometimes panic.

A good adviser will discuss attitude to risk and capacity for loss and if necessary manage a client's overconfidence. But those making their own investment decisions may end up making poor investment decisions if they are overconfident.

Lack of confidence may result in biases towards to ultra-safe options which may not deliver the best outcome.

INFORMATION BIAS

There is a lot of information about pension freedoms but not all of it is truly independent and unbiased. Making decisions on information which is either not factually correct or biased towards a particular point of view can lead to poor decisions.

Pensions are often perceived as complex and annuity rates poor value because interest rates are low but this does not mean they are bad options. Pensions and annuities are usually good value for money and have valuable benefits.

There maybe such thing as 'adviser bias' where advisers themselves are biased towards one particular option and don't consider all the options.

A good adviser will make sure their clients receive information which explains the advantages and disadvantages of each relevant option.

MYOPIC LOSS AVERSION

This is a generic phrase which refers to the tendency for people to be more concerned about losing money than taking some risk in order to increase their savings.

Myopic loss aversion is the combination of a greater sensitivity to losses than to gains and a tendency for people to worry if their investments fall in fall value in the short term although they may appreciate in the longer term the value may increase.

It is important to take myopic loss aversion into account because it may mean some clients are more conservative with their investment decisions than their risk profile suggests.

Good advisers will not only make sure their clients do not take undue risks, they will also explain the risks of being too cautious, for example the real value of money is reduced by inflation.

Fear of advice

Don't forget, one of the most important behavioural biases might be the fear of advice.

Some clients think they can do it themselves and don't need advice. They may have the mistaken believe that advice is expensive and complex.

This guide shows how this does not have to be the case.

HYPERBOLIC DISCOUNTING

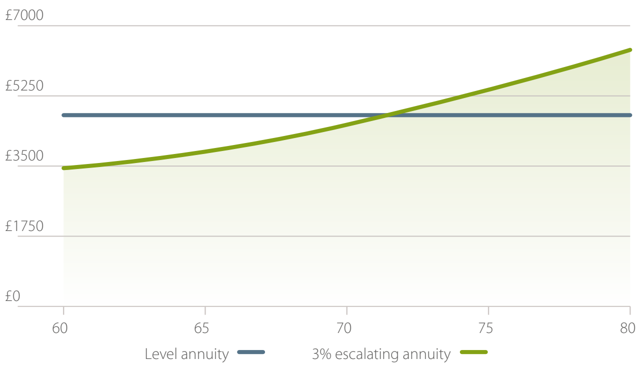
This is where many people tend to place less value on money paid in the future compared to money paid out today.

For example, a level annuity may pay an annual income of £5,000 per annum and an annuity increasing at 3% per annum compound may pay about £3,500. Many people will think £ 5,000 is a much better value because of the higher starting income both represent good value over the projected life span of the annuity, and in the longer term the increasing annuity may have a higher total pay out.

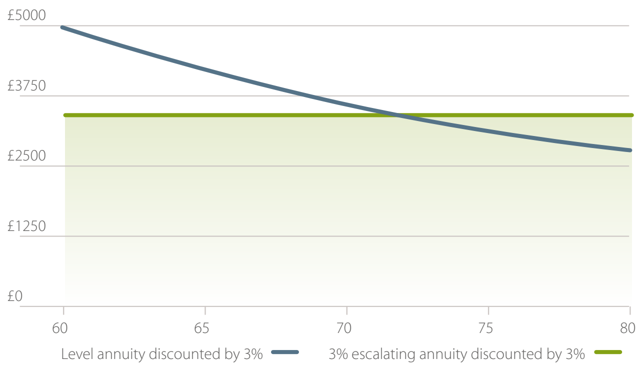
This helps explain why many people choose not to inflation proof their income. A good adviser will help their clients recognise these behavioural biases and encourage clients to take a longer term view of their retirement income needs.

Hyperbolic discounting

Level v 3% escalating annuity (nominal)



Level v 3% escalating annuity (real terms)



Which income stream is the best value? They are both the same but one is presented in nominal terms and the other adjusted for inflation (assumed 3% p.a.). Many people will think the straight line is best, so it depends how the information is presented.

