M&G wealth

Openwork session: Cashflow modelling is for life not just retirement!

with

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The information that follows is based on our understanding of current taxation, legislation and HM Revenue & Customs practice all of which are liable to change without notice.

This is just for UK advisers – it's not for use with clients

WHO WE ARE

Pru
part of M&G plc

M&G wealth

M&G
Investments

M&G

Listening to You

Supporting You

Technical Expertise

Thought Leadership

Continuing to Develop

Investing in Technology

Pru & M&G Investments

- Smoothed, planet-friendly and Risk Managed funds
- Wide range of OEICs
- Full range of tax wrappers – both onshore and offshore

M&G wealth

Platform

- Full asset universe plus Model Portfolio service and bespoke portfolios
- Family linking capability and pricing
- Run your CIP or CRP your way
- Full range of out-sourced investment solutions, including sustainable and smoothed options
- Over 90 external Discretionary Fund Managers
- Simple pricing
- 3rd Party integration

Dedicated Account Management & Platform Adoption Team

Important information

This content is based on our understanding of current taxation, legislation and HM Revenue & Customs practice all of which are liable to change without notice. The impact of any taxation (and any tax reliefs) depends on individual circumstances. Where content includes case studies or examples these are for illustration purposes and are not recommending a specific course of action.

Past performance is not a reliable indicator of future performance. The rate of growth of funds and any income from them cannot be guaranteed. The value of an investment can go down as well as up and your client could get back less than they have put in. PruFund funds aim to grow your client's money while smoothing their investment journey.

The PruFund range of funds all invest in Prudential's With-Profits Fund, which is one of the largest with-profits funds in the UK. However, there are differences across the range of PruFund funds in their objectives and mix of assets, and how PruFund delivers returns to investors when compared to other With-Profits business, which means the returns received by investors will vary by fund choice. Prudential set Expected Growth Rates (EGR); these are the annualised rates your client's investment would normally grow at. The EGRs reflect our view of how we think each PruFund fund will perform over the long-term (up to 15 years). Each PruFund fund has its own EGR and your client's investments into a PruFund will normally grow daily by the relevant EGR. Although we take a long-term view, we do review the rates every three months to allow for any changes, which may mean a change in EGR on a quarterly basis, up or down. While the EGR reflects our long-term view, we need to check that the fund is performing as expected - if not we may need to make an adjustment to your client's fund value, either up or down. There are limits which set out when an adjustment would be required. The value of your client's investment in a PruFund fund is based on the Smoothed Price, this is the unit price, which grows daily by the EGR. We compare the Smoothed Price against the Unsmoothed Price – which reflects the value of underlying assets. If these move too far away from one another we need to adjust the Smoothed Price to narrow the gap. This could be a price increase or a price decrease. In certain circumstances we might need to suspend the smoothing process for one or more of the PruFund funds.

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Our learning objectives for the session

1

Explain how Cashflow modelling can be used in the advice process to help clients visualise their retirement journey.

2

Demonstrate how Cashflow modelling can help clients understand the risks in retirement.

3

Demonstrate your capacity for loss process by effective stress testing of client outcomes.

4

Demonstrate how Cashflow modelling can assist advisers with their Consumer Duty requirements.

5

Explore DB transfers in relation to regulatory requirements and good practice for Cashflow modelling.

6

Describe how Cashflow modelling can be used for effective IHT planning.

Chartered Insurance Institute Accredited

CISI CHARTERED INSTITUTE FOR SECURITIES & INVESTMENT ENDORSED CPD

Provider insight

Rosie Hutchinson
Head of Client Solutions, UK

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With over 30 years of experience in financial services, Rosie is well-versed in the art of collaborating with clients to meet their unique financial objectives.

Rosie has been working at Voyant for 10 years, in her current role as Head of Client Solutions at Voyant UK, she leverages her past experience as both paraplanner and adviser to train financial professionals in goals-based wealth management and cashflow modelling.

Rosie's primary goal is to teach how to better engage with clients and promote overall financial wellness.

Section 1:

Cashflow modelling is just a FAD!

Cash flow modelling stats

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Recent media reports suggest 90% of Advisers are now using cashflow modelling

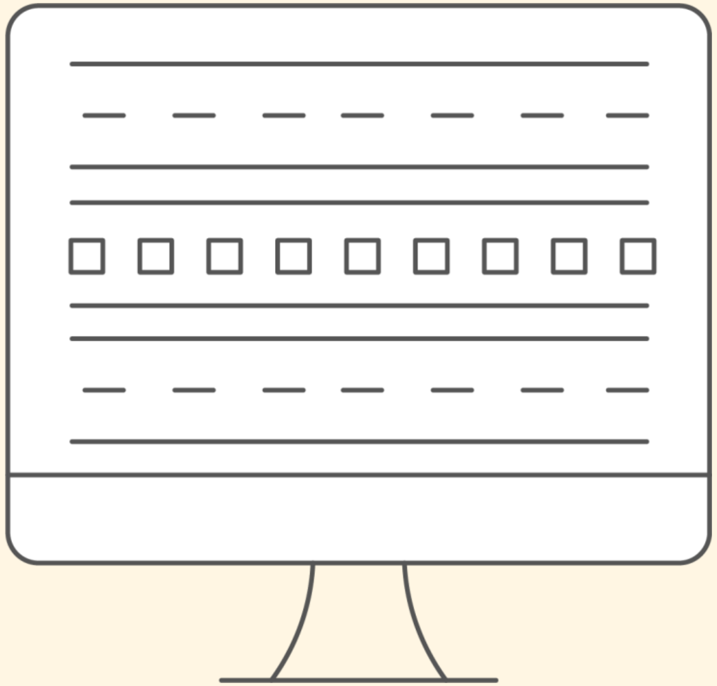
Of those Advisers using cashflow modelling, how many clients are they using it for?

How many Advisers are using ‘goals based’ cashflow modelling?

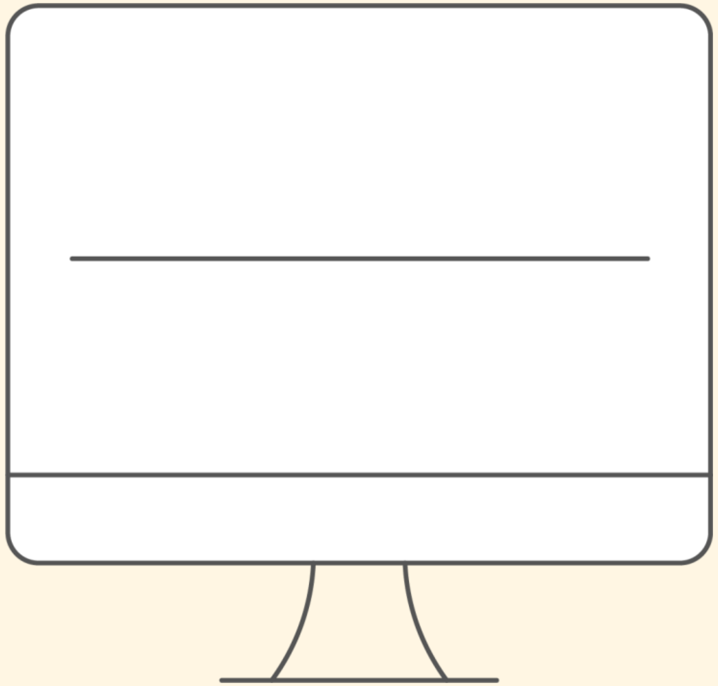
Are Advisers using cashflow modelling ‘live and interactively’ to engage the client, or just presenting a static printed report?

Types of cash flow modelling

Stochastic



Deterministic



<u>Assumptions:</u>

- Reasonable and justifiable
- Reviewed regularly
- Reflect the assets that you're invested in
- Forward looking
- Go beyond average life expectancy
- Follow the guidance set for DB transfers
- Stress Test!

Thematic Review

2.15 - The data survey indicated:

401 out of 956 firms used deterministic CFM

409 firms used stochastic CFM

146 firms did not use CFM

634 firms reviewed the underlying assumptions annually

Source: https://www.fca.org.uk/publications/thematic-reviews/thematic-review-retirement-income-advice

Thematic Review Chapter 2: Use of CFM

2.11 CFM has a significant role to play in helping to illustrate how much income could be drawn in a sustainable manner for the duration of the customer's lifetime, taking into account their circumstances and the size of their pension savings. It can also help establish their CFL, which is covered under 'Risk profiling' findings. Many firms indicated in response to the data survey that they used CFM tools. While the use of CFM tools may lead to better outcomes for customers, firms should ensure they use reasonable and justifiable underlying assumptions otherwise customers risk withdrawing too much or too little income.

