CASE STUDY NO. 5

ADVISER PROFILE: a firm of Chartered Financial Planners offering comprehensive independent financial advice with £150 million AUA. The firm's clients are, on average, between 55 and 60 years old. Around 60% of the client base is in decumulation.

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.

The M&G Wealth Platform is provided by Investment Funds Direct Limited, registered in England and Wales No. 1610781. Registered office: Trimbridge House, Trim Street, Bath BA1 1HB. Authorised and regulated by the Financial Conduct Authority No. 114432.

Investment Funds Direct Limited is a subsidiary of M&G plc, incorporated and registered in England and Wales. Registered office: 10 Fenchurch Avenue, London EC3M 5AG. Registered number 11444019. M&G plc is a holding company, some of whose subsidiaries are authorised and regulated, as applicable, by the Prudential Regulation Authority and the Financial Conduct Authority.

1

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

We do, yes. Our CRP is a combination of cashflow, a review process, reviewing income withdrawals and investments, as well as having an investment proposition that supports a sustainable income in retirement, either through a secure annuity or drawdown.

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?

Ultimately it is much the same as our CIP, the only differences are around cashflow modelling and sustainability. In accumulation we wouldn't really do much cashflow modelling, but as people start to approach retirement, they almost fall into the CRP so we start doing cashflow then, as well as stochastic modelling for income withdrawals.

We also have a lot of different income strategies for retirement clients – we tend to base this around their attitude to investment risk and then look at capacity for loss. So, if they have a high attitude to risk then we'll go down the route of drawdown and if someone is low risk we'll look at an annuity or a hybrid product.

Predominantly we use CashCalc and then FE Analytics to run back-tested withdrawals on the portfolio that we're planning to put the client into. Broadly a client's portfolio doesn't change between accumulation and decumulation because their attitude to risk stays the same, but their capacity for loss becomes different, and that's the only reason we'd look at making a change.

We don't typically use a sustainable withdrawal rate as we tend to focus more on what's right for the individual client. Sustainability of income is of course important to our clients, but a lot of them have worked in heavy industry and, for example, their partner may not have any pension, so they want to pass this onto them. So, the sustainability isn't just for the individual – it's almost a joint retirement strategy based on two people with different lifestyle and health circumstances. We also have to work quite hard to convince the client to test their income until age 100, even if they might not think they'll get past 75 – there is often an important conversation about how a client can maintain a level of income.

Ultimately it [the CRP] is much the same as our CIP, the only differences are around cashflow modelling and sustainability.

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's the same in accumulation and decumulation and we used Dynamic Planner, which is based on a sort of asset allocation. We then assess their capacity for loss, so looking at any secured income sources they have, like a DB (defined benefit) pension or State Pension, and then we fit a retirement strategy around those secured incomes. If it's appropriate we would also look at transferring their DB pension.

Cash flow modelling: We look at cashflow modelling and stress test this using investment returns and we also set it to a relevant ONS life expectancy figure, plus a good margin, to help ensure that a client's pot can stretch out beyond their lifetime.

Client reporting & review process: We tend to have quite a lot of meetings as clients approach retirement and then one every six months for the first year or two just to check that they're comfortable with where they are. The review also depends on their service proposition and how complex their needs are. We also use things like the Monte Carlo Simulation when we're going through our client reporting and review process – if it's going to be too aggressive in the early years then obviously we can tone it down. There's plenty of empirical research which we've looked at which shows clients don't actually spend £3.5k per month when they're 60-80, so that can get factored in as well.

Disclosure e.g. MiFID II costs and charges: If it's a platform SIPP we just use the tool they produce and then we walk through that with the client. There are some cases where it's not the easiest to access charges, so we check the exact amount that has hit our bank account and then work out approximately how much the client has paid and share this with them. Even though there is no requirement to do this we feel it's best endeavours on our part and it's also best for the client.

Other: The only other thing we do is a type of mind mapping tool for clients when they're collating assets at retirement and putting a strategy in place. The central topic will be their £24k a year income and a diagram explains how much of this we'll take from their ISA and how much from their pension etc. It's a one-page diagram, which is a bit easier for a client to understand than a lengthy report about tax wrappers. We use this for all our at-retirement clients.

Broadly a client's portfolio doesn't change between accumulation and decumulation because their attitude to risk stays the same, but their capacity for loss becomes different, and that's the only reason we'd look at making a change.

4

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

Our clients will receive different services to clients in accumulation, but we don't charge any differently for this.

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?

Annuity rates are quite poor. Typically, when we've got somebody who has a lower attitude to risk, an annuity would still be a good option for them but when we go to run an annuity quote it doesn't really give them what they need. So sometimes we find ourselves having to look at drawdown just to get them the income that they need. So a lack of annuity products and poor annuity rates are a big issue.

I think it's also important for advisers to look at adding value beyond a client's annual review, so looking at lifestyle financial planning.

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 always ask clients if they are planning to leave something for their children and they almost always say yes because, who wouldn't? Although the most important thing in someone's retirement has to be themselves, then their spouse and then anything that's left we'll look at putting towards children. Where we're based, there are very few clients with a mortgage so they'll use some of their tax free cash to give to their kids. Also, sometimes we find that a grandparent dies in a family and passes money to their grandchildren. If the parent is a client already then we'll help set the child up with a Stocks & Shares ISA or a Lifetime ISA, so we're making sure that we're looking after the whole family.

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 in the process of changing our segmentation to better reflect complexity of needs. Other things we might look at for segmentation include pre- and post-retirement, as well as the number of different tax wrappers a client has, as an indication of complexity of needs.

This is still something that we're in the process of reviewing at the moment. PROD is the main driver of this and we're still collating the data needed. What we do know is that we have some very high value clients with simple needs and with other clients it's the converse. So, we are in the process of changing our segmentation to better reflect complexity of needs. Other things we might look at for segmentation include pre- and post-retirement, as well as the number of different tax wrappers a client has, as an indication of complexity of needs.

8

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

We use CashCalc and FE Analytics to try to test as well as we can using historic data, but we also look at investment propositions that will minimise sequence risk for clients. If it's a low risk client where we would have gone with an annuity but couldn't because it wouldn't give them what they need, then we'll look at certain products that can give them that smoothing effect. These can be quite expensive so we do try to limit our use of them.

We have to keep looking closely at platform and investment charges but there is obviously a point where it's not possible to lower a platform charge any further and you sometimes do get what you pay for. So, it's about being sure that we can justify the cost because it's ultimately the right thing for the client.