defaqto

Drawdown review guide: How to assess ongoing suitability

July 2020

Created in partnership with

canada life

Accredited by

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Personal Finance Society PFS ACCREDITED

CISI ENDORSED CPD PROVIDER

Welcome to Canada Life

At Canada Life, we've been providing retirement solutions to our customers for more than a hundred years. We first came to the UK in 1903, but our history stretches back further, to 1847 when we became Canada's first life assurance company.

Today, we're part of Great-West Lifeco. They're one of Canada's largest life and health insurance companies and a financially strong global organisation with a rich heritage.

What do we do?

We take care of the retirement, investment and protection needs of millions of people around the world. In total, we look after more than £951 billion* of assets for our customers.

As a pension provider, we take our responsibilities seriously. It's our job to support you in conjunction with your financial adviser at every step of your journey. Which is why we're committed to excellence in customer service throughout our products, and why we make the process of dealing with us as simple and smooth as possible.

*as at 31 December 2019.

Opportunity

The purpose of the guide is to highlight the key subjects that should be considered during drawdown periodic reviews, from both a regulatory and best practice perspective.

As we write this the impacts of Covid-19 are starting to be felt and understood. Stock markets around the world fell by up to 35% between the start of the year and their late-March lows and businesses have slashed and even suspended their dividend payments. The perfect storm for those in drawdown that many may never fully recover from, primarily due to sequence risk.

This guide is designed to provide an understanding of the concerns your clients may be experiencing. It then explains the key steps that should be considered in every drawdown review so you can provide your clients with a clear evidence-based pathway forward.

A drawdown review is a critical part of the process and you will need to record your decision making and conclusions. You may recommend your client does nothing, but with such significant market changes that is unlikely. Whatever you decide to recommend you need to record your research and findings to **evidence ongoing suitability and sustainability**.

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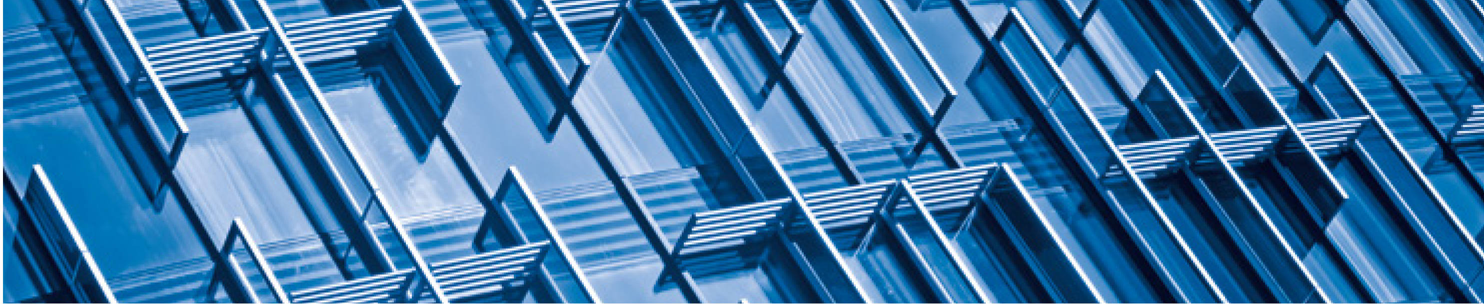


Introduction

Welcome to the Defaqto 'Drawdown review guide: How to assess ongoing suitability'. It is written for financial advisers and paraplanners providing ongoing advice to clients in drawdown.

Advisers face an array of options to consider at every review and these include:

- Changes in clients' personal circumstances (ie life events, health, values, needs and objectives)
- Changes in economic circumstances (ie market corrections, inflation and dividend yields)
- Moving some of the funds into cash
- Restructuring the income being taken (ie due to economic conditions and market corrections)
- The purchase of some form of secure or guaranteed lifetime income (ie annuity or annuity-style solution)
- A move, in part or in full, to a different investment risk level
- A move to a different style of fund/portfolio

We will consider the pros and cons of these options and many others within this guide.

This guide does not include a review of the suitability of your investment advice; that is a guide in its own right. That said there are a few headline factors we suggest you consider, including:

- With many property funds suspended and businesses realising that working from home actually works well, should your recommended investment weighting in commercial property be altered?
- Some clients may rely upon the value of a property in an owner-managed business and/or be reliant upon on that property to produce an income for them. Is this still an appropriate investment to meet their stated needs and objectives?
- How much sequence risk is present within your centralised investment portfolios and should it be decreased?

Patrick Norwood
Investment Consultant
pnorwood@defaqto.com

Richard Hulbert
Insight Consultant (Wealth)
rhulbert@defaqto.com

The reality is none of us knows what tomorrow holds and the right advice today will only be known in hindsight.

However, this guide will help you to build a robust and repeatable process that enables you to give evidence-based advice and your clients to make prudent financial decisions.

As with all independent guides from Defaqto, we have included checklists and templates for you to use as a foundation for your files and as helpful aide memoires. We hope you find this guide both interesting and informative.

Canada Life team

Within this independent drawdown review guide, Defaqto invited Canada Life, as a recognised provider and manufacturer of retirement income solutions, to provide their insights into the various themes covered in this publication.

Andrew Tully
Technical Director

Jeremy Martin
Pension, Tax & Estate Planning Consultant

John Chew
Pension, Tax & Estate Planning Consultant

Kevan Ramanauckis
Pension Technical Specialist

Learning objectives

Reading this document will enable you to:

1	Structure and undertake a periodic review and know the steps that should be included.
2	Understand the importance of categorising different types of expenditure as 'core' and 'lifestyle' and be able to match suitable income sources to them.
3	Explain the impact of sequence risk on those in drawdown and how to structure a decumulation investment strategy to help mitigate against it.

Assessing suitability

Drawdown reviews fall under FCA assessing suitability rules. Here is an extract from their website stating the regulatory standard expected:

FCA Thematic Review (TR16/1)

Know your client

You must obtain the necessary information from the client to be able to make a suitable recommendation. This includes:

- their financial situation
- their investment objectives
- information on a number of issues relating to risk, ie the client's risk profile (attitude to investment), capacity for loss and knowledge and experience of investments

Research and due diligence

The FCA use this expression to refer to the process carried out by firms to assess:

a) the nature of the investment

b) its risks and benefits, and

c) the provider (to establish if the provider is an organisation to which you believe it is appropriate to entrust your client assets).

COBS 19.2.2: Suitability

When a firm prepares a suitability report it must:

1. (in the case of a personal pension scheme) explain why it considers the personal pension scheme to be at least as suitable as a stakeholder pension scheme; and
2. (in the case of a personal pension scheme, stakeholder pension scheme or FSAVC) explain why it considers the personal pension scheme, stakeholder pension scheme or FSAVC to be at least as suitable as any facility to make additional contributions to an occupational pension scheme, group personal pension scheme or group stakeholder pension scheme which is available to the retail client.

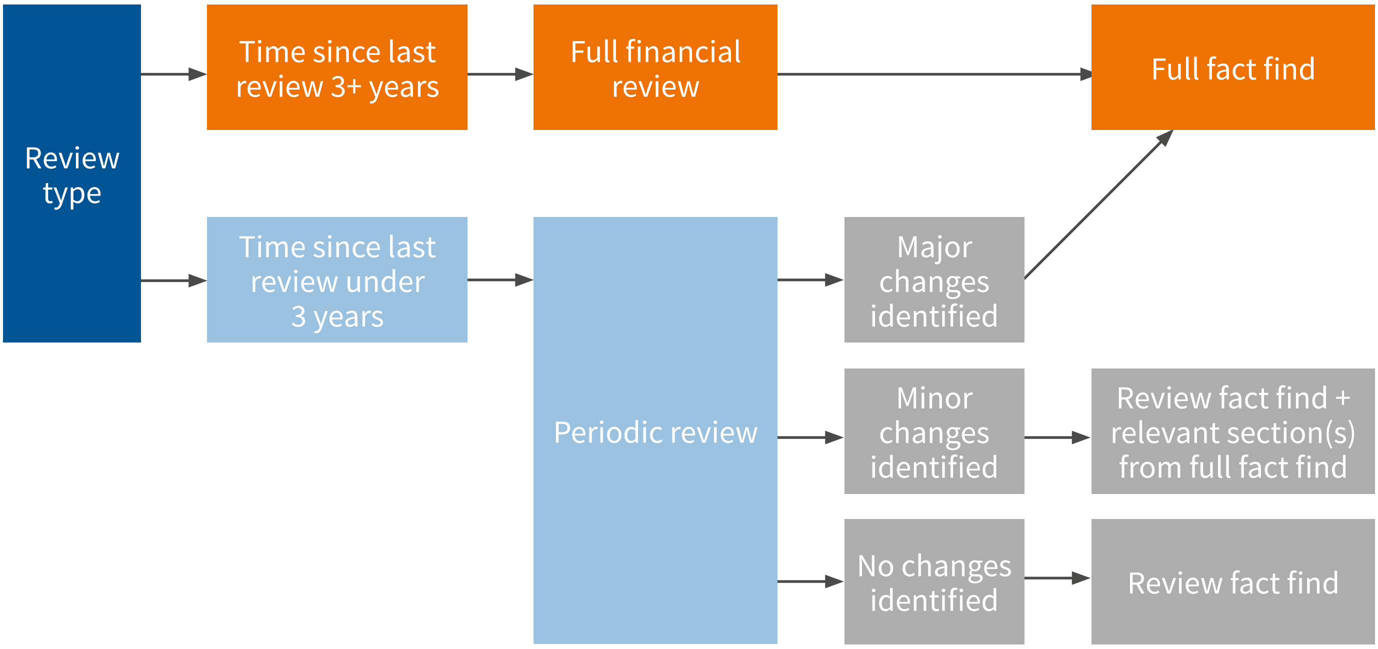
Full details of the FCA's expectations can be found in COBS and in the FCA Thematic Review (TR16/1) entitled 'Assessing suitability: Research and due diligence of products and services'.

