M&G wealth

Is it Friend, Foe or FAD – Cashflow modelling is for life not just retirement!

with

FinCalc

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.

M&G plc is a company incorporated and with its principal place of business in England, and its affiliated companies constitute a leading savings and investments business.
M&G plc is the direct parent company of The Prudential Assurance Company Limited. The Prudential Assurance Company Limited is not affiliated in any manner with Prudential Financial, Inc, a company whose principal place of business is in the United States of America or Prudential plc, an international group incorporated in the United Kingdom.

Important notice: FinCalc

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Data sharing

As M&G Wealth (part of M&G plc) and FinCalc have teamed up to run this seminar, event data and feedback from this seminar will be shared between M&G Wealth and FinCalc accordingly. By registering and/or attending this seminar you have agreed to these terms. For more information on each company's data handling process, please visit their privacy notices on their websites.

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

FinCalc:
Explain the impact of different retirement income strategies.

Chartered Insurance Institute Accredited

CISI Chartered Institute for Securities & Investment ENDORSED CPD

Cashflow week

voyant

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

FE CashCalc

Explore Digital fact finds and software integration and how Cashflow modelling can be used for protection planning.

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Explain the impact of different retirement income strategies

Provider insight

FinCalc

Gavin Shears, Senior Product Consultant

Gavin has been working in the Financial Services industry for over 20 years. Gavin joined O&M in 2005 as a paraplanner and transfers technician. After achieving Pension Transfer Specialist status, he moved to the IFA team in 2008.

Gavin now works as a key component in the FinCalc arena using his knowledge of Financial Services and the advice process to help with the continuous development of the FinCalc financial planning tools.

Section 1:

Cashflow modelling is just a FAD!

Cashflow modelling in the press

'The future of cashflow modelling' – Money Marketing Nov 2020

Started the debate around how important cashflow modelling could be in the market.

Consumer duty has made the market think more about this as we are seeing more and more IFA networks looking to provide modelling tool solutions for their advisers and building advice processes using these tools.

Some headlines this year alone…

'How can technology aid advisers with Consumer Duty compliance?' – Professional Adviser Aug 2023
'Cashflow planning can 'ensure' consumer duty requirements are met' – FTAdviser Jul 2023
'Illustrating the value of protection with cash flow modelling' – Cover magazine May 2023
'Can technology improve the service for high-net-worth clients?' – Money Marketing May 2023
'Embrace cashflow modelling or face extinction' – Money Marketing April 2023
'What are the benefits of cash flow modelling?' – FTAdviser Feb 2023

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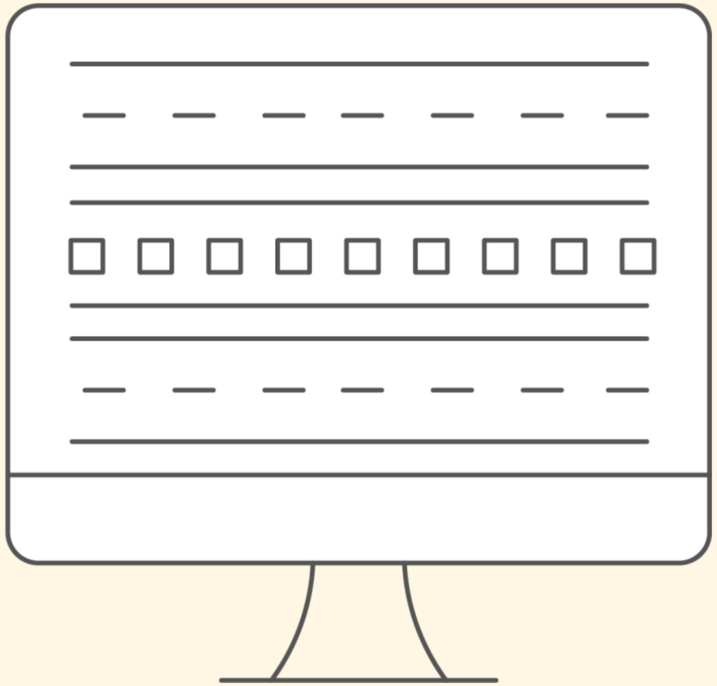
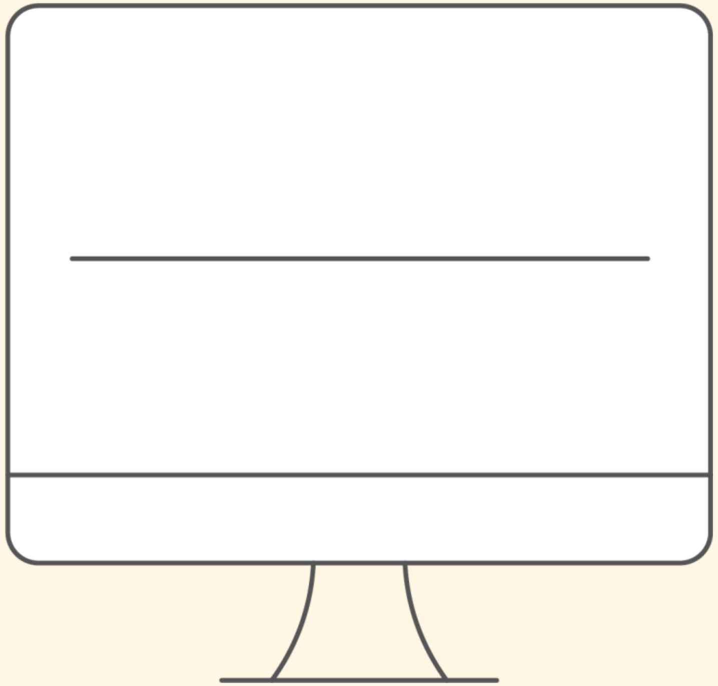
Types of cash flow modelling