What clients need to know – the key issues

In my experience, the best financial decisions are made when clients play an active role in the decision-making process. However, they can only play an active role if they have a good understanding of the key issues and options.

But how much information and knowledge do clients need to have? Too much and they will be confused, but too little and they will not be able to contribute to the advice process. Clients do not need an depth knowledge about mortality drag, how to calculate safe withdrawal rates or other technical stuff but they do need to know how to navigate through the maze of retirement options.

The table below shows the key issues people need to understand in order to contribute to the advice process;

KEY ISSUES	KEY RISKS
It's important to plan ahead for retirement and think about long term objectives	Without a good retirement plan it is difficult to make the right decisions
Life expectancy, health and how circumstances change throughout retirement	Underestimating life expectancy or not taking health into consideration are common retirement planning mistakes
Income needs, inflation and taxes	Risk of running out of money or paying too much tax
How much risk to take with pension income	Risk of taking undue risk or not enough risk
Death benefits and inheritance planning	Risk of not adequately providing for surviving spouse, partner or family
The impact of behavioural and emotional factors	Risk of being influenced by behavioural biases

LIFE EXPECTANCY AND HEALTH

It is a well-known fact that many people underestimate their life expectancy when they approach retirement and don't take account of the consequences of declining health in older age. This can hamper the retirement planning process because no account is taken of what happens on later life.

There are a number of techniques for encouraging people to think about their life expectancy and health. These include looking at the age of parents or family and their medical history.

	MEN		WOMEN	
Age now	Years	To age	Years	To age
60	25	85	28	88
70	16	86	18	89
80	09	89	10	90

Source: 2016 based UK Cohort Expectation of Life, Office for National Statistics

Inflation is like sin; every government denounces it and every government practices it.

Frederick Leith-Ross

PLANNING AHEAD FOR RETIREMENT

Many clients, especially those with modest pension pots, fall into the trap of thinking that converting their pension pot into cash and income is a single event or transaction rather than thinking of it as part of their retirement plan. It is important to have a plan, no matter how basic. At first, a client might be reluctant to plan ahead but a good adviser will encourage them to think about their future retirement objectives.

A good way to get clients to plan-ahead is to break down the future retirement journey into bite sized chunks and get them to discuss their objectives, aspirations and fears at each stage.

Top Tip

Try and separate your strategy from the tactics. Strategy is about having a plan. It does not have to be complicated, but you do need a plan. Tactics is about choosing the right options.

	YOUNG AND RETIRED (60-65 YEARS)	RETIRED AND ACTIVE (65-75 YEARS)	RETIRED AND LESS ACTIVE (75-80 YEARS)	LATER RETIREMENT (80 YEARS ONWARDS)
Income requirements	Many people are attracted to the 25% tax free cash sum to either repay debt or for large item expenditure but if still working there may be no need for income	When income from employment stops or savings are running low, it may be a good time to start taking income from the pension pot	Income needs may reduce as expenditure reduces and there may be money to save	May need more income to pay for help at home, long term care or property alterations
Risk	Flexibility and control may be important in early retirement and it may be appropriate to continue taking some investment risk if there is sufficient capacity for loss		As clients get older there they should consider reducing their exposure to investment risk and guaranteed income options become more attractive	

INCOME, INFLATION AND TAXES

One of the effects of pension freedoms is to de-couple pension savings from pension income because many people see their pension plan as a pot of money rather than a regular income. Everyone needs an income in retirement but without some structure and discipline it is easy to spend too much in early retirement and end up short in later life.

When working out future income requirements it is important to take account of inflation and taxes. Many people make a mistake at just looking at the before tax income without allowing for tax. A good adviser will explain the various ways of reducing tax and suggest tax-efficient income strategies.

The most effective way of getting clients to think about how much income they need in retirement, and where this will come from, is to prepare a cash flow forecast. This is standard practice for higher net worth clients where the fees cover the cost of providing this service. But what about clients with modest financial assets where the advice process does not cater for detailed planning? A good way of producing a simple cash flow is to use the four stages of the retirement journey; consider how much income is needed at each stage and how much should be guaranteed, and how much flexibility is needed.