Advisers need to understand all of these factors in order to judge whether a solution is suitable. This means that the purpose of an ongoing review is to consider all of these factors in order to evidence ongoing suitability of your advice and drawdown solution.

When we look across the industry there appears to be no standard working practice for how these reviews are conducted. Some advisers complete a full fact find each time, while others undertake a softer touch review. Both have merits and issues.

Remembering the old rule – *if it's not written down it didn't happen* – it is not uncommon to find the working practice in place shown in Diagram 1.

Diagram 1: Example of which fact find style to use



Source: Defaqto

Please note, the timescales above relate to the type of fact find use. Best practice is to always evidence ongoing suitability of a drawdown solution at least annually.

A review fact find simply lists the key factors that affect suitability and whether the client's circumstances or needs have changed in these areas. An example of a review fact find is shown in Diagram 2, and then we explain each of the factors over the following pages.

Diagram 2: Example of a review fact find

Client(s)	
Adviser	

Fact find type	Full fact find	Review fact find	Date of this review
Date last completed	/ /	/ /	/ /

Subject	Detail changes since last review fact find (put none if applicable) Impact on ongoing suitability &/or advice need uncovered
1. Client needs and objectives	see table below
2. Personal circumstances	Any vulnerability and mental capacity factors?
3. Wealth overview	
4. Expenditure and liabilities	Consider core and lifestyle
5. Income	
6. Cash reserves and savings	
7. Protection	
8. Risks and the client's attitude towards them	See separate questionnaire(s)
9. Investments	
10. Products and solutions	
11. Estate planning	Consider wills, power of attorney and (pension scheme) expression of wish forms
12. Legislation and regulation	State existing and confirm if changed
13. Education and the suitability checklist	
14. Revisit needs and objectives	

Importance	Needs and objectives	Timescale	Rationale	How being met & benchmark
1				
2				
3				

Action points established (in priority order)

A	
B	
C	
D	

Impact of COVID-19

Communicating with your clients

COVID-19 and isolation rules have changed the way financial advisers work. Face to face meetings are no longer the default option.

The problem is that drawdown review meetings for most clients are best done face to face. This is because both participants can read the other's visual clues – this in turn improves understanding and helps build trust.

This is a real benefit when presenting difficult news, such as decreased capital and income, as may be the case in many drawdown reviews in 2020. Therefore, providing your client with the ability to see your face could make a positive difference. We therefore encourage you to employ online tools like Skype, Teams and Zoom. They provide the next best option to a real meeting, an online face to face conversation.

These tools are generally easy to use. To get started they simply require you to register and then send your client a link to click on to begin the conversation. That said, be sure to sign up and practise with a friend or colleague before inviting your client to join you!

While many of these tools are free, it is often worth paying for the enhanced version, especially if you wish to share content such as performance charts and cashflow modelling.

One significant benefit is that many of these services include the ability to record the conversation. This could remove the need for you to complete a file note of the meeting. Just be sure to check your compliance officer is happy with this and that you comply with the General Data Protection Regulation (GDPR) in both the recording and the retention of the recording.

Vulnerable clients

Vulnerable clients does not mean just the elderly and those with reduced health and mental capacity. *We are all vulnerable clients from time to time*.

For many of us the trigger will be 'stress' as this can cause us to make poor decisions, thereby making us vulnerable. It is therefore important to have in place a process for dealing with vulnerable clients. This is required on two levels:

Managing self

A process designed to reduce or remove your own concerns and vulnerabilities so your clients receive impartial evidence-based professional advice. This will also help you evidence compliance with treating customer fairly (TCF) rules.

Managing client

A process designed to ensure your clients are treated in a professional and impartial way that requires their understanding and commitment before proceeding.

Many clients will currently be vulnerable due to the stresses COVID-19 has created. This is because not only are they having to endure social distancing for weeks on end, but they are also experiencing capital loss and a reduction in their income. This is obviously an issue during a drawdown review as the decisions made will impact your client's financial future and standard of living for the rest of their life.

Part of your job is therefore to identify those clients in a vulnerable state and help them avoid bad decisions. Indeed, your client may need your emotional support more than your financial advice.

Insight from Canada Life

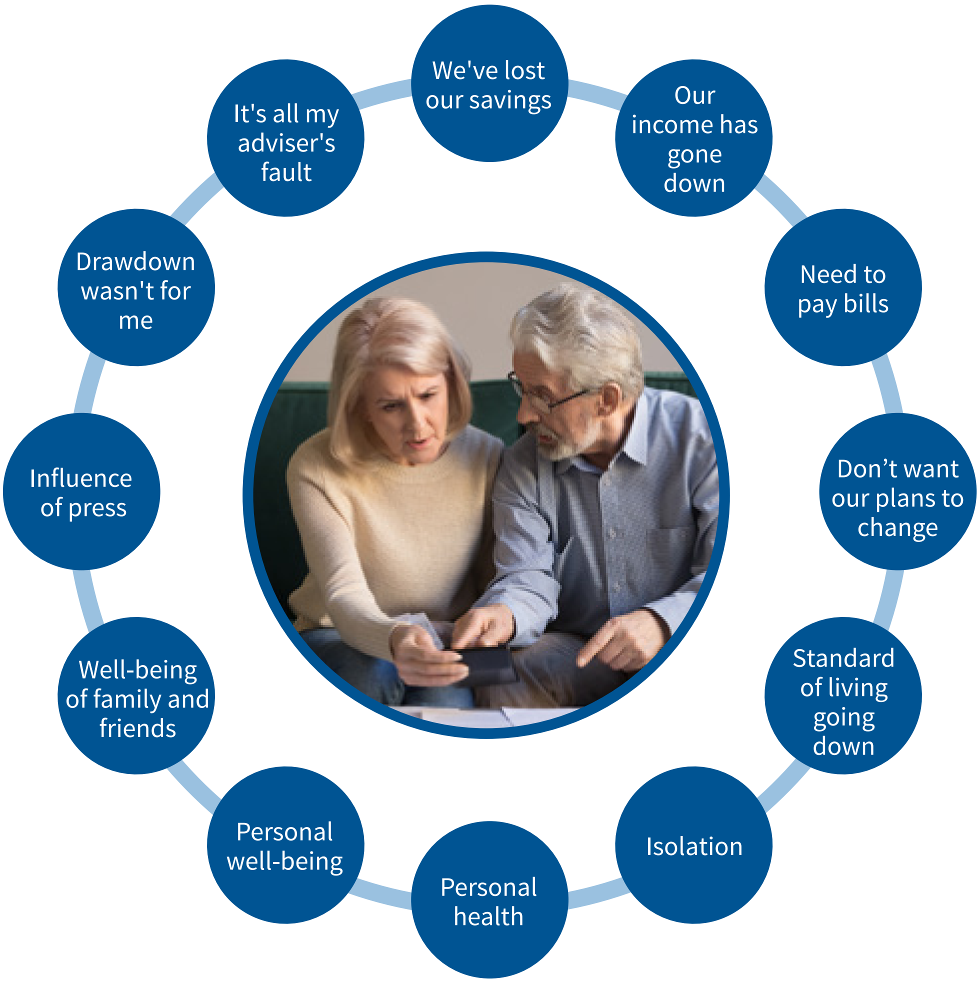
Vulnerability comes in many different forms. It could relate to your client's health, certain life events (such as divorce), how resilient their finances are to unexpected losses, or even their level of financial knowledge.