Stochastic



Deterministic



<u>Assumptions:</u>

- Reasoned and reasonable
- Reflect the assets that you're invested in
- Stress test
- Go beyond average life expectancy

How do I measure capacity for loss?

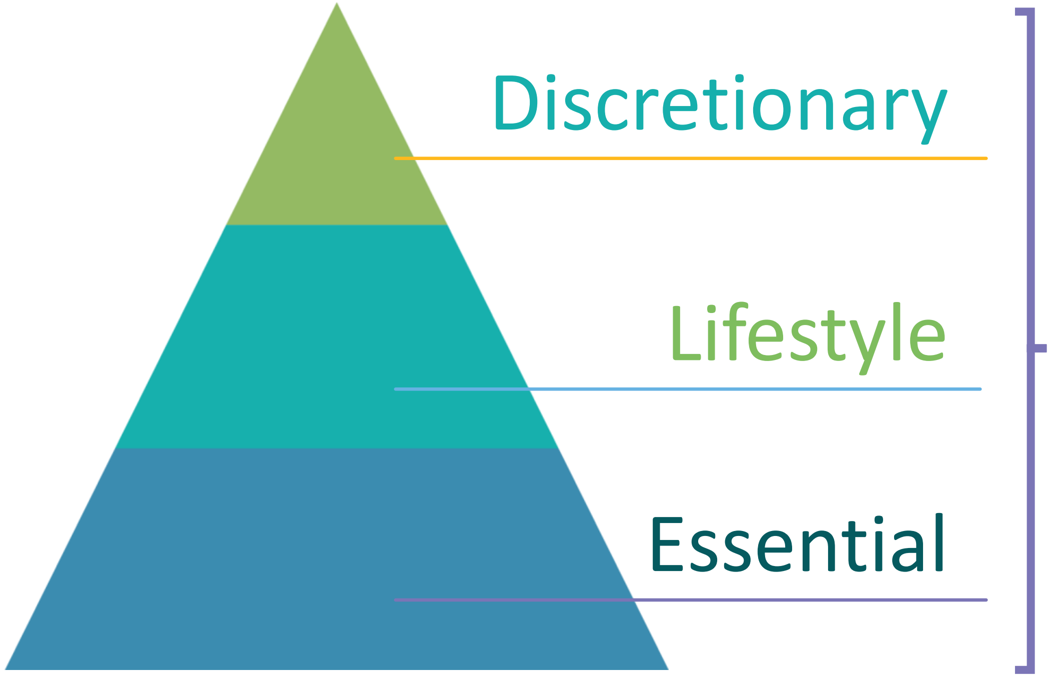
Client ABILITY

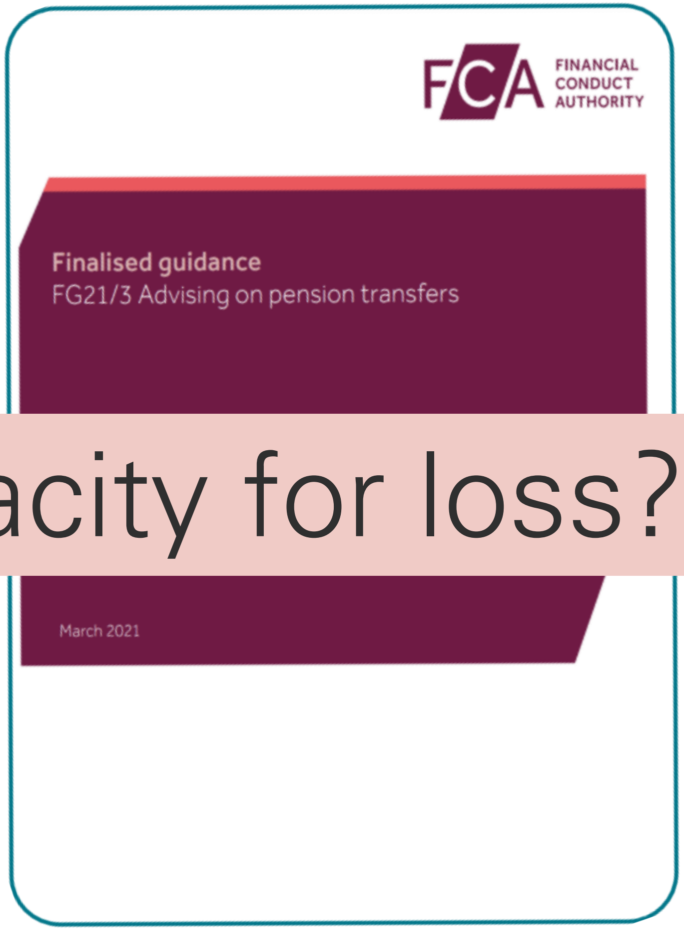
What expenditure?

Client discussion

All about the Numbers

Establishing the need & potential cross over from FG21/3




FINANCIAL CONDUCT AUTHORITY

Finalised guidance
FG21/3 Advising on pension transfers

March 2021