One advantage of this approach is it encourages clients to think about the longer term without getting bogged down with detail and it also helps think how their circumstances will change. Don't forget to allow for inflation when looking at future income needs.

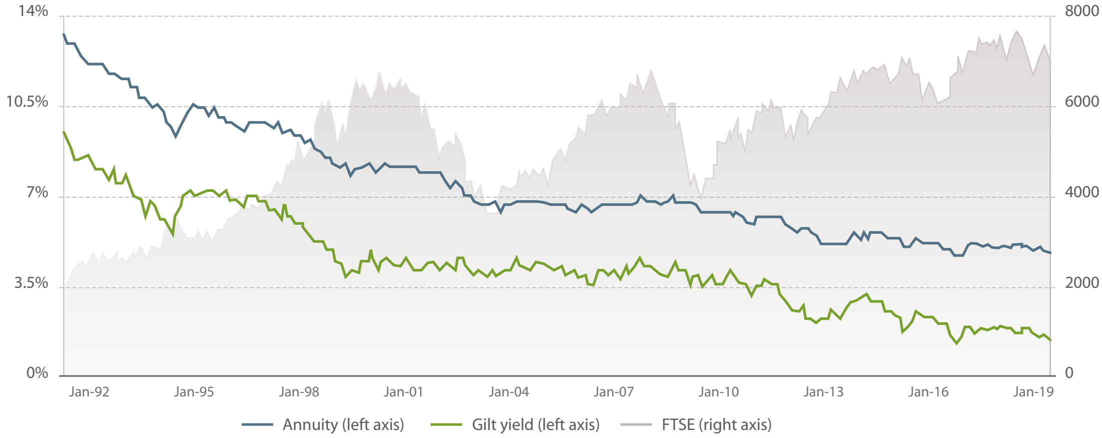
Pensions & Savings

It is not logical (from an adviser's point of view) to take money from a pension pot where there is no tax on investment returns and deposit the money in the bank where there is little interest and maybe subject to tax.

However, many people have done this because they either do not trust pension providers or they do not understand the implications.

HOW MUCH RISK

Drawdown clients are faced with two main risks; the risk of running out of capital through poor investment returns and the risk of running out of income by taking too much income or living longer than expected. Managing these risks involves much more than putting a medium risk investor into a medium risk fund. It is important to look at other risk factors such as the anxiety caused if the amount of income taken has to reduce.



The chart above plots annuities, gilt yields and FTSE. It shows that advisers need to keep an eye on annuities and equities.

Risk

One of my observations is that there is often an inverse relationship between the amount of risk people take with their investments compared to their experience with risk.

This means that those involved with risk e.g. actuaries, bankers and investment professionals tend to be cautious while those not involved with financial risk e.g. architects, people in the media and politicians, often take more risk than they should.

DEATH BENEFITS AND INHERITANCE PLANNING

Given the choice, most people would obviously rather leave money to their family rather than leave it to an insurance company or pension scheme. Leaving money to the family is now much easier after pension freedoms and this is a major consideration for those transferring from DB to SIPPs.

Although it is tempting to plan to leave money to a partner or family it is important not to overlook the advantages of annuities. Annuities convert a pension pot into guaranteed income for life and benefit from 'mortality cross subsidy'. Also, don't forget a future government could decide to change the generous death benefit rules.

Pension type	How benefits can be paid	Taxation on death of policyholder	
		Before age 75	After age 75
Pension still untouched	Lump sum payment or drawdown income or annuity	All income and lump sum payments will be tax-free	All income payments will be taxed at the beneficiaries' marginal rate Any lump sum payments[2] will be taxed at the beneficiaries' marginal rate
Annuity being paid	Joint-life, guarantee or value protection		
Drawdown income	Lump sum, drawdown income or annuity		

The cost of advice and value for money

All the advisers I know are passionate about giving their clients the best possible advice and service, but they are also well aware that in order to continue providing good advice they must run their business profitably. Most of my clients value and appreciate the advice I give and understand that I must charge a reasonable fee for the work I do. This begs the question "What is a reasonable fee that enables firms to be profitable while at the same time providing good value for their clients"?