By assessing your clients against each of the FCA's drivers of vulnerability – both at outset and at their regular reviews – you can ensure your advice is tailored accordingly.

Plus having your vulnerability policy set out within a CRP means there can be consistency across your firm.

Jeremy Martin
Pension, Tax & Estate Planning Consultant

Here are some of the common concerns and stresses your clients may have on their minds in 2020:



During the meeting it may not be instantly obvious to you whether your client is vulnerable. It manifests itself in many different ways and common clues to look out for include:

Postponing the review	Inability to make decisions	Snap decision making	A change in personality
Stepped change in attitude to risk	A desire to gamble rather than de-risk	Lack of interest	Blaming
Unpredictable behaviour	Inability to understand	Inability to accept	Negative tone to conversation

It is good practice to record in your file note your thoughts on whether your client was in a vulnerable state or not. If you thought they were, be sure to include details on what you did to overcome this issue.

Additional information and guidance can be found at:

FCA occasional paper 8, Consumer Vulnerability (February 2015) and
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societyoflaterlifeadvisers.co.uk

SOLLA
Society of Later Life Advisers

1) Client needs and objectives

The whole point of a drawdown solution is to meet the client's stated needs and objectives. These are driven by both their personal values and financial goals.

Collectively the needs and objectives form the agreement between you and your client. They should therefore specify not only the goals, policies, and parameters in place but also how success should be judged (ie value for money) through the use of benchmarks.

At the review you are ultimately looking to make sure the needs and objectives are being met or are still on course to be met, with a reasonable level of probability.

In addition, advisers should also be looking to evidence:

- Whether the client's needs could be better met by switching to smarter and/or cheaper providers, products and/or solutions
- Whether portfolios and plans may require realignment (driven by client need and/or market conditions)

Sometimes needs and objectives are specified in a formal 'Withdrawal Policy Statement'. However they are documented you should make sure they are recorded in a SMART format.

As a minimum we suggest listing out the needs and objectives as shown in Diagram 3. If you did this at the last review, you can simply copy and paste them.

Record needs and objectives **SMART**:

S Specific

M Measurable

A Attainable

R Relevant

T Timely

Diagram 3: Example of how to record client needs and objectives

Importance	Needs and objectives	Timescale	Rationale	How being met and benchmarks and parameters
1				
2				
3				
4				

Common needs and objectives that we see listed include:

- Cash reserve of £x
- Income from drawdown of £x per annum (net of tax and charges) to be maintained for X number of years or lifetime
- Minimum capital value of £x to be maintained for estate planning purposes
- Capital and/or income return targeted to exceed inflation; this is benchmarked using CPI + x%, calculated by averaging the return over the previous three or five years

Insight from Canada Life

No doubt there will be difficult conversations to be had at some client reviews. But many advisers stress-test models and discuss the outcomes with clients, and that may help these clients understand advisers know this kind of event does happen, and they have plans in place.

Taking a long-term approach to financial investment is hugely important, because markets fluctuate over time.

Andrew Tully
Technical Director

2) Personal circumstances

From a client's perspective, this is just the polite chit chat before you get down to business. From your perspective as the adviser, this is collecting *soft facts*. Questions to consider include:

- How are you?
- How is your family? (record their names, relationships, jobs, etc)
- How is your job/retirement treating you?
- What plans do you have for the future?

The objective is to have the client open up and tell you their story and plans. This way you will discover their needs and objectives, their tolerances and time frames, along with their emotional triggers and an order of importance. You may also discover potential issues and/or a decline in your client's cognitive capacity.

Try to record soft facts in the client's own words, so you can use them when explaining your recommendations, as this aids their understanding. This is especially important for clients who are vulnerable.

In February 2020 Debbie Gupta (FCA Head of Life Insurance and Advice Supervision) stated that looking at the emotions and reasoning behind goals could help create more robust recommendations.

'The best firms are capturing soft facts. They help tell the client's story. From a regulatory perspective they provide the evidence the advice is suitable. They help explain why it's a client's objective and what achieving their objectives means to them… Advisers consider what a client wants, but few consider what the client really needs.'

Ultimately, it is your job is to discover what has changed or is expected to change as this will impact on the suitability of your recommendations.

3) Wealth overview

It is not possible to give accurate financial advice without considering the client's entire financial position. Diagram 4 provides a quick overview and highlights notable changes so they can be considered in the financial planning process.

There is no harm in part completing the following overview and then asking your client to complete the rest prior to the review meeting.

Diagram 4: Example of how to record a wealth overview

Client(s)	
Adviser	

Assets and liabilities	Owner	Value last review	Value this review	Change
Cash reserves		£	£	£
Liabilities		(£)	(£)	(£)
Assets (unadvised)		£	£	£
Assets (advised)		£	£	£
Property (main residence)		£	£	£
Property (other)		£	£	£
Other wealth		£	£	£
Net position		£	£	£

Income sources (gross)	Owner	Value last review	Value this review	Change
State pension		£	£	£
Annuity		£	£	£
DB pension(s)		£	£	£
DC pensions(s) (unadvised)		£	£	£
DC pensions(s) (advised)		£	£	£
Non-pension income(s)		£	£	£
Total income		£	£	£
Resulting income tax rate		%	%	%

4) Expenditure and liabilities

There are three categories to ask your client about:

Category	Description	Examples
Liabilities	Known or expected debts that your planning needs to consider	• Overdrafts • Credit cards • Personal debt management • Business debt management and loans
Core costs	Income required to maintain the home and a reasonable standard of living	• Utility bills • Home maintenance • Key insurances (transport/car/care)
Lifestyle costs	Income required to maintain a desired standard of living	• Entertainment/holidays • Lifestyle insurances (health) • Health support • Home improvements • Estate planning • Changing car • Wedding/funeral

Ascertaining ***liabilities*** is reliant upon the client acknowledging them as a debt. For example, clients who have consistently used their overdraft facility may not consider it as debt. However, in April 2020, 'approved' overdraft interest rates jumped to c.40% pa, and so with cost in mind this is now a facility best avoided.

Core costs are those that cannot be avoided so long as your client remains in their home – we all have these.

Lifestyle costs, however, are selective spending to maintain a lifestyle and it is within this category that most savings (if required) can be found.

When looking at ***expenditure***, most people tend to run their finances through a few accounts. Taking a copy of the account statements will enable you to see exactly what your client is spending their money on and help to categorise it as core or lifestyle.

Insight from Canada Life

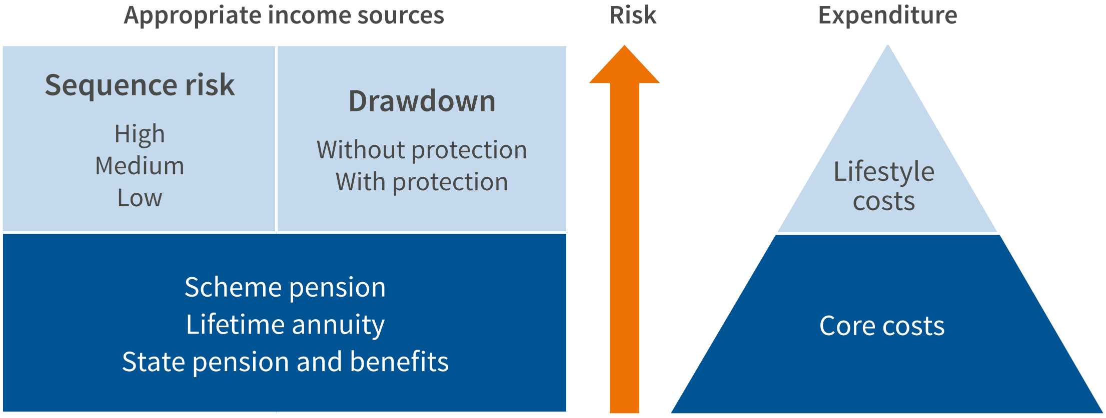
Retirement is a great unknown. People struggle to come up with realistic budgets for retirement because their expenditure changes through retirement, as do sources of income as people transition to part-time working or the state pension kicks in.

Thankfully, with products now offering greater financial flexibility, your budget doesn't have to be a set amount right from the start, as you can adjust as you go.

John Chew
Pension, Tax & Estate Planning Consultant

The reason for categorising income is so your financial plan can provide security for the greatest income needs. It is good practice to recommend that core costs and expenditure be covered by income sources with the greatest security, as shown in Diagram 5.