2.12 There are 2 types of CFM approaches in use, deterministic or stochastic. Deterministic models use assumptions which do not vary, like a future growth projection. Stochastic models allow for variability and produce a range of possible outcomes based on a statistical model. Whichever type firms use to illustrate possible outcomes, they should also set out why the actual outcomes will vary in practice. Firms should also ensure that the underlying assumptions or parameters used in CFM are reasonable and reviewed regularly to ensure they remain appropriate.

2.13 There are no specific requirements for firms to use CFM. However, we have previously set out expectations on CFM for DB pension transfer advice. Firms may find this information helpful when using CFM

COBS 19 Annex 4A Appropriate pension transfer analysis **FG21/03 FCA DB Transfers – Good & Poor Practice**

Source: Thematic review of Retirement Income Advice | FCA

How do I measure capacity for loss?

Client ABILITY

What expenditure?

Client discussion

All about the Numbers

RIAAT – Expenditure & Capacity for loss

2.42 The **template** breaks expenditure down into 3 broad types:

(a) The **basic cost of living** – This includes all non-discretionary expenditure; for example, utility bills, council tax, food and any outstanding

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accommodation payments (such as mortgages and rents) or care expenses if these are ongoing. This is expenditure that the **client** would find it exceptionally hard/potentially impossible to reduce.

(b) **Lifestyle expenditure** – This is expenditure to support the **client's** lifestyle. For example, **clients** may wish to spend money on socialising, holidays, cleaning, etc. Whilst this expenditure is not non-discretionary and, in theory, could be reduced, many **clients** may not wish to compromise on this expenditure as they see it as necessary to maintain the lifestyle they expect in retirement.

(c) **Discretionary expenditure / savings** – This is expenditure which is purely discretionary and could easily be cut back by the **client** at any time. It may include current savings into pensions or investments which may well cease upon retirement. For **clients** still in employment, this may instead be termed "disposable income".

Example 8: The client does not have the capacity to bear the risk associated with this recommendation

About capacity for loss

3.102 Capacity for loss, or ability to bear risk, refers to the **client's** ability to absorb falls in the value of their investment. For decumulation, this is specifically focussed on their ability to absorb falls in their income or their income running out prematurely. If any loss of capital would have a materially detrimental effect on their standard of living, by reducing the level of income that can be taken, this should be considered in assessing the risk that they are able to take.

3.103 Capacity for loss is an objective assessment, based on the financial circumstances of the **client**. How much can the **client** afford to lose before this would materially affect their standard of living? It should be clear from the **information gathering** whether there is an issue around capacity for loss.

4.31 It's unlikely that asking your client if they are prepared to take a fall in income of a specific percentage is enough to understand their capacity for loss, but it can inform your assessment of their attitude to investment risk. But by asking the right questions, you can use your assessment of capacity for loss to explain to your client how an unrecoverable fall in asset values may affect the income they can take and the effect on their lifestyle in retirement. They may then be able to take a view on the extent to which they are prepared to give up income.

Good Practice – capacity for loss

As well as assessing each client's financial capacity for loss, a firm considered their client's degree of comfort with accepting loss. Although Ms Singh could manage by withdrawing £200 less each month, she did not want to cut her income by more than £100 each month. So her investment risk profile was based on the lower of the level of loss that she could afford to suffer and the level of loss that she was willing to accept.

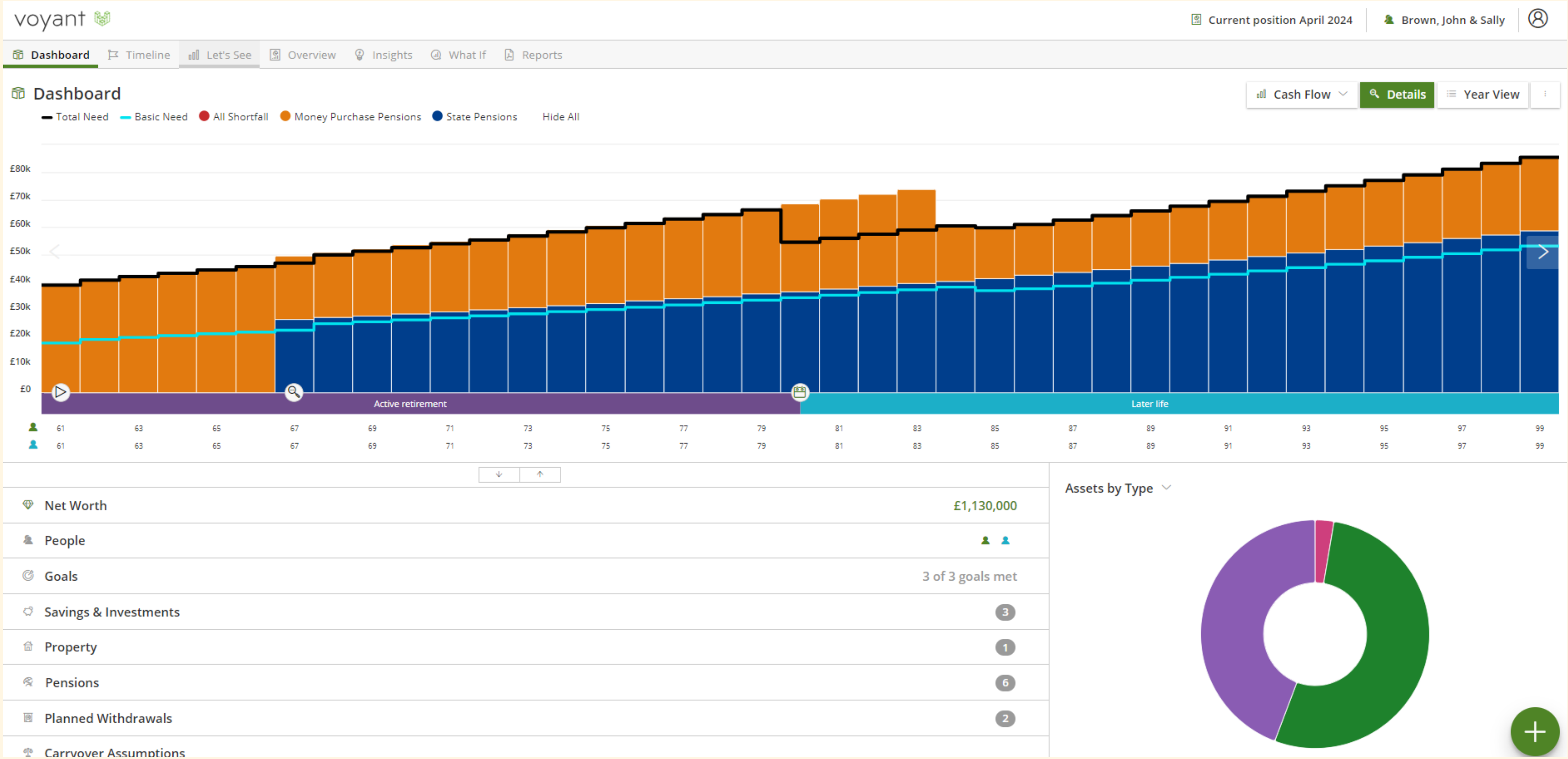
Source: [Instructions for Retirement Income Advice Assessment Tool (RIAAT) (fca.org.uk)](https://www.fca.org.uk/publication/finalised-guidance/fg21-3.pdf)

https://www.fca.org.uk/publication/finalised-guidance/fg21-3.pdf

Cash Flow Modelling – summary

- Ensure income levels are appropriate, assessed and challenged – both present and future needs
  - Basic cost of living
  - Lifestyle
  - Discretionary
  - Savings
- Determine if the advice is on a single or joint life basis,
- Consider how circumstances may change throughout retirement – future needs, lump sums etc
- Challenge the accuracy of the information
- Go beyond average life expectancy