Capacity for loss?

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

Demo of FinCalc

Stress testing demo

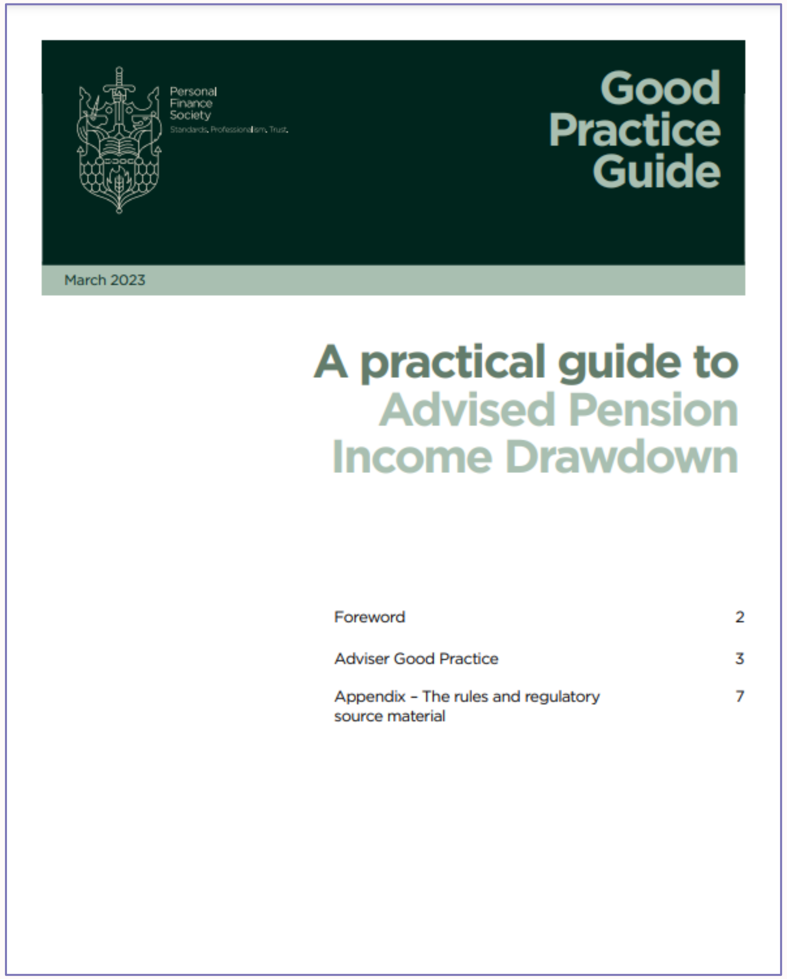
See replay recoding

FinCalc

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..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Good Practice Guide

March 2023

A practical guide to Advised Pension Income Drawdown

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

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

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!’