Diagram 5: Example of how to connect income sources to expenditure



Source: Defaqto

As the need for income security decreases, it may be appropriate to recommend less security in exchange for the potential for a greater return. That said, do not forget to consider the impact of inflation on the 'real' income and growth needs over the longer term.

5) Income

There are two factors to consider when recommending income withdrawals. Is the income being withdrawn (a) needed/suitable advice, and/or (b) sustainable?

Needed/suitable advice

Today's financial advisers are not order takers. Recommending a client takes income from a tax-efficient product they do not need is unlikely to be suitable advice. This is simply moving wealth from a tax-efficient environment, potentially paying charges and taxes, to then place it into a potentially taxable location. Understanding your client's income tax rate and providing education on the implications of this will help a client understand the value of your advice and help shape their income needs.

It is not unusual for clients to expect x% income from their drawdown arrangement. However, this is not always based on evidence, or with consideration of sustainability. It is therefore part of the adviser's job to educate their client so they can understand what a realistic sustainable income drawdown rate for them should be.

One small benefit created by the world's reaction to COVID-19 is that many people may not have been able to spend, resulting in them increasing their cash reserves. Shops have been closed and travel banned. Where clients have accumulated cash, this creates the opportunity either to reinvest it to produce income, or to use it to supplement income over the coming few months, while they take a drawdown holiday, in the expectation that their drawdown capital value increases sufficiently.

When income withdrawals are being recommended the FCA is quite clear in its expectations:

COBS 9.3.3
Income withdrawals, short-term annuities and uncrystallised funds pension lump sum payments

When a **firm** is making a personal recommendation to a retail client about income withdrawals, uncrystallised funds pension lump sum payments or purchase of short-term annuities, it should consider all the relevant circumstances including:

1) the client's investment objectives, need for tax-free cash and state of health;

2) current and future income requirements, existing pension assets and the relative importance of the plan, given the client's financial circumstances;

3) the client's attitude to risk, ensuring that any discrepancy is clearly explained between his or her attitude to an income withdrawal, uncrystallised funds pension lump sum payment or purchase of a short-term annuity and other investments.

Source: FCA COBS 9.3.3

With this in mind it is sensible to ascertain sustainability and test drawdown income against a realistic estimated life expectancy (not the average).

When ascertaining the suitability of the drawdown rate, we suggest that at every review you check for the best (enhanced) annuity rate available as a benchmark and advise your client of it. This will allow a realistic critical yield to be established for evaluation and discussion with the client that will satisfy the requirements of COBS 9.3.3 as stated above. You can do this for free on the Money Advice Service website. However, completing providers' more detailed application forms can provide the best underwritten rates.

www.moneyadviceservice.org.uk/en/tools/annuities

Being able to obtain a secure income without longevity risk, ongoing charges and reviews will be attractive to many clients. Indeed, some may accept a (small) decrease in income to achieve it.

In addition, we suggest you agree a benchmark against which to test and evidence ongoing suitability. Benchmarks to consider include:

- Cash account return
- GAD rates
- Critical yields
- Natural (investment) yield

Sustainability

Meeting your client's income need today is relatively easy compared to meeting their long-term need. Therefore, evidencing the sustainability of income is a crucial factor in every review. Suitability is dependent upon you being able to evidence that the solution you recommend is able to provide the income required for the set period of time or until death, within the agreed risk and investment parameters.

If income is not required for life or for a surviving partner be sure to record why

When the income need is not being met

When an income requirement is not being met, advisers should consider the following options:

Restructure	Rebalancing the investment portfolio or changing the investment risk profile will change the income produced. Be mindful of costs and that increasing risk to increase income is unlikely to be suitable advice (see section 9 'Investments')
Reduce	Reducing withdrawals (income) to a sustainable level could allow the drawdown strategy to get back on track to meet the client's longer-term needs
Suspend	Suspending withdrawals (income) for a period of time could allow the drawdown strategy to get back on track to meet the client's longer-term needs
Stop	More likely to be the solution when a change in needs or objectives is identified, such as a full or partial switch to a secure income (annuity) or where income is no longer required and the remaining value is being used for estate planning
Other wealth	Adding client's wealth held outside of the drawdown arrangement into the solution may help to increase the probability of your client's needs and objectives being prudently met

When recommending a lower drawdown income it is worthwhile also suggesting some relatively small lifestyle changes as these can reduce the required income from drawdown. This in turn could greatly increase the likelihood of the drawdown arrangement sustainability.

Having already looked at your client's expenditure you may have a better understanding of their spending than they do. Here are a couple of examples of how small lifestyle changes can reduce the income need:

Category	Saving based on income tax rate		
	0%	20%	40%
Stop buying a £2.75 coffee on their daily walk	£1,004	£1,255	£1,673
Downsize from a luxury estate to a medium hatchback (depreciation or lease cost)	£3,000	£3,750	£5,000

Advice suggestions

- **Taxation** – Understanding your client's income tax rate and providing education on the implications of this will help a client understand the value of your advice and their true sustainable drawdown income need.
- **Evidence** – Many cashflow modelling tools provide a sustainability probability assessment and we encourage you to use these at every review to evidence the suitability of your advice. Always remember to place a copy of this assessment on file.

Summary

- The suitability of your drawdown advice depends upon the sustainability of the income.
- Help evidence suitability by assessing the drawdown solution returns against more secure income sources, including an enhanced annuity. The optimum solution often includes a combination of secure (annuity) style income along with drawdown income.
- Making relatively small lifestyle changes can reduce the income required from drawdown.

Insight from Canada Life

It may be tempting for some people to dip into their pension to help them through any short-term financial problems. However, for those who take some taxable income, the Money Purchase Annual Allowance (MPAA) will be triggered.

People being able to take some of their pension in this unprecedented situation is hugely beneficial. But in future clients may want to make up for those withdrawals by paying in more to their pension, and it seems bizarre the rules may restrict their ability to do so.

Scrapping or amending the MPAA is a change the Government should make.

Andrew Tully
Technical Director

6) Cash reserves and savings

We all like cash, but having too much or too little is not suitable advice. Some of the common reasons why clients maintain their cash reserves are discussed below.

<table>
<tr><th>Reason</th><th>Thoughts</th></tr>
<tr><td>Zero risk</td><td>There is no such thing as a zero risk home for wealth. Banks have gone bust and savers have lost money through this.

While the FSCS provides some security, it is also worth remembering that it only covers an individual for up to £85,000 of bank deposits per provider.</td></tr>
<tr><td>Zero cost</td><td>Savers may not be paying a stated fee to hold cash, but they are paying in other ways. For example, interest paid on bank accounts rarely exceeds inflation and for some it is taxable as well.

Let's consider £10,000 held in a deposit account earning interest at 1% pa:

<table><tr><td>Interest earned at 1% pa</td><td>£100</td></tr><tr><td>Current rate of inflation 1.8%</td><td>£180</td></tr><tr><td>Total cost =</td><td>0.8% or £80</td></tr></table>
<table><tr><td>If tax payable at standard rate, total cost =</td><td>1.0% or £100</td></tr><tr><td>If tax payable at higher rate, total cost =</td><td>1.2% or £120</td></tr></table>
In summary, despite interest being earned, to hold £10,000 in this account costs the saver between £80 and £120 pa.</td></tr>
<tr><td>Cash always provides a good return</td><td>See above point. The reality is that cash often produces a negative return in real terms.

That said, there are occasions when investment markets decrease in value and so a return (even a negative one) results in cash being the best performing asset class.</td></tr>
<tr><td>I need £x as a rainy day fund</td><td>Often clients provide random numbers that they feel comfortable with, or that someone previously suggested to them.

As with all financial advice it is best to educate first, then suggest an appropriate balance to meet their needs – evidence-based advice.

Try simply listing out what they feel their rainy day fund is for and many will have a reserve that does not match it.</td></tr>
<tr><td>My cash reserve does not include my cash ISA</td><td>Cash can be taken out of an ISA at any time. However, you should always check the ISAs terms and conditions as there may be restrictions and/or costs involved.

If the ISA is a 'flexible ISA', then cash taken out can be put back in during the same tax year without reducing the current year's contribution allowance.

This means by using 'flexible ISAs', for at least part of the client's cash reserve, cash can be held tax efficiently for a rainy day.</td></tr>
</table>

What is the right cash reserve to recommend?

Firstly, there is more than one reserve to recommend and they include:

Instant access	Rainy day/ income support	1–2% of plan value	Investment
Bank account	**Term account Cash ISA**	**Pension or platform general investment account**	**See centralised investment policy or model portfolio weightings**

There is no set formula for calculating the most appropriate balance. This is because every client's needs are individual and will evolve over time.