Demo of Voyant

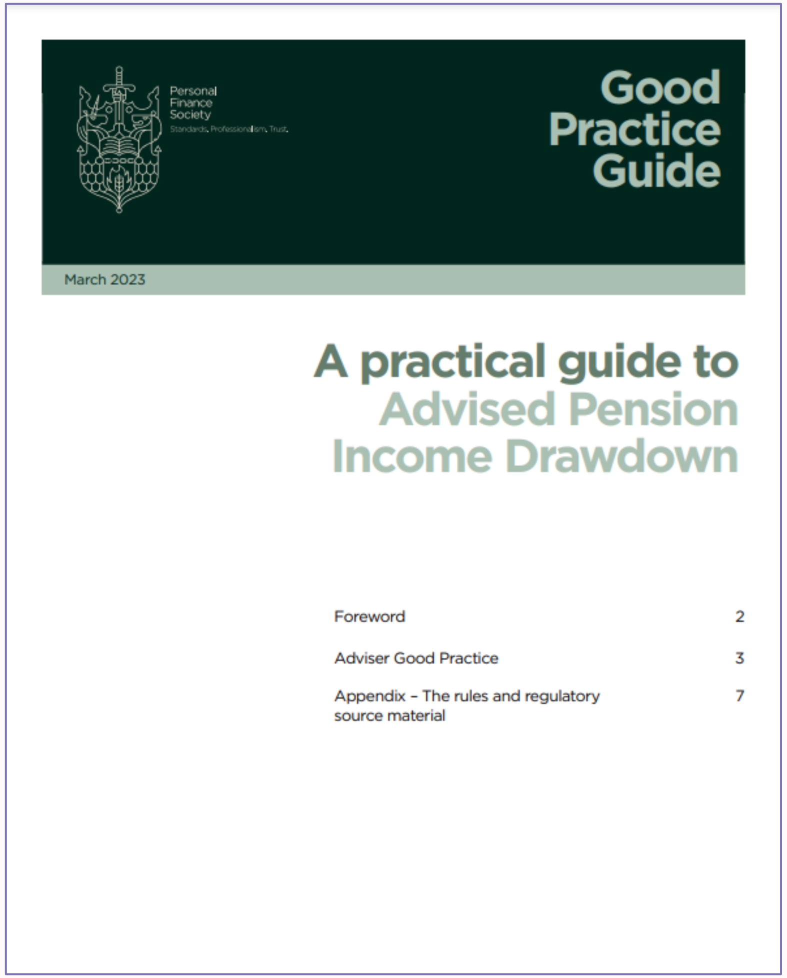


PFS good practice guide

4. Use of cashflow modelling

Robust Cash Flow modelling should stress test different combinations of retirement income solutions across a range of different market conditions, enabling the client to understand the most suitable way to meet their personalised objectives and how they might be affected by certain events such as:

- Periods of increased/decreased market volatility and different sequences of market return
- The need to increase income taken from a portfolio
- The need for any ad hoc withdrawals
- Inflation is higher (or lower) than expected/predicted
- Living longer than expected
- Future returns prove to be lower than expected
- Unpredictable events – a global recession, the need to fund long term care etc..


Personal
Finance
Society
Standards. Professionalism. Trust.

Good
Practice
Guide

March 2023

A practical guide to
Advised Pension
Income Drawdown

Source: https://www.thepfs.org/media/10129449/good-practice-guide-advised-pension-income-drawdown-c1.pdf

Section 2:

FOE: Cash flow modelling can leave you at risk of challenge about your assumptions.

‘Cash flow modelling is like letting a child mark their own homework!’

Undertaking cashflow modelling to demonstrate suitability of retirement – related advice

Cashflow modelling can project a variety of outcomes, depending on the inputs and assumptions used. When used effectively, these outcomes can help clients understand how different economic circumstances could affect their retirement income. But if used incorrectly, it can create misunderstanding and unsuitable advice.

Source: https://www.fca.org.uk/firms/undertaking-cashflow-modelling-demonstrate-suitability-retirement-related-advice

Cash Flow Modelling – summary

- Using justifiable rates of return
- Investment growth rates should be reasonable, justifiable and should be based upon a forward-looking view rather than historical returns.
- Aligned to the investments that will be recommended
- Linked to the client's attitude to risk and therefore are likely to vary across clients with different risk profiles where asset classes are different in the underlying investment.
- Apply appropriate tax rates
- These should be regularly reviewed and be consistent across different advisers.
- All charges should also be taken into account, and models should be typically run assuming above average life expectancy.

Stress testing to include:

- Consider a feasible fall in asset values at the start of any income withdrawal period
- Allow for inflation
- Showing how higher withdrawals will deplete the fund sooner

Choice of ‘smoothed’ multi asset funds
Helping investors ‘stay the path’

Expected Growth Rates
25th Feb 2024

7.7% PruFund Growth
7.0% PruFund Cautious

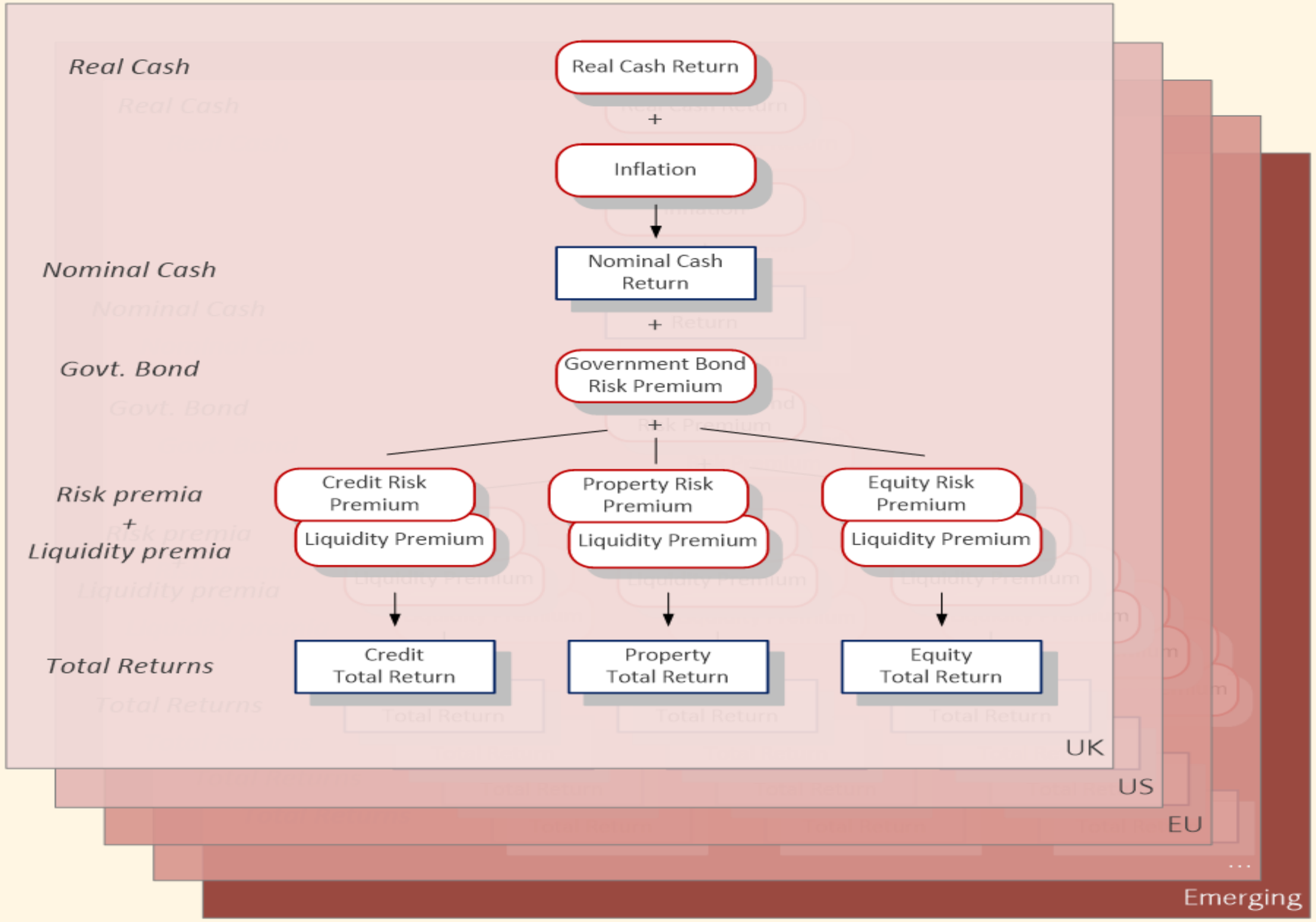
- Realistic return expectations are key to retirement planning
- The Expected Growth Rate (EGR) is an estimate of the expected investment return over the long-term
- Our in-house stochastic asset model is used to generate a distribution of possible future investment returns (having regard to the current asset mix in each fund) over a 15-year period

https://www.mandg.com/dam/pru/shared/documents/en/prue10294.pdf The table shows the current Expected Growth Rates, gross of all product charges (including Annual Management Charges).