The key to this question is to understand the difference between cost, price and value:

- **Cost** – this is how much is spent on fixed and variable costs to provide the advice
- **Price** – this is the fee for advice charged to the client
- **Value** – the monetary benefit and importance of peace of mind and security

The key element in the pricing equation is the added value. This is relatively easy to explain and quantify to higher net worth clients, but it can be difficult to explain this to those who are less well off. One of the reasons why there is an advice gap is many people with modest financial wealth think the price of advice is higher than the value of the advice to them. Therefore, the financial sector must look at ways of reducing costs and quantifying the added value of advice if we are serious about looking at ways to reduce the advice gap.

ADDED VALUE

Whereas cost and price are measured in purely monetary terms, value is measured in both monetary and subjective terms. For example, advice may result in the best priced annuity or competitively priced SIPP, but it can also provide peace of mind and security which you cannot put a price on. The value of advice can be measured in monetary terms by working out the added value from superior investment solutions or additional income.

Price of advice = cost + value added

REDUCING COSTS

Reducing costs is a challenge when there are such high regulatory costs but one way to reduce costs and deliver better value is to delegate certain tasks to paraplanners or administration staff. For example, the regulated adviser will want to play an active role in the first meeting and in formulating the advice but there is a lot of behind the scenes work that can be done by paraplanners.

Another way of reducing costs is for advisers to brush up their skills of the trade so they can be more efficient without compromising on high quality advice.

COST OF ADVICE

There are many different charging models. Some advisers may still be working on a percentage of funds basis, others may work on a fixed basis and some will charge by the hour. Although advice firms will have their own structures, all fees should be fully transparent and justifiable.

Technology

Most advisers rely on technology to run their business and many older people are just as tech savvy as the younger generation, so technology is now at the centre of the advice process. At one end of the spectrum, advisers communicate with clients electronically and give them online access to investment and pension platforms. At the other end, some firms are using 'robo-advice' propositions.

Computing power

Deep Blue was a chess-playing computer developed by IBM. It was the first computer to win a chess match against a reigning world champion.

If a computer can beat a world champion chess player, why can't a computer work out the best way to convert a pension pot into cash and income?

ROBO-ADVICE

Robo-advice has the potential to reduce the cost of advice because there is minimal human intervention and some firms and policy makers think that automated advice may help fill the advice gap. However, whilst robo-advice is being used to achieve better outcomes for those with modest sums, more development is needed before it becomes mainstream for retirement income advice.

On the one hand there is huge potential to harness the power of artificial intelligence to develop sophisticated mathematical rules and algorithms. On the other hand, as this guide explains, there are several unique features in retirement income planning which are difficult to replicate with robo-advice.

As with many things in pensions, it doesn't have to be black or white and there is plenty of scope of for a 'hybrid service' which combines technology in conjunction with the skills of a specialist adviser.

USING TECHNOLOGY IN THE ADVICE PROCESS

Forward thinking advice firms are harnessing technology to deliver better quality advice and reducing costs by making the advice process more efficient. Technology can be used in several ways including:

FACT FINDING AND RISK ASSESSMENT	INVESTMENT AND PENSION PLATFORMS	ANNUITY QUOTATIONS
• Clients can complete online questionnaires • Online cash-flow modelling tools	• Online valuations and income maintenance • One wrap for all investment and pensions	• Easy to compare the market • Online underwriting • Platform based annuities

CONCLUSION

Good use of technology can help to reduce costs and increase efficiency as well as improve client engagement and result in better outcomes, but it does not need to be at the expense of personal service. These solutions do not have to be complicated or expensive because there are a many off-the-shelve packages that can be tailored to the needs of individual firms.

Technology allows financial advisers to give their clients 24-hour access to online portals with real-time valuations and information. Online tools and educational material can help increase client engagement and confidence in financial matters which should enable then to play a more active part in the advice process.

