CASE STUDY NO. 1

ADVISER PROFILE: a Chartered Financial Planner working with higher net worth clients. Average client age is approximately 51 and assets are broadly evenly split between accumulation and retirement (58%/42% respectively).

Adviser insights: centralised retirement propositons

With the retirement income market an area of continued growth and focus, we wanted to better understand how advisers are dealing with the broad spectrum of needs, priorities, risks and options to be considered with and for their clients. In short, their retirement philosophy.

Working with our friends at the lang cat, we spoke with a number of advisers to find out what a centralised retirement proposition (CRP) means to them, how it may (or may not) fit into their proposition and their views on some of the key themes around retirement income planning.

Our grateful thanks goes to the advisers for sharing their time, experience and expertise with us.

For financial advisers only.

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1

Does your firm currently have a CRP and can you summarise your interpretation of what a CRP is?

We wouldn't formally call it a CRP. Really, it's a variation on our CIP (centralised investment proposition). We tend to think that a CRP and CIP are almost one and the same, particularly in this day and age when people are not necessarily working flat out one day and then retiring the next. It's also worth mentioning that our clients are relatively HNW (high net worth) – our average client case size is about £1.1 million. They tend to have other assets in addition to what would be nominally their pension assets, so we're often looking more at their overall capacity for loss. We don't have a specific transition of one moment where you're in accumulation mode and the next you're in decumulation – well I suppose we do sort of look at it that way but it doesn't greatly influence matters and there is no great process change. Short answer is we don't really have one (a CRP).

I'd say we probably take a more formalistic approach to retirement and the sorts of things that we're maybe doing are reducing portfolio risk slightly, looking more closely at income generation and what the portfolios can produce, as well as deciding on the most tax efficient place to take assets from. Often, we'll run down a particular pot or less effective tax wrapper until there is nothing left and then move onto the next one. For instance, if the client has a General Investment Account (GIA) we'll generally run that down subject to CGT (capital gains tax) and then move onto something like bonds – whether onshore or offshore – then on to ISAs and then finally to pensions. However, there are a lot of other variables which might affect these decisions along the way, such as the Lifetime Allowance.

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2

Do you take a different approach to clients in retirement compared to those in accumulation? If so, how does your approach to clients in retirement differ?

Our strategy is essentially very flexible. A CRP, I would imagine, is reasonably rigid and sets limits on clients through a pretty formulaic process. One of our guidelines is ideally not to withdraw more than 4% from a portfolio because that's a common criterion. While most of our clients would be taking around or about that level, clients can exceed that in the early years particularly if they can accept an increasing level of risk. It's important for the client and adviser to know if this is pushing them into the red at all – we would use cashflow modelling for this. You have to be very careful with your assumptions (we tend to make these pretty conservative) and use regular reviews to make sure clients are on track without taking too much risk.

3

Please talk us through how you approach the following key areas of the advice process, when dealing with clients in retirement.

Risk profiling: It doesn't change greatly post retirement. We use FinaMetrica (which is based on a psychometric Q&A) but we're also very much looking at the client's objectives and what sort of growth they need. The psychometric tests are really pretty accurate and will tell you if the client can sleep at night, whether they're used to volatility, that sort of thing. But if you've got a wealthy client you might just set risk at the level the client needs to take. We have a general tendency to move clients' risk profiles down a notch around retirement, for example adjusting a balanced portfolio with 40-85% equities down to a 20-60% equity-type portfolio. But sometimes we don't do that because there is still a high capacity for loss, so we just let it continue to run at a client's attitude to risk. The client's attitude to risk can change slightly when they are not earning, but we often find bigger influences from stock market performance.

Something we do notice is that when a new client comes to us, they tend to set the risk parameters lower. That's because they are coming to an adviser with discretionary management and they don't want to give us too free a rein initially.

Cash flow modelling: We use Truth cashflow modelling running to age 100 or 105 if there is a history of long life in the family.

Client reporting: Not really, it stays the same.

Client review process: The review process isn't different. Normally annually.

Disclosure e.g. MiFID II costs and charges: Again, no change. That would just be the same for all clients.

Anything else: We are likely to put more of a focus on client vulnerability and health issues. As clients age we are on the lookout for these factors. We are trying to improve our training and skill in this area and to also be aware of the influence of children in the background. It's early days for us, and we don't have many particularly elderly clients, but we are also conscious of physical and mental disabilities and we advise a personal injury trust. We are communicating with the beneficiaries of those trusts and they come into meetings, which are usually organised by the trustees, so we are reasonably geared up for that.