Setting the EGR and SAA

Translating quantitative and qualitative research into implementable portfolios

Capital Market Views



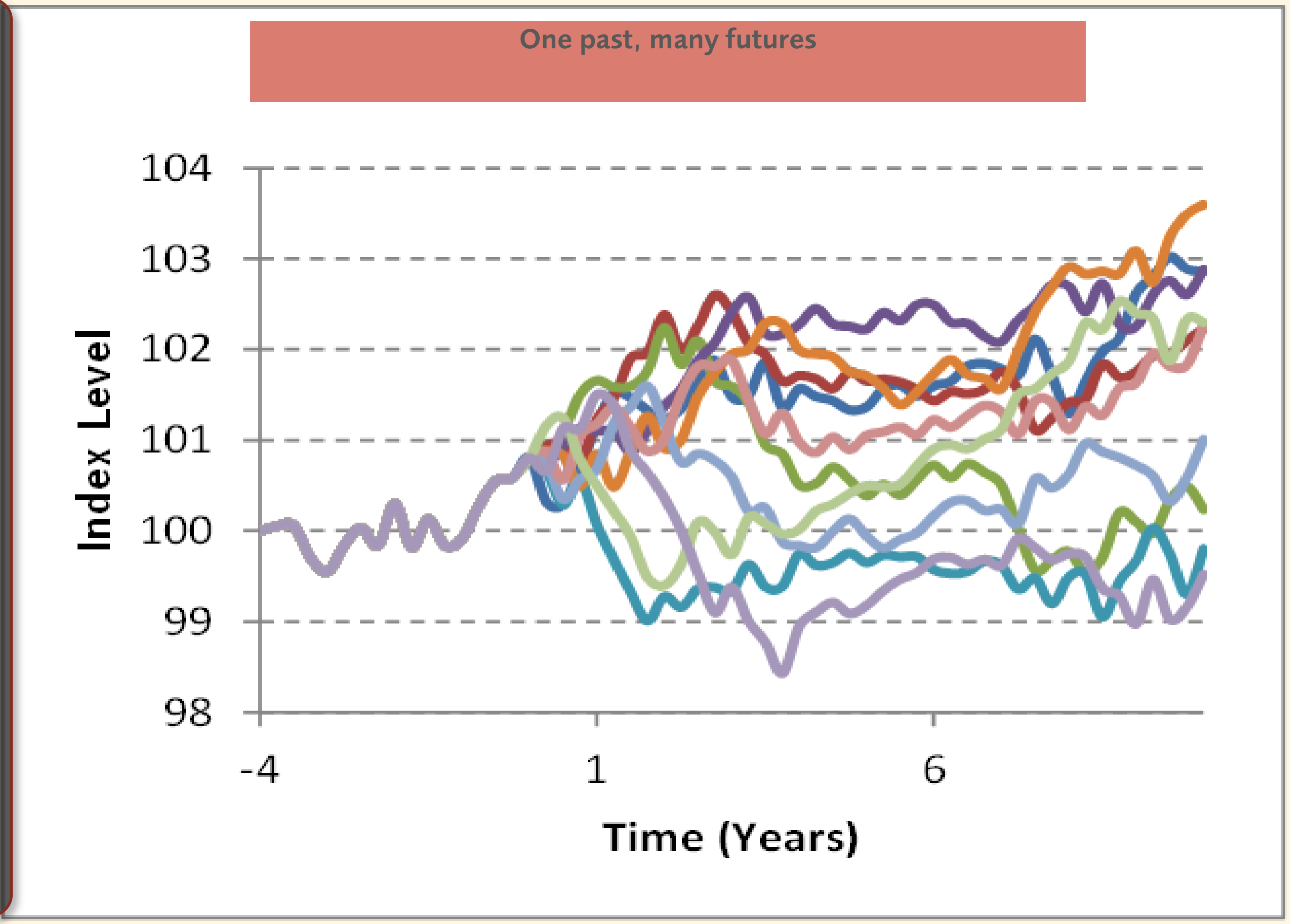
1. Capital Market Views and Thematic Research

- Historical capital market returns and analysis
- Bespoke ex-ante research and modelling
- Market insight internal/external research
- Quality position papers on new asset classes and thematic trends

SAA setting process at a glance

Translating quantitative and qualitative research into implementable portfolios

Scenario Modelling



2. Qualitative and Quantitative Scenarios

- One realised past but many potential futures
- Combination of quantitative and qualitative methods
- In-house tools and knowledge acquired over many years

SAA setting process at a glance

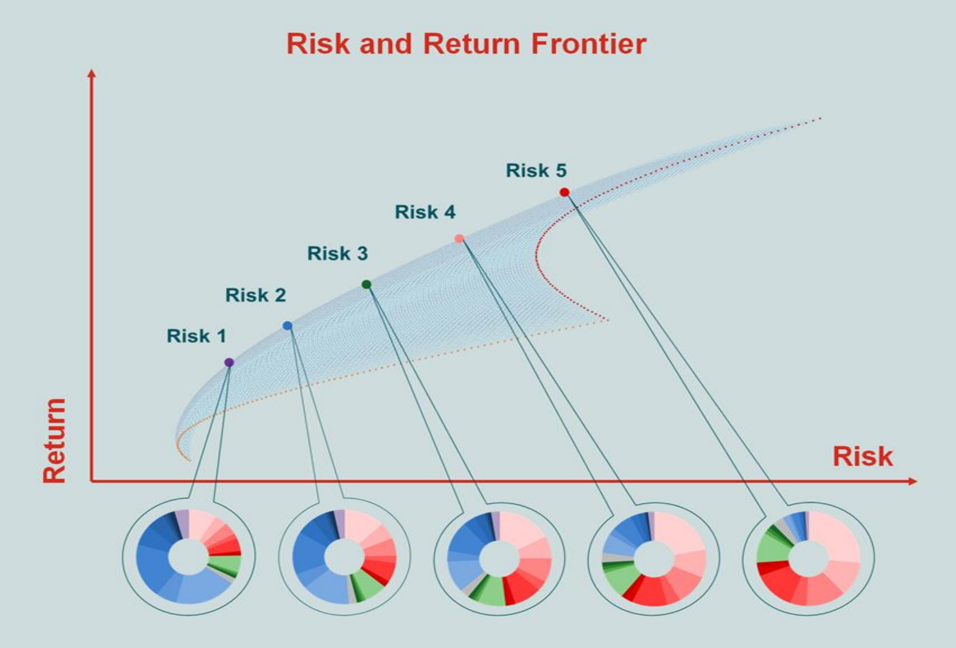
Translating quantitative and qualitative research into implementable portfolios

3. Portfolio Construction

Construct a bespoke portfolio to allow for:

- Risk Appetite
- Liquidity needs
- Cost constraints, regulations, etc.

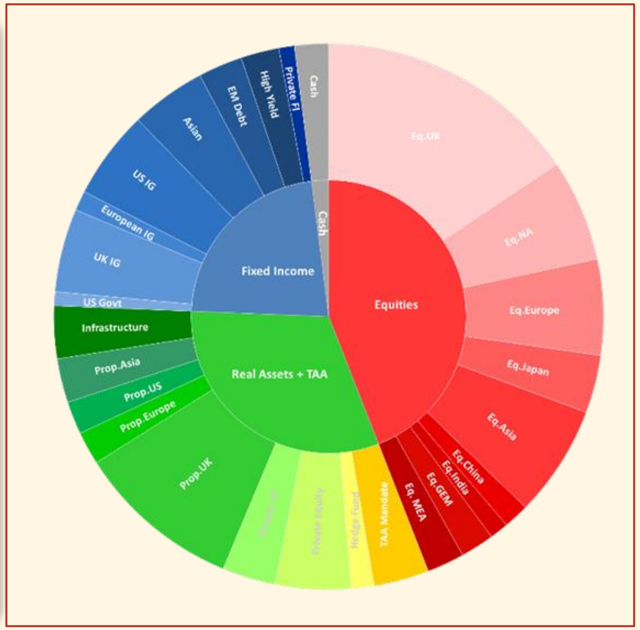
Portfolio Construction



4. SAA

- Leads to a return optimised portfolio, diversified across asset classes and geographies
- Tried-and-tested framework with proven track record

SAA



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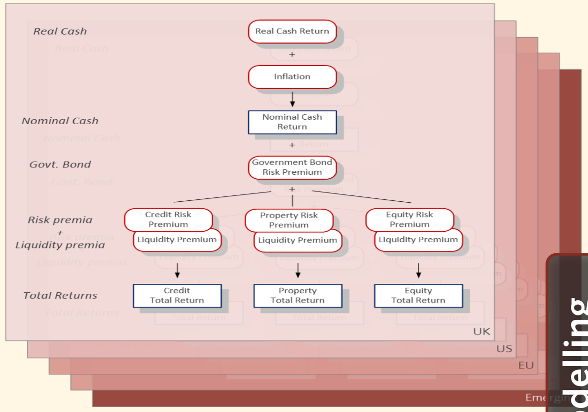