When recommending the rainy day/income support cash reserve we have come across a number of different guidelines in use across the industry, which include:

- £20,000 (because most emergencies cost less than this)
- 1 to 3 years of expenditure (with or without state pension included)
- 1 to 3 years of drawdown income, so the client is not dependent upon the drawdown in the short term. This increases the potential for capital growth while decreasing the potential impact of sequence risk
- 10% of total wealth

None of these guidelines is without problems, but then no formula fits all.

With this and the FCA's TCF rules in mind, we suggest advice practices have in place one guideline: an assessment formula that works for all clients and importantly that is consistently used by all advisers and paraplanners.

Summary

There are pros and cons in holding cash, so recommending the right balance is important.

A good practice will often involve holding one to three years of retirement income in cash or cash-like funds to ensure there is sufficient liquidity to avoid encashing asset-backed securities when values fall.

In times of economic uncertainty many investors turn to lower risk and cash-based assets

This is rarely a good idea in the long term

Do not forget to consider inflation when reviewing cash reserves

Assuming inflation was 2.5% pa, a cash reserve set 10 years ago would need to be 28% more today to have the equivalent buying power

7) Protection

For clients in drawdown, the chances are they have limited protection needs. Indeed, high net worth (HNW) clients may well be able to self-insure.

If you fail to consider their protection needs, you will not know if they have any.

Importantly, you also will not be able to evidence that you considered your client's protection needs and therefore that your advice was suitable.

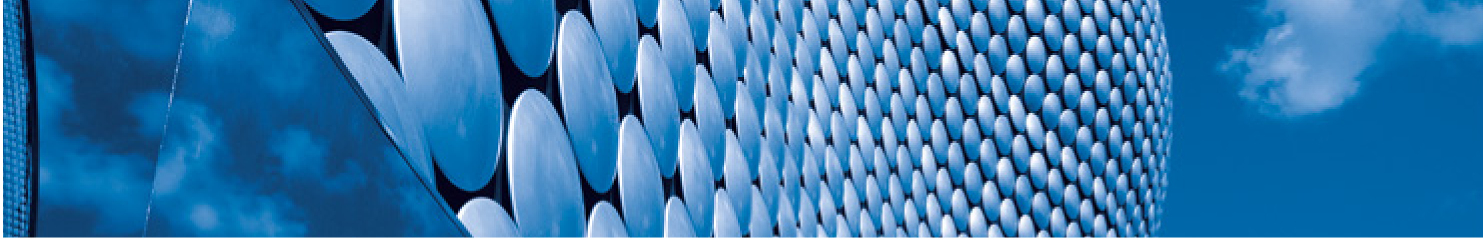
Wealth protection solutions to consider with clients in drawdown include:

- Income protection (if still working)
- Private medical insurance
- Life cover, term and whole of life, for protection and/or estate planning

Advisers may find cashflow modelling tools help evidence the suitability of their protection advice (including where no protection is being recommended).

Pension death benefit rules change at age 75, therefore your estate planning advice should change too

We consider this in more detail later



8) Risks and the client's attitude towards them

In this section we consider the main risks clients face while in drawdown and how their attitudes to risk, capacity for loss, and environmental, social and governance (ESG) preferences affect the suitability of your advice.

Attitude to risk

This is one area where COVID-19 is likely to have had an impact. Weeks of social distancing, alarming 24/7 rolling news and recent reductions in their capital and income will have altered many clients' personal values.

It is therefore arguably one of the most important aspects to spend time on and get right.

In decumulation, increasing risk does not equate to increased potential returns

Risk profiling your client evidences their willingness and ability to take investment risk. Using investments that have been matched to the client's risk profile will help evidence the suitability of the underlying investments.

If the connection between the client's risk profile and solution is not made, then the suitability of your advice comes into question.

There are three reasons why this assessment must be undertaken periodically (at least annually):

1. Clients evolve in terms of their attitude to risk
2. Questionnaires evolve
3. Product profiles evolve

The key points to consider are set out below:

Are you using the right questionnaire?	Attitude to risk changes depending on whether a client is in accumulation or decumulation. In addition (1) the withdrawal rate, (2) the duration the income is required for and (3) sequence risk are only applicable to/only have an impact in the decumulation stage. It is therefore sensible to ask questions that relate to and produce results relevant to decumulation, something many accumulation questionnaires struggle to do.
Correlation of risk profiles	There is no standard method or formula for assessing risk. This means each provider has a different understanding and different parameters, although they commonly present the results in a similar language, eg Cautious, Balanced and Growth, or on a 1 to 10 scale. Do not assume that a fund with 5 in the name from provider A has the same risk profile as a fund with 5 in the name from provider B, or a fund called Balanced from provider C has the same level of risk as a Balanced fund from provider D. They may well have different risk levels. Advisers should evidence how offerings from different providers have the same risk profile. There are independent firms with risk mapping tools available that provide risk ratings of funds and portfolios, for example Defaqto through its Engage software.

Do not paraphrase the questions	The individual words used in questionnaires are chosen on purpose. If you fail to ask the question with word for word accuracy then you are asking a different question and therefore your client is answering a different question. This might seem obvious, but it is a common mistake.
Do not recycle last year's questionnaire	Always ask your clients to complete a blank questionnaire. If you send your client a copy of the questionnaire they completed last year to review, many will not give it their full consideration and just renew on the same basis. Asking them to complete a fresh questionnaire increases the perceived importance and therefore the time taken to complete it, thereby increasing the accuracy of the results. Also, questionnaires and the resulting profiles created change as well, but this is not always obvious.

Capacity for loss

As (1) markets move, (2) clients withdraw income from their drawdown solution and/or (3) they spend their cash reserve, their capacity for loss will change, sometimes considerably.

Loss in any area will have an impact on a client's future, most notably on their capital and income (both short term and long term).

Assessing your client's capacity for loss acts as a safety check on the attitude to risk profile indicated by the questionnaire they completed.

For example, a client might complete the attitude to risk assessment, resulting in a high level of risk being appropriate. If, however, all of their capital is needed to produce secure income as they are barely covering their core expenditure, then the reality is that their capacity for loss is very low and they cannot actually take a high level of risk.

It is also possible that a client will have a different attitude to risk for each of their income types, ie wanting a lower level of risk in producing an income to cover their core costs but having a willingness to take on greater risk to cover their lifestyle costs.

Remove your own influence by asking your client to complete these questionnaires prior to the review

ESG

From 2021, advisers will also need to consider their client's ESG preferences in their risk profile assessments. Advisers will start to see ESG question sets appear in their off-the-shelf attitude to risk questionnaires.

The difficulty for advisers is being able to evidence exactly that the agreed profile of the client matches the solution recommended. There is no regulatory standard or agreement on how ESG stances should be assessed or reflected in the underlying investments. This is resulting in some early assessment tools providing differing outcomes.

For example, one 'responsible' fund may completely avoid investment in the oil industry. Another responsible provider, however, might take active investments in the oil industry in order to engage with company management and/or use their shareholding voting rights to influence change from within. These potential solutions may have the same risk profiles and end-goals, but their strategies in terms of responsible investment are polar opposites.

Advisers may find outsourcing the evidencing of suitability between client/questionnaire/profile and investment strategy/underlying investments to be a prudent step as we move into 2021.

It is a requirement from 2021 for advisers to consider their client's ESG preferences in their assessments

Overview of common risks

Drawdown is a balancing act between mitigating risk, receiving returns and retaining flexibility.

Some of the key risks to consider with clients when assessing their options for annuities and drawdown are shown in Table 1.