Putting theory into practice

CASE STUDY: TAX EFFICIENT INCOME WITHOUT TAKING UNDUE RISKS

James is an accountant *(see side bar for details)* who is considering his retirement options as he gradually reduces his workload. His instincts are to take the maximum tax-free cash and to take income by way of pension drawdown. He is worried about the outlook for global financial markets, so he doesn't want to take undue risk with his investments, especially as he is moving into the retirement phase of life.

He wants to make sure he is doing the right thing so he speaks to his financial adviser Charles. At the start of the advice process Charles explained one of the best ways to partially retire is take his pension in slices each year. This is often called phased retirement or colloquially 'salami slicing.' This is where segments of pension are encashed every year and the 25% tax free cash is used towards income in addition to the income from drawdown. It is both tax-efficient and flexible.

As an accountant, James understands the tax advantages of using the tax-free cash as income, but he is keen to take the full 25% tax-free cash at the outset to have this in his own bank account. He also thinks the salami slicing solution looks complicated and might result in higher fees. As he does not want to take undue risks, Charles explains the advantages of risk-rated multi-asset funds and as well as smoothed returns funds. He recommends a well-diversified fund from a well-known pension provider. But James is sceptical about these funds because he prefers investing directly in equity and bond funds.

At their next meeting, Charles tactfully explains to James that he is letting his instincts and prejudices get in the way of making good decisions. Good advice comes after analysing a client's objectives and then suggesting the relevant options. Charles summarised the key points as follows:

James:

Age: 62

Pensions: Several

Objectives: To reduce his workload to have more leisure time

Income: Replace income he is losing by reducing his hours

Risk: Cautious / medium

Key points:

- ✓ Try to make the complex simpler
- ✓ Look to overcome behavioural biases
- ✓ Be prepared to tactfully challenge your client's assumptions if necessary

JAMES'S OBJECTIVE	POSSIBLE SOLUTIONS	ADVICE CONSIDERATIONS
To take income from the pension pot to replace his earnings as he reduces his workload	To convert part of his pension pot into cash and income by using pension drawdown	If the full tax-free cash taken it moves money out of a tax privileged plan
To minimise the amount of tax paid	Phased retirement reduces tax because part of each payment is tax-free	Income taken from a pension pot it is taxed at the recipient's marginal rate
To make sure he is not taking undue risks	Multi-asset and smoothed return funds aim for investment growth over the longer term whilst reducing volatility	As James gets older he should be taking less investment risk
To retain pension flexibility and investment control	Phased retirement provides maximum flexibility	Consider a combination of multi-asset and equity/bond funds

CONCLUSION

Charles suggested a transfer to an online pension platform and this makes it easy and cost effective to take his pension in slices each year. Part of the pension will be invested in multi-asset and smoothed returns fund and the balance in equity and bond funds.

James agreed with this recommendation and explained that now he was re-assured he could take his full tax-free cash over time through the salami slicing method he can see how the tax efficiency of this solution makes sense.

He also felt that combining multi-asset funds with other growth funds provided a good balance of risks, especially if he takes his slices of tax-free cash from the smoothed returns funds.

Billy Burrows – Retirement Intelligence

Billy Burrows has been involved with retirement options for 25 years, advising clients on all aspects of annuities and retirement income options. As well as being a director of Retirement Intelligence, he is Retirement Director of Better Retirement and a regulated financial adviser.

In 1992 he helped establish Annuity Direct and then in 1997 he set up William Burrows Annuities. A year later he joined Prudential Annuities as their Marketing Director for annuities. In 2001 he returned to running William Burrows Annuities and in 2010 became part of Better Retirement Group, enabling us to offer the highest quality of services to all approaching retirement.

Billy divides his time between advising individual clients about their retirement options, helping Better Retirement develop new services and writing retirement guides. The quality and depth of the information on his website www.williamburrows.co.uk make it popular with potential clients, clients and professionals.

He is frequently quoted in the national press, appears on radio, podcasts and videos and writes extensively on retirement options.

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*Correct as at 31 December 2018

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