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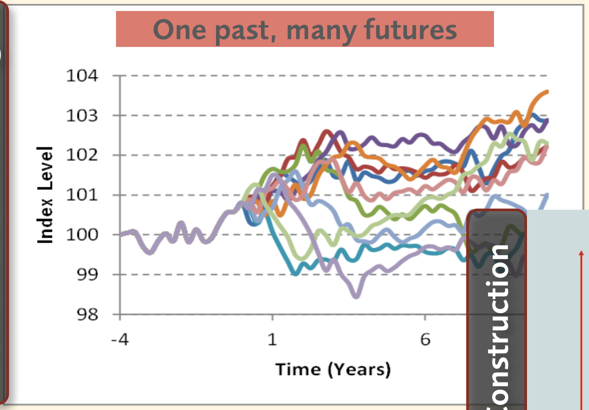

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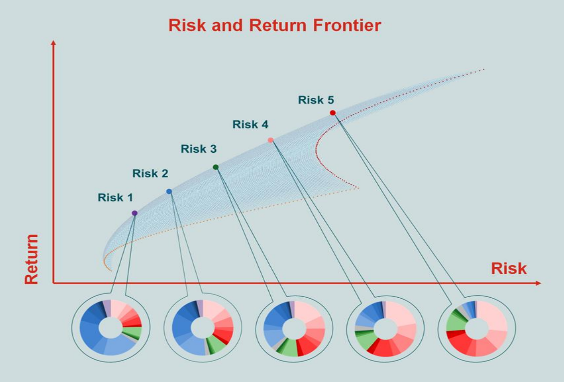

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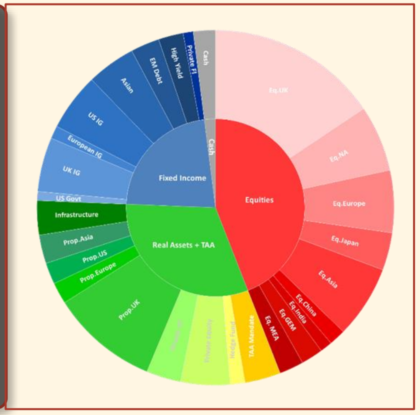


4. SAA

- Leads to a return optimised portfolio, diversified across asset classes and geographies
- Tried-and-tested framework with proven track record

Screen shot of ONS

Age

- | 62 | +

Sex

Male | **Female**

Calculate your life expectancy

Your average life expectancy is

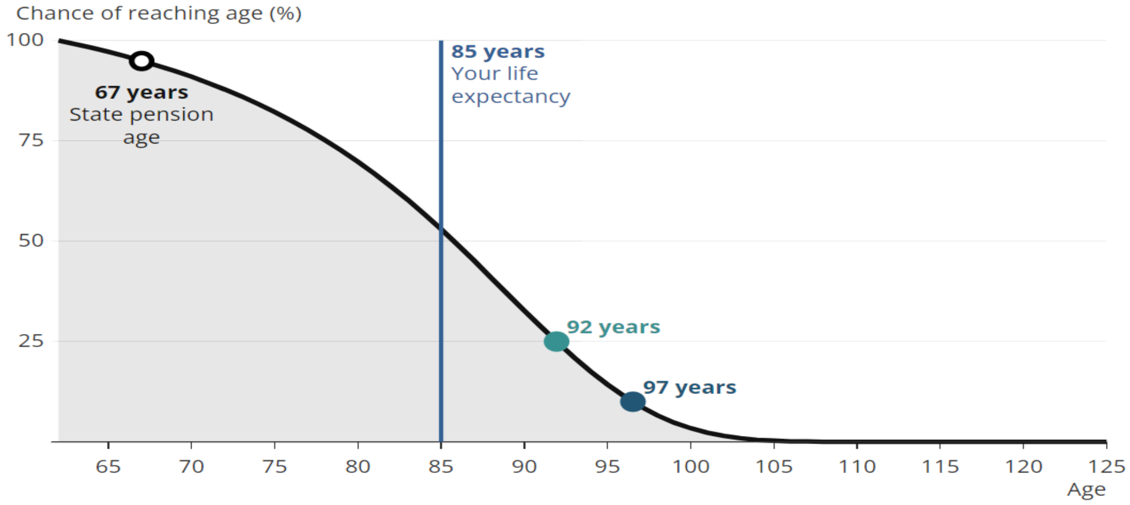
85 years

However there's a chance you might live longer...

92 years
1 in 4 chance

97 years
1 in 10 chance

100 years
3.4% chance



State Pension ages are approximate. For your actual State Pension age, please refer to the State Pension age timetable

Source: https://www.ons.gov.uk/peoplepopulationandcommunity/healthandsocialcare/healthandlifeexpectancies/articles/lifeexpectancycalculator/2019-06-07

Section 3:

Cashflow modellers are the friend of the adviser….

FCA – Undertaking cashflow modelling to demonstrate suitability of retirement – related advice

Cashflow Modelling

The FCA released a separate article on cashflow modelling. The findings highlighted in the article were as follows

1. Firms relying on information without considering accuracy
2. Using justifiable rates of return
3. Planning for uncertainty (using a consistent approach, planning beyond average life expectancy and stress testing models)
4. Consumer understanding (consider consistency of communications)
5. Consider the output (such as ensuring appropriate to objectives, availability of assets modelled for income, impact of tax)

Further information can be accessed here https://www.fca.org.uk/firms/undertaking-cashflow-modelling-demonstrate-suitability-retirement-related-advice

What is the consumer duty?

Consumer Principle

- A firm must act to deliver **good outcomes for retail customers**
- **Principle 12**

Cross-cutting rules

Firms must

- Act in **good faith** toward retail customers
- Avoid **foreseeable harm** to retail customers
- Enable and support retail customers to pursue their **financial objectives**

Four outcomes

- Products and services
- Price and value
- Consumer understanding
- Consumer support

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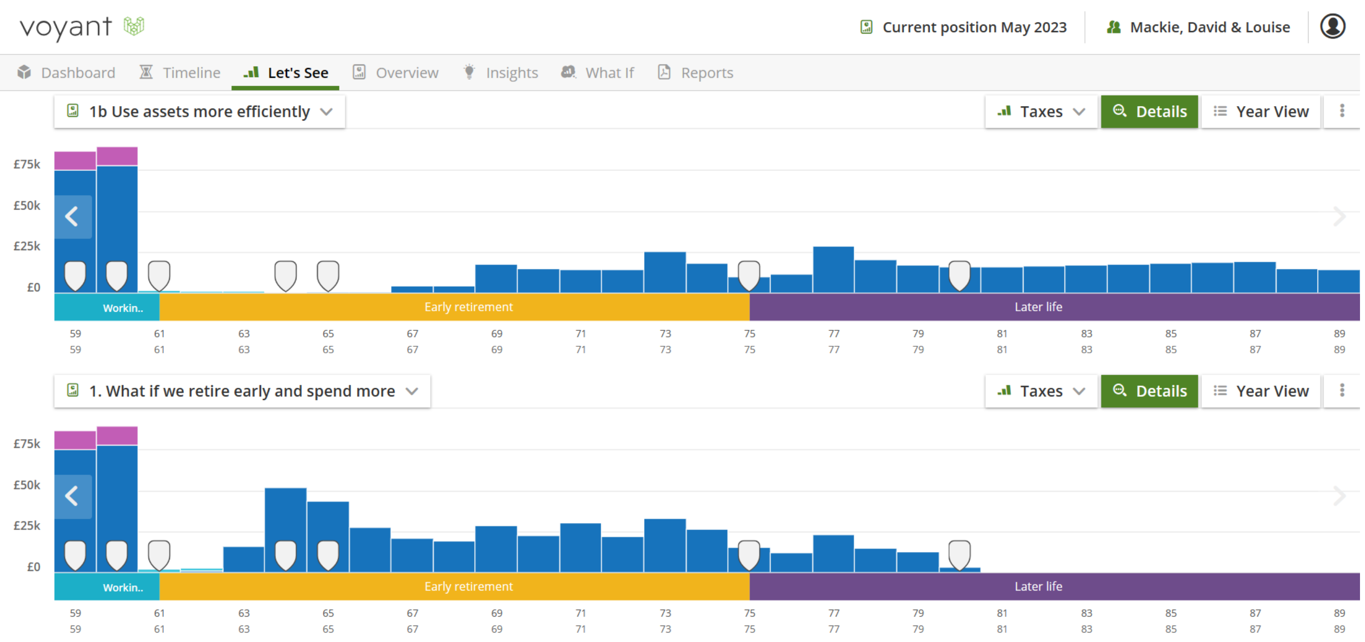
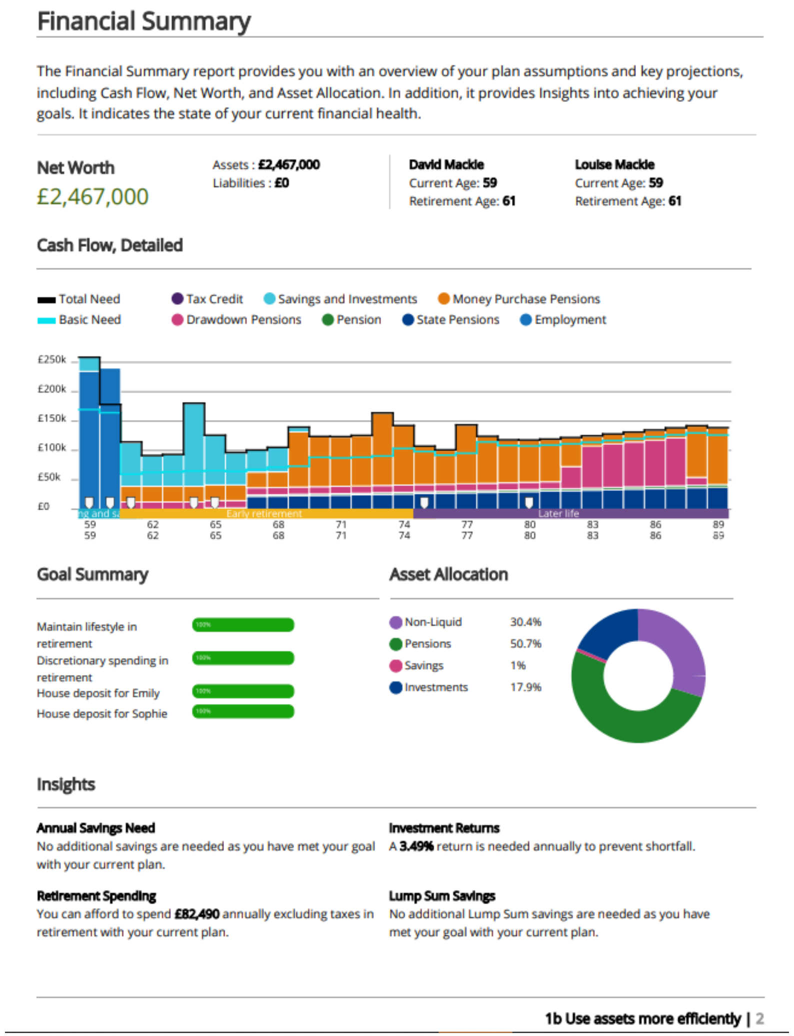
Consumer duty and cashflow modelling