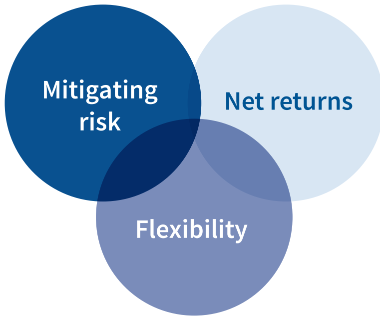


Table 1: Common risks to consider with your clients in drawdown

Fund range	Investment proposition
Market evolution	Risk that products may not be available or cost effective to meet needs at the required time
Longevity	Risk of living too long (longer than income can be produced for)
Sequence (of returns)	Risk of a poor sequence of returns when income is being taken, in particular bad returns in the early years, having a detrimental effect on capital values and therefore the income available in the future
Inflation	Risk of inflation eroding the buying power of the capital and/or the income produced from it
Investment	Risk of poor market returns that reduce capital sums and by association the level of income produced: • Systemic market risk – an event impacting on a market or asset class • Specific risk – a specific investment underperforming
Interest rate	Risk that interest rate movements may adversely affect annuity style products and guaranteed or protected funds/solutions
Commitment	Risk of selecting a solution and not being able to change the product choice, benefit shape, income level or death benefits
Financial ruin	Risk of exhausting the capital and income while still alive and as a consequence experiencing a lower standard of living for the remaining years
Diversification	Risk of putting all your eggs in one basket, or too many baskets
Insurer credit and counterparty	Risk of failure of a provider of all or part of the solution
Political	Risk that a change in legislation and/or regulations will impact on the net benefits received and by whom, and on the advice given
Timing	Risk of securing the level of income required at the time required
Health	Risk that deteriorating health will bring about the need to access retirement capital or income to cover non-insured medical expenses and healthcare, or that better than expected health introduces longevity risk
Consumer protection	Insurance-based contracts, such as an annuity, carry 100% protection under the FSCS whereas a drawdown solution may carry less

Source: Defaqto

9) Investments

We will presume for this section that you have completed the stages set out in Section 8 for your client and the assessment of their attitude to risk and capacity for loss has resulted in an agreed risk profile. This means you have evidenced the suitability between client/questionnaire/profile and investment strategy/underlying investments.

Factors to consider in respect of assets (individually and collectively) and your report on them include:

1	Governance and regulation
2	Provider financial strength and/or capability
3	Investment management key factors including: • Investment philosophy • Investment process and management of risk
4	Performance of capital and income: • Actual versus target/expectations • Actual returns and yields (as well as risk-adjusted measures) • Market value adjustments, eg with-profit funds and smoothing • Rebalancing and de-risking
5	Cost (could this outcome be achieved smarter and/or cheaper?)
6	Benchmarking and whether ‘value for money’ has been demonstrated

Sustainability of income

Receiving the income expected is critically important to your drawdown clients as for many it maintains their home and lifestyle.

However, the probability of the income being sustained for the client’s chosen term or lifetime changes daily as the underlying investment capital value and income yields alter.

There are six key factors that impact on sustainability, each of which we suggest you consider in every review. They are:

1. Initial capital balance
2. Withdrawal amount, ie income
3. Duration (the term the withdrawals are required for)
4. Level of sequence risk
5. Reduction in yield, ie cost
6. Residual capital (the amount the client wishes to have at the end of the duration)

Defaqto has carried out stochastic projections of an initial capital amount under reasonable assumptions for factors 2 to 5 above. Some of our research shows:

- If sequence risk is increased (and the other three factors are held constant), then the expected value of the capital will be higher at the end of the duration
- Greater sequence risk, however, also means more uncertainty around the expected value, ie a greater range of potential outcomes on the upside and more importantly on the downside
- If the withdrawal rate is increased then the expected value of the capital will be lower at the end of the duration, or the capital is more likely to run out before the end of the duration

Constructing optimal solutions

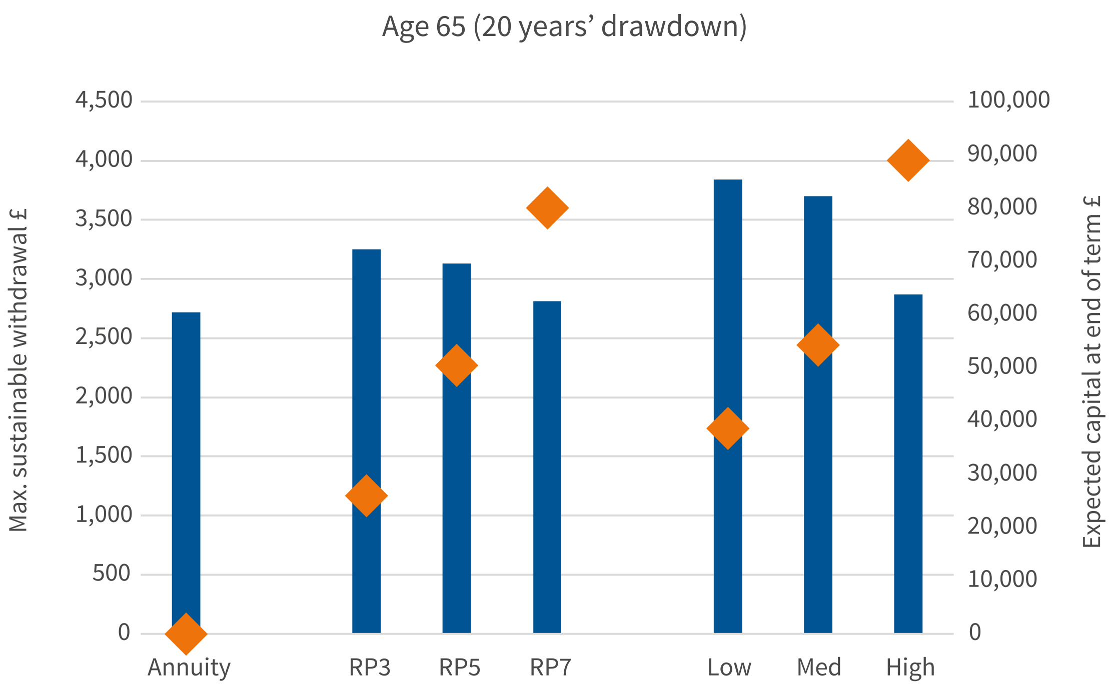
In the case of accumulation, the focus is on maximising expected returns for a given level of expected total return volatility. With decumulation, however, the focus will usually be on achieving the duration before the capital runs out, within a defined level of confidence, subject to a certain level of sequence risk and withdrawal rate.

Advisers using accumulation risk profiles in order to determine a portfolio for their clients are therefore not considering sequence risk or the client's ability to withdraw a suitable income without their capital running out over the duration.

Stochastic projections

This last point is illustrated in Diagram 6, which is based on further stochastic projections by Defaqto. The dark blue vertical bars indicate the maximum income per annum that can be taken, starting with a capital balance of £100,000, without the capital running out before the end of the duration, which is 20 years in this example (the value of the income is on the left axis). The orange diamonds indicate the expected capital value at the end of the 20-year term (the value of which is on the right axis).

Diagram 6: Stochastic projections



RP = Risk profile

Source: Defaqto

These income amounts and capital values are shown for (1) three levels of sequence risk, (2) a spread of three accumulation risk levels on a 1 to 10 scale and (3) an annuity (we have used an index-linked annuity rate as a like for like comparison).

A single 65 year old male, non-smoker, in good health could expect the following lifetime annuities:

Annual growth rate	RPI	LPI	3%	None
Initial income	£2,632	£2,716	£2,962	£4,572

Source: MAS website 22/05/2020

Diagram 6 tells us:

- In the case of both the accumulation and decumulation risk profiles, as the risk taken on increases, the expected capital at the end of the term rises, but the maximum sustainable income decreases. As mentioned earlier, though, there is greater uncertainty around the capital value and therefore income levels as the risk increases.
- The decumulation risk profiles produce both greater levels of sustainable income and higher expected capital amounts at the end of the duration, compared to the accumulation profiles.
- An annuity provides the lowest income on the illustrated inflation-based basis and no capital at the end of the duration.

What have we learnt?

- To evidence suitability, the focus in decumulation should be on sequence risk and withdrawal rate, rather than maximising expected returns for a given level of expected total return volatility as is commonly the case in accumulation.
- Taking on more sequence risk increases the expected amount of capital at the end of the term, but there is more uncertainty around this amount and therefore greater downside potential.
- Taking on more risk also means the maximum sustainable income is lower.
- Withdrawing more income reduces the expected amount of capital at the end of the duration and increases the chances of the capital running out before the end of the term.

How are you evidencing:

✓ Capacity for loss?

✓ The level of risk you recommend?

✓ The sustainability of the withdrawal rates you recommend?

✓ The suitability of the solution(s) you recommend?

10) Products and solutions

While drawdown is technically a pension-driven subject, the same principle can be applied to your client's entire financial wealth. It is simply a matter of making your client aware of the advantages and disadvantages of using each source of wealth as an income generator.

For example, using different income sources in the 2020/21 financial year, it is possible to produce *£27,800 of tax-free income*.

Income tax allowance	£12,500
Dividend allowance	£2,000
Personal savings allowance (higher rate taxpayers = £500)	£1,000
Capital gains tax (CGT) allowance at 0%	£12,300
Total	£27,800

Source: MAS website 22/05/2020

Do you recommend all of these tax-free income sources?