The sort of thing that we deal with more regularly is a death in the family, or occasionally a divorce, and we have to handle these very sensitively. As an example, there was a lady who was very recently widowed, and she was very keen to gift money to her children – our advice to her was to not do anything too immediate but rather take time to consider.

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4

Do your clients pay a different fee structure depending on whether they are pre- or post-retirement.

No. The only thing we might do is have an at-retirement report and maybe charge a flat fee for that analysis. Otherwise it tends to be our usual ad valorem charge.

5

Peoples' needs in retirement are changing rapidly. What do you see as the biggest current challenge in the wider retirement landscape and in what way is this impacting how you approach decumulation clients?

Long-term care isn't that big an issue for most of our clients. It might be if they have dementia or something similar. Most of our clients will still have a main residence which might be sold to fund care. The main issue and focus of attention for us tends to be more about reducing IHT (inheritance tax) for clients and getting them to gift assets. We are also getting more involved with coaching clients around their approach to the period just after retirement. We want to get people thinking about retirement, their hobbies and what they're going to do with their time. And then, when they get even more elderly, to think about long-term care or slowing down. We build it around something called the 'Four Freedoms': money, time, relationships and health, and we ask clients to score themselves on that e.g. "Do you feel you have enough time?". They'll give us a score to describe where they see themselves and this really kicks off the conversation, e.g. "If you don't feel you have enough time, are there things you could do about that or could give up in favour of other things?". We call this the front-loading of retirement, where people take those trips or buy that sports car, meaning their expenses tend to be quite high early in retirement and then diminish, but with an extra peak towards the end if long-term care is required. There are other factors with long-term care, such as whether there are any children around to help or anyone else who can assist. It's just getting people to think ahead.

6

How is increasing intergenerational wealth transfer affecting your approach to clients in retirement? Can you give examples of the actions you're taking around this?

It's probably having more effect on their children; we are trying to get closer to them from a business perspective but it's useful to both the clients and their offspring. That's probably the main change and we're introducing a light-touch service to deal with children who are roughly in their 40s and 50s. Rather than just see assets walk out the door when a client dies, this lets us get a feel for what the children's wants are and helps us build a picture of the wider family and even get a sense of their involvement in any long-term care issues that might arise.

7

What level of detail do you go into when it comes to centralisation/segmentation of your client base? Have the PROD rules been a driver of this part of your process?

We are getting more involved with coaching clients around their approach to the period just after retirement. We want to get people thinking about retirement, their hobbies and what they're going to do with their time.

Not a huge level of detail. Although our segmentation is mainly along accumulation and decumulation lines and also by age group (life stage). The PROD rules have formalised our process rather than changed it. All our clients get a very similar service; maybe some with a lighter touch approach for the intergenerational situation we talked about earlier. So that's where the client segmentation comes in and variation in the products used e.g. not using a SIPP in the earlier stages of pension saving. If we went back 10 or more years, we would probably have taken a more 'wealth driven' approach but now we have a tiered fee structure so the fee goes down as the assets increase. Really our driving force is that we're providing the client requirement – whatever that is. Risk profiling also comes into it, which means our clients end up in different portfolios at the end of the day.

8

What impact does sequence risk have on your advice proposition for clients in retirement?

We don't take a great regard of sequencing risk because we're DFMs here, so the way we handle this is by trying not to get off to a poor start. We're conscious of the downside risk for all our portfolios so we tend to have a strategy of limiting downside in turbulent times. If we think there is going to be a setback in the market we would adjust the parameters, reducing the portfolio risk at that time or putting cash aside, and we would also probably have an adult conversation with the client around expenditure and expectations going forward. What we don't do is automatically de-risk or put a pot of cash aside unless we think markets are going to fall – that's just a wasted opportunity with interest rates so low and we think that clients in retirement are probably going to live for around 20 years so many still have time on their side – albeit known health issues have a bearing on this. We also have a minimum annual review process, and cashflow modelling which together with discretionary management means regular fine tuning.

We keep a very close eye on platform charges. Our portfolios come down in cost, we're discretionary and our portfolios are typically a 50/50 mix of active and passive, so the costs are a factor and we also look closely at transaction costs now that this info is available. We haven't changed our own fees in the last five to seven years. Although our fees haven't gone up, we are probably providing more services for our clients e.g. coaching but not charging for this.

Sustainable income isn't that important to us. The way we invest client money, we don't really look at income at all, we look at total return. We think it's a mistake to chase a high level of income in particular; currently it's very hard to get that without going into high yield bonds or other risky assets. Accordingly, we try to create an efficient portfolio with the aim that some of that is income. Our portfolios typically produce about 6% p.a. and that would be about 2% income and 4% capital growth on average over the long-term. As mentioned, we don't really take income across the board but target the least tax efficient areas.