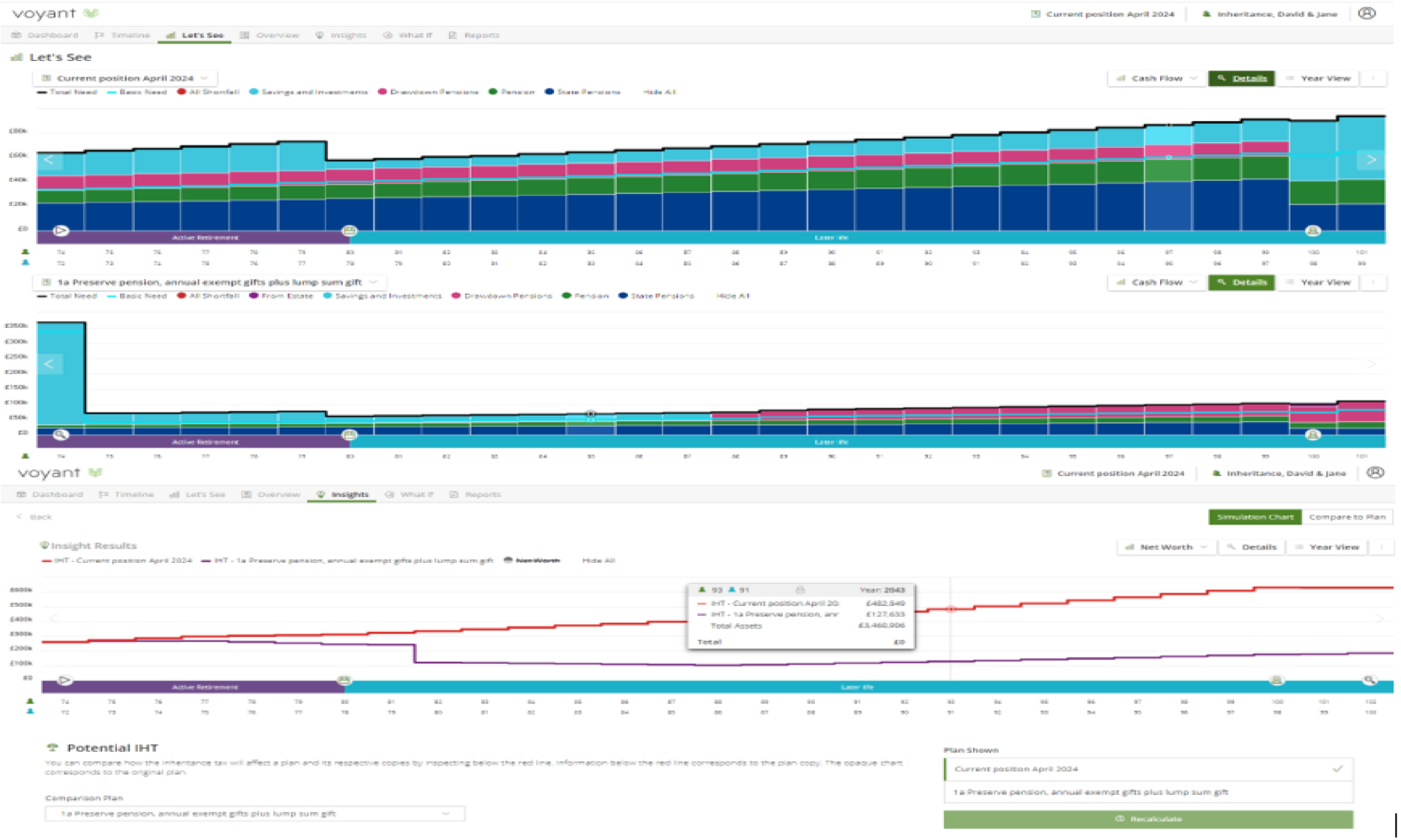
- How can cashflow modelling help you meet Consumer Duty requirements?
- Demonstrate that you have met the clients needs and objectives by tracking their financial goals
- Enhance client understanding by enabling them to visualize their financial future
- Show how your advice can add value by reducing tax, passing more assets to future generations
- Stress test for longevity, investment risk, spending risk





Demo of Voyant

Inheritance tax planning features in Voyant



What is the next evolution in cashflow modelling?

The next evolution in cashflow modelling?