The most successful drawdown solutions are those which consider other assets, such as ISAs, bonds and non-wrapped investments, and this can also include equity release. Each brings different advantages and disadvantages, but collectively they create the greatest opportunities.

The suitability of the drawdown solution, whether weighted towards income or estate planning, should be considered from a number of different perspectives:

- Meeting the client's needs and objectives, while reflecting their personal values
- The income source (security and sustainability)
- The capital value (security, growth and sustainability)
- The type of product(s) in use and being funded (consider ISAs, bonds, equity release, etc)
- The pension scheme (and provider) utilised to provide drawdown

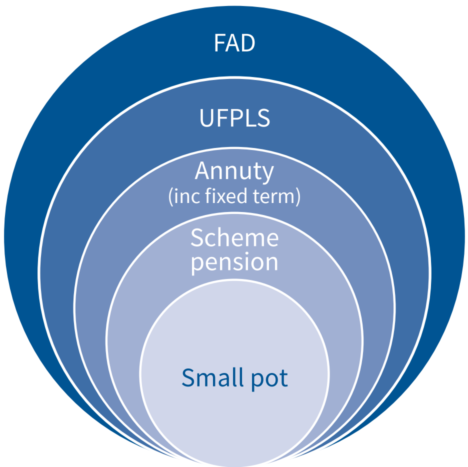
When we were categorising income requirements as being 'core' or 'lifestyle', we also identified that core income requirements can often best be met by secure income sources, including a lifetime annuity and/or scheme pension.

It is therefore good practice to evidence how the core income need is being met by secure income sources. This security will give clients peace of mind.

To meet this need, the most suitable advice may be to move into lower sequence risk investments and/or withdraw part or all of the balance in drawdown and use it to purchase a secure income source.

Diagram 7 illustrates the options and the order in which to consider them, based on security of income.

Diagram 7: Order to consider income sources



Remember, when purchasing an annuity this is the one time in life where poor health and location can be a benefit because enhanced annuities reward them.

Always consider lifestyle and health factors when assessing annuity income sources. We explain how to do this on pages 19 to 21.

Factors to consider for products (individually and collectively) and to report on include:

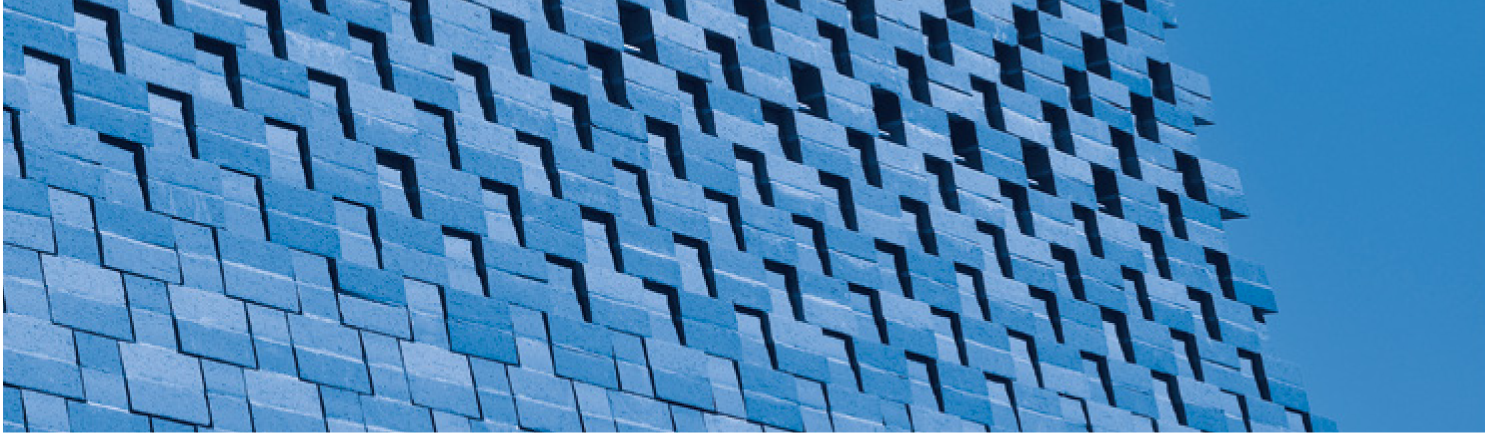
1	Governance and regulation
2	Provider financial strength and/or capability
3	Investment and performance
4	Cost (could this outcome be achieved smarter and/or cheaper?)
5	Benchmarking and how 'value for money' has been created

Insight from Canada Life

Clients can blend drawdown and annuities to meet the combined needs of income security and flexibility.

I think there will be more conversations in the coming months and years about how annuities can play a role in retirement plans, whether that be as part of a blended approach, or as part of a de-risking strategy as clients get older.

Kevan Ramanauckis
Pension Technical Specialist



11) Estate planning

If your client is approaching age 75 or has changed their estate position or aims, this may mean you should reconsider your drawdown advice.

This is important because the level of tax payable on pension savings when the holder dies depends on their age and can be summarised as:

Age at death	Tax rate applied to pension savings
74 or below	0%
75 or above	Beneficiary's marginal rate, or 45% to non-qualifying parties (ie discretionary trust or estate)

This makes wealth held within pension savings potentially very tax efficient. Therefore, for some, it may be appropriate to consider the pension savings for estate planning rather than (solely) as an income source.

There are three types of pension beneficiary, and advisers should be considering each at every review:

Dependant

- Spouse or civil partner
- A child of the deceased who is under age 23
- A child of the deceased of any age, who was dependent upon them due to mental or physical impairment
- Others who are financially dependent upon the deceased, such as a non-married partner or a mentally or physically impaired individual

Nominee

- A non-dependant nominated by the deceased or the scheme administrator
- A scheme administrator can only nominate if there is neither a dependant alive nor an alternative nominee

Successor

- Successors are nominated by a dependant, nominee, successor or the scheme administrator
- A scheme administrator can only nominate if there is no successor nominated

Additional estate planning key factors to consider at the review:

Is a lasting power of attorney in place?	• Do you have a copy? • Have you got to know the attorney, as they may be your client's representative in the future?
Is an up-to-date Will in place?	• Do you have a copy? • Where is the original (can it be accessed after death)? • Have you got to know the beneficiary (they may be your future client)?
Is an up-to-date expression of wish or Trust in place?	• Does it express your client's objectives? • Does it give the scheme administrator/trustees flexibility to adapt outcome? • If not sure, complete a fresh one

Insight from Canada Life

An expression of wish form is a vital piece of the pension jigsaw.

Given the complexities of life and how things can change so quickly, it is crucial these are reviewed regularly and especially as people approach age 75 when the tax consequences following death change.

The legislation around death benefits is more complex than it needs to be, so ensuring suitable nominations are made is likely to allow more flexibility for benefits to be passed on in a tax-efficient way.

Andrew Tully
Technical Director

12) Legislation and regulation

There are a number of critical legislation factors to be considered at each review and they include:

Income tax	Allowances change every year and can have a significant impact on the net income received and the suitability of your advice. Your advice should change with the allowances.
State benefits	For those below the state pension age there is a limit on the total amount of state benefits available. Not everyone receives the same state pension. How much your client receives depends on their history of paying National Insurance. If your client has yet to claim their state pension you should ask them to apply for a state pension forecast by filling in a BR19 form at: www.gov.uk/government/publications/application-for-a-state-pension-statement There are other state benefits that your client may be entitled to claim. As an adviser you should be aware of these and be able to recommend whether to apply for them or not. It is important to remember that taking benefits from pension savings can affect entitlement to state benefits.
Tax-free cash	Also known as the pension commencement lump sum (PCLS). Under normal circumstances, the maximum allowance is 25% of the fund value at the time of taking the benefits. If the PCLS is not taken then it can be taken as tax-efficient income instead, although do not hold it as cash within the pension otherwise the allowance can be lost forever.
Lifetime allowance	The lifetime allowance (LTA) is an overall limit on the amount of pension benefits that can be taken before the LTA charge is levied, when the client crystallises benefits and/or turns 75. In essence, the LTA reduces the benefit of saving in pensions where the combined value exceeds the LTA. In 2020/21, the balance over the LTA of £1,073,100 is subject to a tax charge of 25% if paid as income, or 55% if paid as a lump sum.

