CASE STUDY NO. 4

ADVISER PROFILE: a group of independent financial advisers with AUA of £179m. The majority of the firm's clients are in retirement.

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?

Our firm currently has a CRP in draft form – our team has a working knowledge of how the CRP is structured and the processes to follow as part of this. However, we're in the process of creating a formal company document for the CRP.

We interpret a CRP to be an established and clearly articulated process for advisers to follow with clients who are at retirement or taking income/capital withdrawals in retirement. And the overall objective of the CRP is to deliver a uniform process.

2

Can you tell us about how and why your CRP differs from your CIP (centralised investment proposition) and how you approach clients in retirement differently to those in accumulation?

I would say that cashflow planning is the main difference – it's an essential part of our CRP and not so with our CIP. We also do something called a (financial) 'impact on death' assessment which needs to be completed for couples, as part of a sustainable withdrawal assessment and, again, this is something that's unique to our CRP.

The first few years' income will be set aside as a capital sum based upon the client's withdrawal rate. And we stress test by forecasting a bad scenario – something like the dot com bubble – which would cause a market downturn.

3

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

Risk profiling: Yes, we do this. Our clients start by completing a risk questionnaire and we'll give this a sense check just in case there are any contradictory responses. Once this is done we'll then look to get mutual agreement on the risk score between ourselves and the client – based upon their willingness, ability and need to take risk, and time horizons. Each year we also check clients' risk scores against their investment structures and investment behaviours, as well as their evolving circumstances.

Cash flow modelling: We start by establishing a client's 'basic living' expenditure requirement and also their 'lifestyle' expenditure requirement. These get contrasted against a client's existing income sources, so we can identify any shortfalls. For the purposes of cashflow modelling, we typically cover 'basic living' expenditure requirements using fixed income methods such as a State Pension, DB (defined benefit) pension or an annuity. Accessible assets are also used to flex lifestyle expenditure in line with a client's requirements as they evolve over time.

The first few years' income will be set aside as a capital sum based upon the client's withdrawal rate. And we stress test by forecasting a bad scenario – something like the dot com bubble – which would cause a market downturn.

Other factors that we also use as part of our cashflow modelling include obtaining average life expectancy dates via ONS (Office for National Statistics) figures, making allowances for tax, and we also assume 2.5% inflation and a 4% investment return (net of charges) – this is sense checked against the asset allocation generated via a client's risk profile and we adjust the forecast if necessary.

This process then gets reviewed and repeated on an annual basis with our clients.

Client reporting & review process: Every retirement client receives an annual report which includes investment structure fundamentals – risk profile, performance and charges. If behaviours are within our original cash flow assumptions and if a client's circumstances have not changed then a more detailed review may not be necessary. But if their circumstances have changed, or if three years have passed, then we will do a more detailed review and reassessment of their needs.

Disclosure e.g. MiFID II costs and charges: We break this down between product, fund(s) and adviser. This gets declared as both a percentage and monetary amount and is based upon prevailing values, not exact amounts, throughout the year.

> *A client's withdrawal rate is assessed against cashflow forecasting. For example, we may find that it is okay to erode one or more investment pots, depending on how this fits into the wider strategy.*

4

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

No, not presently.

> *We find that quite a lot of our younger clients are unsure about whether to factor in a potential inheritance from their parents.*

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?

One of the challenges which we definitely see is that clients' lifestyle expenditure ends up being greater than they anticipated, and this becomes even more of a challenge when combined with the fact that expectations of future returns from investments are now more conservative.

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?

We find that quite a lot of our younger clients are unsure about whether to factor in a potential inheritance from their parents. Those who do factor this in are less likely to appreciate the way in which long-term care costs can decimate the value of a parent's estate. And, to add further complication, this is actually almost impossible to asses unless the parents' estate values are known and, ideally, they are party to the financial planning process or if parents are already receiving care and the costs of this are known.

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 use services to help segment our clients based on the complexity of their needs.

We use services to help segment our clients based on the complexity of their needs. Clients can receive our Financial Monitoring Service, which includes annual reporting of ongoing investment performance and suitability of existing solutions, based on the client's original circumstances and objectives for retirement. Or alternatively, they will receive our Financial Planning Service, which covers annual reporting as mentioned already, plus an adviser meeting, wider planning pre- and post-retirement, income withdrawal management, tax planning and IHT (inheritance tax) planning.

8

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

This relates back to the point I made about setting aside a client's first few years' income as a capital sum, based upon their withdrawal rate. So, essentially, the higher a client's withdrawal rate, the higher the capital sum will be to serve as a hedge against sequence risk.

A client's withdrawal rate is assessed against cashflow forecasting. For example, we may find that it is okay to erode one or more investment pots, depending on how this fits into the wider strategy. It could be part of a phasing into full retirement strategy or it may be that the stress-tested complete depletion may not be an issue. It's also important to consider that a client's overall expenditure will reduce in the future, with their lifestyle costs decreasing as they get older. Our cash flow forecasting drives all of this planning and stress-testing.

Low cost is also a major focus for us and we try to predominantly utilise passive investment strategies, as long as it's appropriate for the client.