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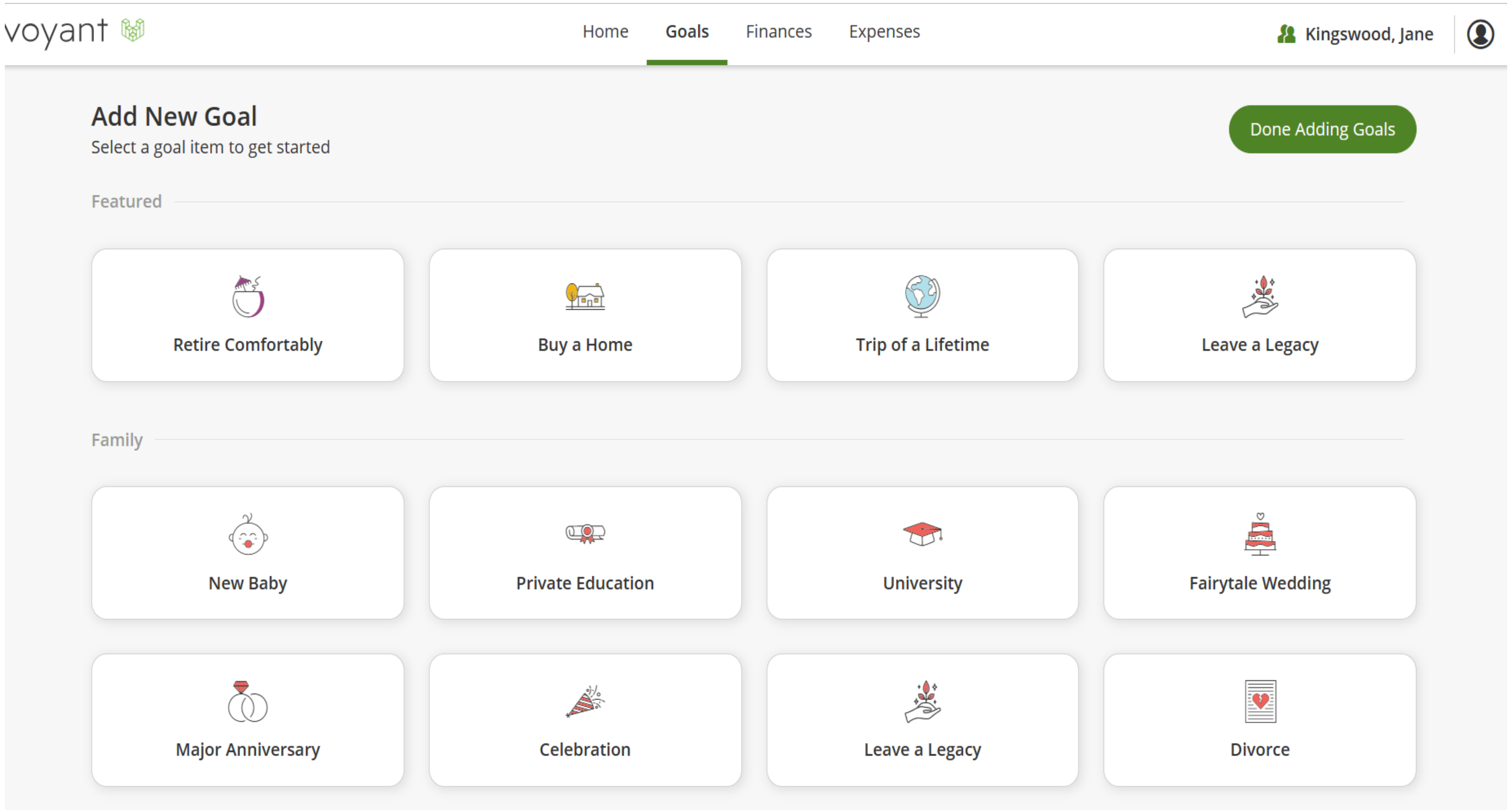
- Invite your clients to interact with cashflow modelling using Client Go - for onboarding new clients or review meetings with existing clients – focussing on capturing client goals

- Integrations with back office systems eg. IO, Curo, Salesforce, IRESS



Evidence based income strategy

Adapted for a cashflow modelling process

1. Client aims and objectives
2. Income needs analysis
3. Assess risk
4. Optimal withdrawal
5. Investment solution
6. Continually assess/review

Digital fact find and / or expenditure analysis

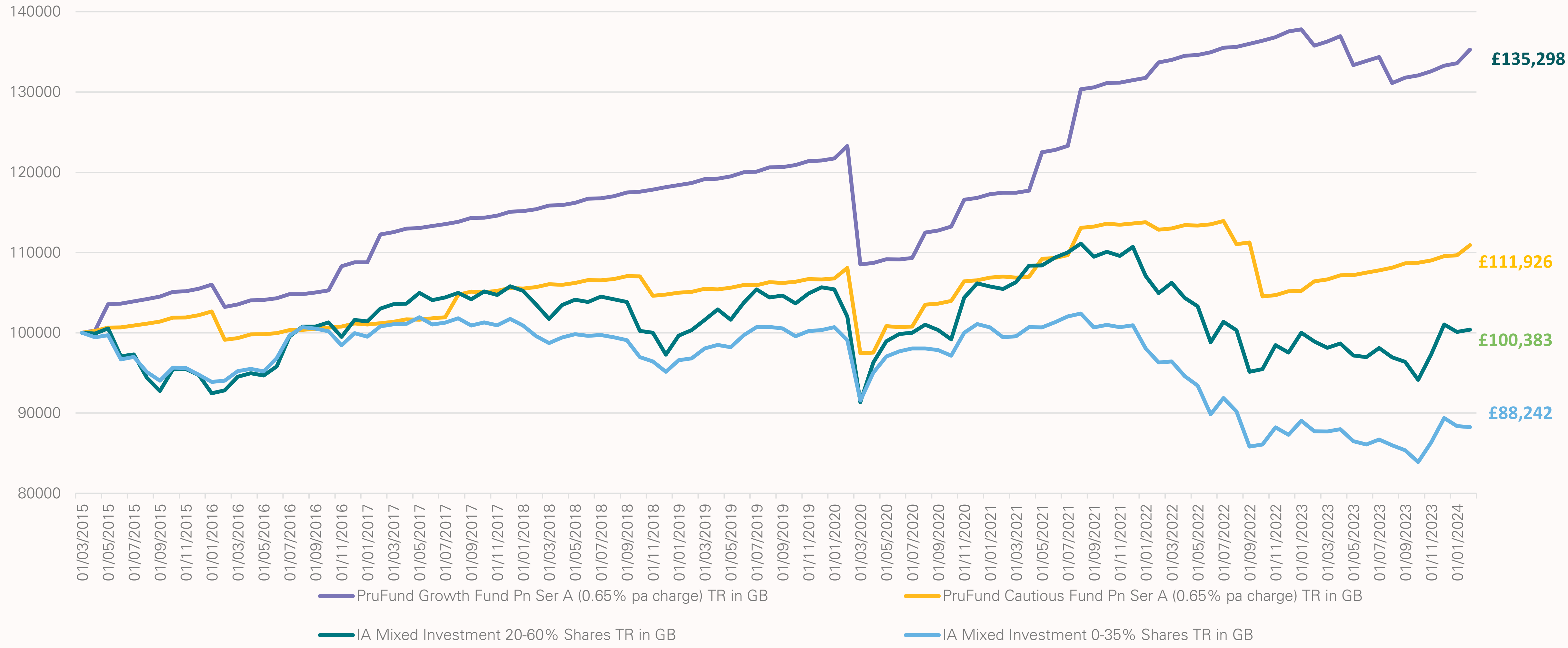
→

Cash flow modelling with process for C4L / stress testing. Establishing the most tax efficient withdrawal across tax wrappers
Assess 'sustainability' of income or impact of situations

→

Cash flow modelling linked with the investment process, relevant assumptions & stress testing. Integral part of the client review to assess sustainability & suitability

The impact of withdrawals



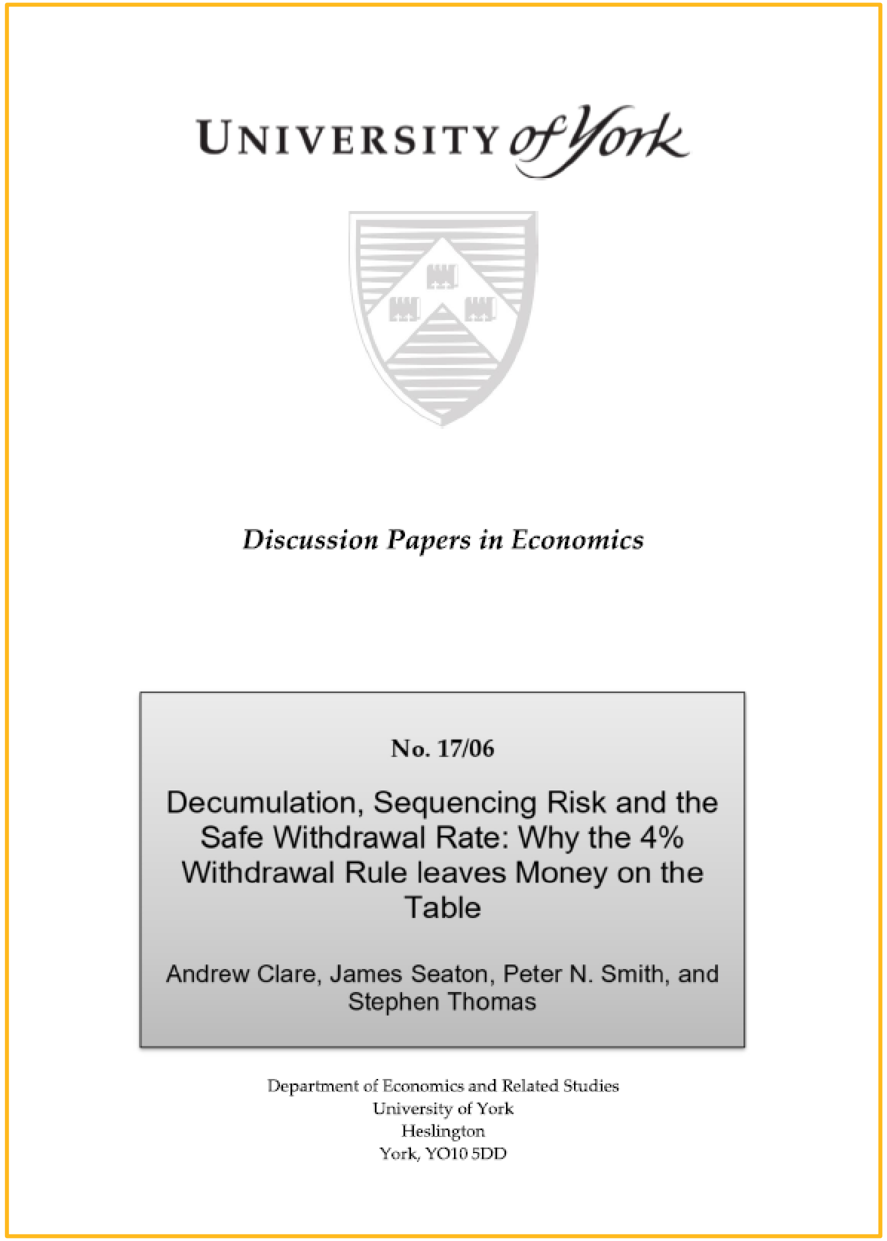
Figures are for PruFund Cautious Pn Ser A and PruFund Growth Pn Ser A and are from 31 Mar 2015 to 31 Mar 2024. Initial investment of £100,000 and withdrawals of £250 per month taken at the end of the month. The PruFund figures include a representative annual charge of 0.65% and any additional investment expenses, but not any product or advice charges, so the amount an investor would get back would be less than shown here. Some, if not all, of the funds comprising the IA sector averages are net of fund charges. This example represents a typical situation. It is not related to any particular individual and does not recommend that course of action. Past performance is not a reliable indicator of future performance. **The value of an investment can go down as well as up. Your clients may get back less than they have paid in.** Source: FE Analytics