For those clients in drawdown but still continuing to save into their pension, there are additional factors to consider. These have been introduced to prevent abuse of the tax system. All can be in force at the same time and the numbers below relate to the 2020/21 financial year:

Restriction	Allowance reduction
Money purchase annual allowance	£40,000 to £4,000
Alternative allowance	£36,000
Tapered annual allowance	£40,000 to £4,000

The ***money purchase annual allowance*** (MPAA) is a reduced annual allowance for contributions into money purchase pension schemes. When pension benefits have been 'flexibly accessed', the amount that can be saved in the future tax efficiently in a money purchase pension is reduced and the excess becomes taxable. There are some ways of taking pension benefits which don't trigger the MPAA (such as taking tax-free cash only, or buying a guaranteed lifetime annuity), which you should consider with your client.

The ***alternative allowance*** is the maximum amount of defined benefit (DB) pension savings that qualify for tax relief once the MPAA has been triggered. It may be less than £36,000 when the tapered annual allowance also applies.

The ***tapered annual allowance*** affects those with income of £200,000 or more. The annual allowance of £40,000 is reduced by £1 for every £2 that adjusted income exceeds £240,000, up to a maximum reduction of £36,000, reducing the annual allowance to £4,000 (for those with adjusted income of £312,000 or more).

Legislation

We all know that COBS rules are always evolving and advisers should make sure they keep on top of the changes and the implications of them.

Occasionally the FCA is targeted in its instruction to advisers – warning them even.

One recent example you should be aware of is the 'Dear CEO' letter, published on 21 January 2020. This highlights that the FCA has advice in its targets.

The following is an extract from the letter:

> We will be carrying out further work on the suitability of advice and associated disclosure. The review will focus on initial and ongoing advice to consumers on taking an income in retirement.
>
> This evolving market has changed significantly following the pension freedom reforms and we want to assess the outcomes consumers are receiving.
>
> **Action to take**
>
> You need to ensure the advice you provide is suitable, costs and charges are disclosed clearly, and you act in the best interests of your clients.
>
> Conflicts of interest must be identified and where they cannot be prevented, disclosed and managed.

Source: FCA 'Dear CEO' letter, 21 January 2020

13) Education and the suitability checklist

If a client does not understand the drawdown process then arguably they cannot agree to your advice.

With this in mind, we have compiled the following checklist (Diagram 8) of the key subjects you should be sure to educate your client upon. This same checklist can be used by advisers to double check they have considered the key factors required in a periodic review.

Diagram 8: Suitability checklist

	✓
Knowledge of all assets and liabilities (total net worth)	
Defined contribution (DC) pension, also known as money purchase pension	
Defined benefit (DB) pension savings, also known as final salary and career average	
Crystallised and uncrystallised values	
Taxation of benefits	
PCLS (tax-free cash)	
Consolidation	
Loss of guaranteed annuity rate (GAR) and other benefits	
Small pot allowance	
Continue to contribute (auto-enrolment and other drivers)	
Income tax	
Lifetime allowance	
Alternative allowance	
Annual allowance	
Money purchase annual allowance	
Tapered annual allowance	

	✓
Income sources	
State pension and other benefit entitlements	
Annuity (enhanced)	
Scheme pension or cash balance pension	
FAD flexible access drawdown, also known as just drawdown	
UFPLS uncrystallised funds pension lump sum	
Other sources (including equity release)	
Due diligence factors	
Provider	
Product	
Investment strategy • Suitability • Sustainability	
Performance • Actual versus expectations • De-risking, rebalancing and appropriateness of the investment strategy	
De-risking or restructuring required	
Guarantees	
Charges	
Risks (see page 27 for list)	

14) Revisit needs and objectives

This is where you state the needs and objectives going forward (see Diagram 9).

If there are no changes you need simply to repeat the first section and record:

- How the strategy is meeting the needs and objectives
- The appropriateness of each product and investment being utilised
- How the existing and/or new strategy is performing against the agreed benchmark

Where changes are being recommended, detail:

- Why
- The costs being incurred
- The benefits being created
- The new benchmark and timeframe

Remember to record values, needs and objectives – **SMART**:

S Specific

M Measurable

A Attainable

R Relevant

T Timely

Diagram 9: Example of how to record changes to client needs and objectives

Importance	Needs and objectives	Timescale	Rationale	Changes recommended, benchmarks agreed and rationales for them
1				
2				
3				
4				
5				

Learning objectives revisited

Having read this document you will now be able to:

	Learning objective	How met
1	Structure and undertake a periodic review and know the steps that should be included	Review template on page 10 Suitability checklist on page 37
2	Understand the importance of categorising different types of expenditure as ‘core’ and ‘lifestyle’ and be able to match suitable income sources to them	This is explained on page 31
3	Explain the impact of sequence risk on those in drawdown and how to structure a decumulation investment strategy to help mitigate against it	This is explained on pages 28 to 30

Test yourself for CPD purposes

To assess your knowledge following completion of this publication, why not work your way through the following questions?

1	State the three high level factors to be considered to meet the FCA's 'Know your Client' guidelines.
2	State the three high level factors to be considered to meet the FCA's 'Research and Due Diligence' guidelines.
3	Which investment strategy should produce the most income over the long term? • Low risk accumulation • Low sequence risk decumulation?
4	List the three types of pension beneficiary.
5	In 2020/21, what tax rates are payable on income and lump sums on balances in excess of the lifetime allowance?
6	In 2020/21, the tapered annual allowance affects those with incomes over how much?

CII/PFS and CISI accredit this document for up to **30 minutes** of structured continuing professional development (CPD).

Name	
Signature	
Date	
CPD time recorded	

Answers

1. Financial situation, investment objectives, risks (attitude to investment, capacity for loss, and knowledge and experience)
2. Nature of the investment, risks and benefits, and the provider 3. Low sequence risk decumulation
4. Dependant, nominee and successor 5. Income 25%, lump sum 55%. 6. £200,000

Send us your feedback

Your feedback is extremely important to us and we would be grateful if, after completing this publication, you would take a few minutes to complete a short survey. Your answers will be treated in the strictest confidence and the results of this will help the development of future publications.

The survey can be accessed at:

snapsurveys.com/wh/s.asp?k=144610976149

About Defaqto

Defaqto is an independent financial information business, helping financial institutions and consumers make better informed decisions.

Our experts research, collect and continuously assess over 43,000 financial products. Our process is extremely robust and is driven by over 60 specialist analysts who have unparalleled knowledge of financial products, services and funds in the market. Our independent fund and product information helps banks, insurers and fund managers with designing and promoting their propositions.

Defaqto Ratings

Defaqto Star Ratings are the most trusted expert assessment of products in the market. Products can receive a Rating of 1 to 5, depending on the quality and comprehensiveness of the features it offers. A 1 Star Rating indicates a basic product, while a 5 Star Rating indicates one of the highest quality products in the market. Star Ratings provide consumers, advisers and brokers with an accurate benchmark so that they can see at a glance how products and policies in the market compare.

A Diamond Rating reflects the performance of a managed fund or fund family. Funds or fund families can receive a Rating of 1 to 5 based on a detailed and well-structured scoring process, allowing advisers and other intermediaries – and their clients – to see instantly where they sit in the market in terms of fund performance and competitiveness in areas such as fees, scale, access and manager longevity. A 5 Diamond Rating indicates it is one of the best quality funds available in the market.

Service Ratings provide advisers with a simple and unbiased assessment of provider service. Based on advisers' perceptions of the service they receive, providers are rated Gold, Silver, Bronze.

Risk Ratings use the projected volatility of a fund using asset allocation and historic volatility, based on observed standard deviations, to map a fund to a Defaqto Risk Profile. Risk Profile 10 indicates highest risk and Risk Profile 1 represents lowest risk.

Income Risk Ratings are unique to the market, comparing fund objectives, asset allocations, income and capital volatilities, and maximum drawdown. The Ratings are mapped to four Income Risk Profiles based on the income required and the level of risk. They are: capital preservation, low income volatility, medium income volatility, high income volatility.

Defaqto Engage and Engage Core

Defaqto Engage is our end-to-end financial planning software solution enabling advisers to manage their financial planning process all in one place.

Engage CORE
At the heart of your advice

Engage Core, the latest version of Defaqto Engage, combines risk profiling, three-way fund, platform and product research and suitability letters templates into one easy-to-use tool. Visit defaqto.com/advisers/engage to learn more.

The Service Ratings and satisfaction results by category are available within Engage. Advisers can use the Service Rating and the individual category satisfaction scores (for example, new business servicing, existing business administration, online servicing) during the research process as one of a number of selection criteria. They can also be added to comparison tables.

Advisers should note that not all providers are rated; to qualify for a Service Rating, providers must receive a minimum number of responses from advisers. So, using any service results in the filtering process may exclude providers offering potentially suitable client solutions from the research output.

We really couldn't create the Service Ratings without advisers – they are different from our Star and Diamond Ratings, which are created by our experts and based on facts, not opinions.

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