University of York

We find two powerful conclusions:

First that smoothing the returns on individual assets by simple trend following techniques is a potent tool to enhance withdrawal rates.

Secondly, we show that while diversification across asset classes does lead to higher withdrawal rates than simple equity/bond portfolios, 'smoothing' returns in itself is far more powerful a tool for raising withdrawal rates.



UNIVERSITY of York

Discussion Papers in Economics

No. 17/06

Decumulation, Sequencing Risk and the Safe Withdrawal Rate: Why the 4% Withdrawal Rule leaves Money on the Table

Andrew Clare, James Seaton, Peter N. Smith, and Stephen Thomas

Department of Economics and Related Studies
University of York
Heslington
York, YO10 5DD

Source: https://pure.york.ac.uk/portal/en/publications/decumulation-sequencing-risk-and-the-safe-withdrawal-rate(a13c955f-a75c-4473-aea0-ab8ba4d8b926)/export.html

Aims and objectives checklist?

This is for UK advisers – feel free to show it to your clients.

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Retirement Aims and Objectives Checklist

This 'Checklist' is designed to help you with your client conversation when recommending your client's first move to retirement or taking benefits from their pension. It should not be seen as advice and you should be comfortable that this meets your regulatory requirements.

There may be wider holistic requirements you need to consider (including, but not limited to) any DB transfers, guaranteed benefits, your client's aims and objectives, their current personal circumstances and any vulnerability. You should also consider whether or not the advice of a pension transfer specialist is also applicable.

Client name

Adviser name

Clients Retirement Aims and Objectives

Will the client be fully or partially retiring? Fully ☐ Partially ☐ Not retiring ☐

If the client is not retiring, what is the rationale for taking benefits?

Have you discussed risk with the client and could the client replay these discussions to you to demonstrate their understanding, and have you recorded this? Yes ☐ No ☐

How does the client feel about investment volatility?

Is the client aware of pound cost averaging during accumulation, and the converse during decumulation? Yes ☐ No ☐

Is avoidance of capital loss a priority? Yes ☐ No ☐

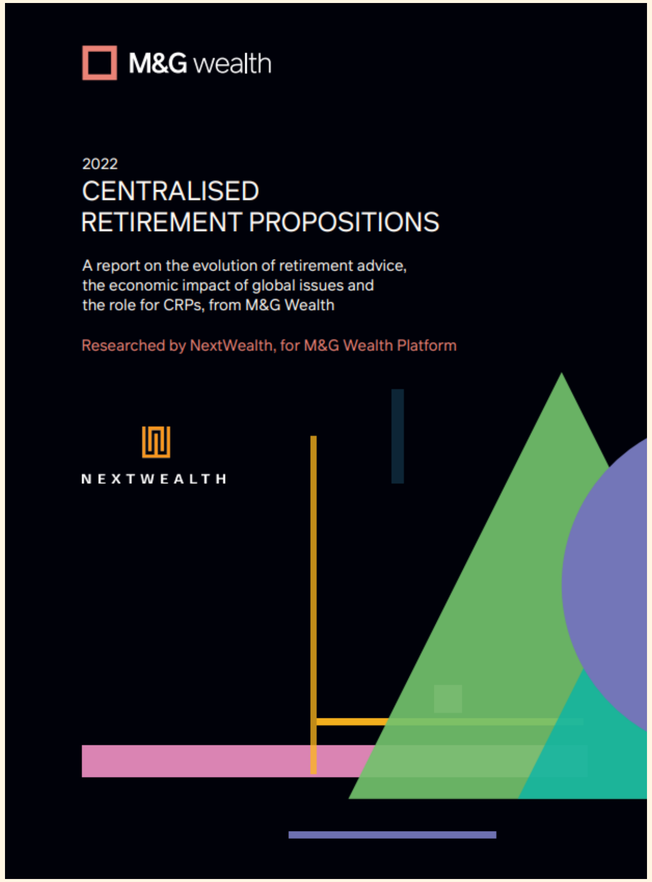
If the fund drops in value what would they do (other sources of income etc)?

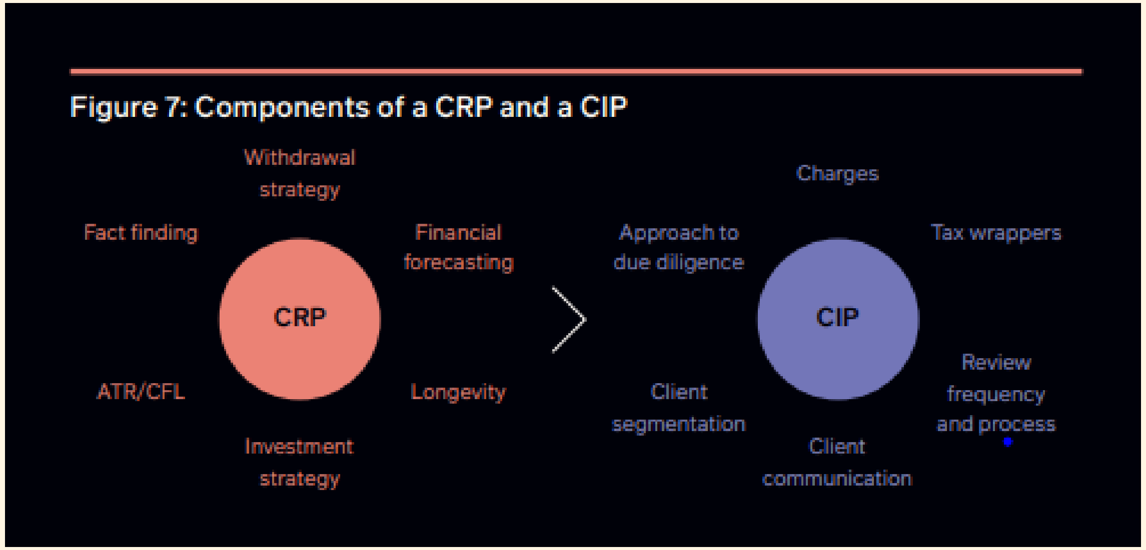
Does the client have short term concerns about the markets? Yes ☐ No ☐

Does the client have any longer term concerns?

Source: https://www.mandg.com/dam/pru/shared/documents/en/frpm100580106.pdf

Centralised Retirement Proposition





Source: https://www.mandg.com/wealth/platform/knowledge/consumer-duty#guides
560 (platformservices.co.uk)

Contact Voyant

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FREE 30 DAY TRIAL of AdviserGo

- https://openwork.planwithvoyant.co.uk
- When prompted for a registration code use - OPENWORK_VOYANT

For questions, contact support@planwithvoyant.co.uk

Our learning objectives for the session

1

Explain how Cashflow modelling can be used in the advice process to help clients visualise their retirement journey.

2

Demonstrate how Cashflow modelling can help clients understand the risks in retirement.

3

Demonstrate your capacity for loss process by effective stress testing of client outcomes.

4

Demonstrate how Cashflow modelling can assist advisers with their Consumer Duty requirements.

5

Explore DB transfers in relation to regulatory requirements and good practice for Cashflow modelling.

6

Describe how Cashflow modelling can be used for effective IHT planning.