‘In preparing for battle I have always found that plans are useless, but planning is indispensable’

Dwight Eisenhower

Cash flow modelling & DB Transfers

FINANCIAL CONDUCT AUTHORITY

COBS 19 Annex 4A Appropriate pension transfer analysis

5	Where a *firm* prepares a cashflow model, it must:	
	(1)	produce the model in real terms in line with the CPI inflation rate in *COBS 19 Annex 4C*1R (4)(d);
	(2)	(if the net income is being modelled) ensure that the tax bands and tax limits applied are based on reasonable assumptions;
	(3)	take into account all relevant tax charges that may apply in both the *ceding arrangement* and the *proposed arrangement*; and
	(4)	include stress-testing scenarios to enable the *retail client* to assess more than one potential outcome.

Source: https://www.handbook.fca.org.uk/handbook/COBS/19/Annex4A.html

DB FG 21/03 – APTA and cashflow modelling

5.19 You may want to use cashflow modelling to demonstrate to the client the extent to which they are able to meet their needs and objectives throughout retirement whether they transfer or remain in the scheme. A cashflow model can factor in the client's other retirement provision. It can also demonstrate the investment risk clients would be taking and when they might run out of money. Firms who use a cashflow model should carry out projections that go beyond average life expectancy as clients may live well beyond the average.

Poor Practice –
A firm undertook cashflow modelling for their clients as part of APTA. Where clients wanted an index-linked income for life, they assumed the same rate of withdrawal of 4% for every client irrespective of their age, the potential returns from the proposed destination or the charges that would apply.
The firm also failed to stress test the model. This meant that the firm failed to consider what the client actually needed or wanted as a starting income, and the extent to which income needs could be met over time as a result of market downturns.
The cashflow model was too generic to be useful to clients and increased the risk that they think that the rate of return was guaranteed.

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

DB FG 21/03 – APTA and cashflow modelling

Good Practice –
A firm used cashflow modelling to show how income from the client's different assets would start at different ages and meet their essential and lifestyle needs up to 100 years old. The firm included relevant charts in its suitability reports to show how discretionary spend might need to reduce over time, particularly if there was a market crash. The firm used the same growth rates in its cashflow modelling as those used in the KFI, so the client could see consistent outcomes for the proposed transferred monies.

Poor Practice –
A firm undertook cashflow modelling but did not assume that tax bands would increase with inflation each year. This meant the firm gave the client misleading information about net income from both the DB scheme and the proposed DC arrangement. The firm used growth rates that were 2% higher than those used in the KFI but provided no justification or explanation for these. They gave the client several pages of modelling output containing tables of numbers that were not explained

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

Example
FCA Retirement Income Advice Survey

77. What assumptions are used for your firm's CFM?
(select all that apply)

- ☐ Health and longevity
- ☐ Additional/other income in receipt
- ☐ Marginal Tax rate applicable
- ☐ Inflation
- ☐ Growth rates
- ☐ Customer income needs, including essential expenditure, and objectives
- ☐ Discretionary expenditure
- ☐ Investment charges assumed
- ☐ Investment charges actual
- ☐ Investment risk
- ☐ Investment growth
- ☐ Totality/level of charges
- ☐ Future inheritance
- ☐ Spouse pension (on death of spouse)
- ☐ Other

Choice of 'smoothed' multi asset funds
Helping investors 'stay the path'

7.0% PruFund Cautious

7.7% PruFund Growth

6.5% Risk Managed PruFund 1

6.9% Risk Managed PruFund 2

7.4% Risk Managed PruFund 3

7.7% Risk Managed PruFund 4

8.0% Risk Managed PruFund 5

6.5% PruFund Planet 1

6.9% PruFund Planet 2

7.4% PruFund Planet 3

7.7% PruFund Planet 4

8.0% PruFund Planet 5

Lower risk ↔ **Higher risk**

- 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

Source: M&G Treasury & Investment Office as at 19th July 2023,
The table shows the current Expected Growth Rates, gross of all product charges (including Annual Management Charges).

Section 3:

Cashflow modellers are the friend of the adviser….

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

Consumer duty and cashflow modelling

(1) Cashflow can help show an understanding of your client and how your service helps meet their needs and objectives.

(2) Quantifying value by showing how your advice can reduce tax. Pre and post meeting survey questions for valuable MI.

(3) Cashflow provides the graphical output to engage clients on a different level and enhances their understanding.

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Consumer duty and cashflow modelling

Pre and post meeting survey questions for valuable MI.

Post Meeting Questions

0% complete

Please answer the following questions on a scale of 1-5 (1 being low & 5 being high)

How certain do you feel about your financial future?

	Bob
1	○
2	○
3	○
4	○
5	○

Scale of 1-5

How well do you understand the products and investments you have?

	Bob
1	○
2	○
3	○
4	○
5	○

Scale of 1-5

From our recent meeting, what helped to improve your understanding of your financial position?

Bob

FinCalc

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

Demo of FinCalc

Best practice & case studies on the system

Including the 6th individual learning outcome

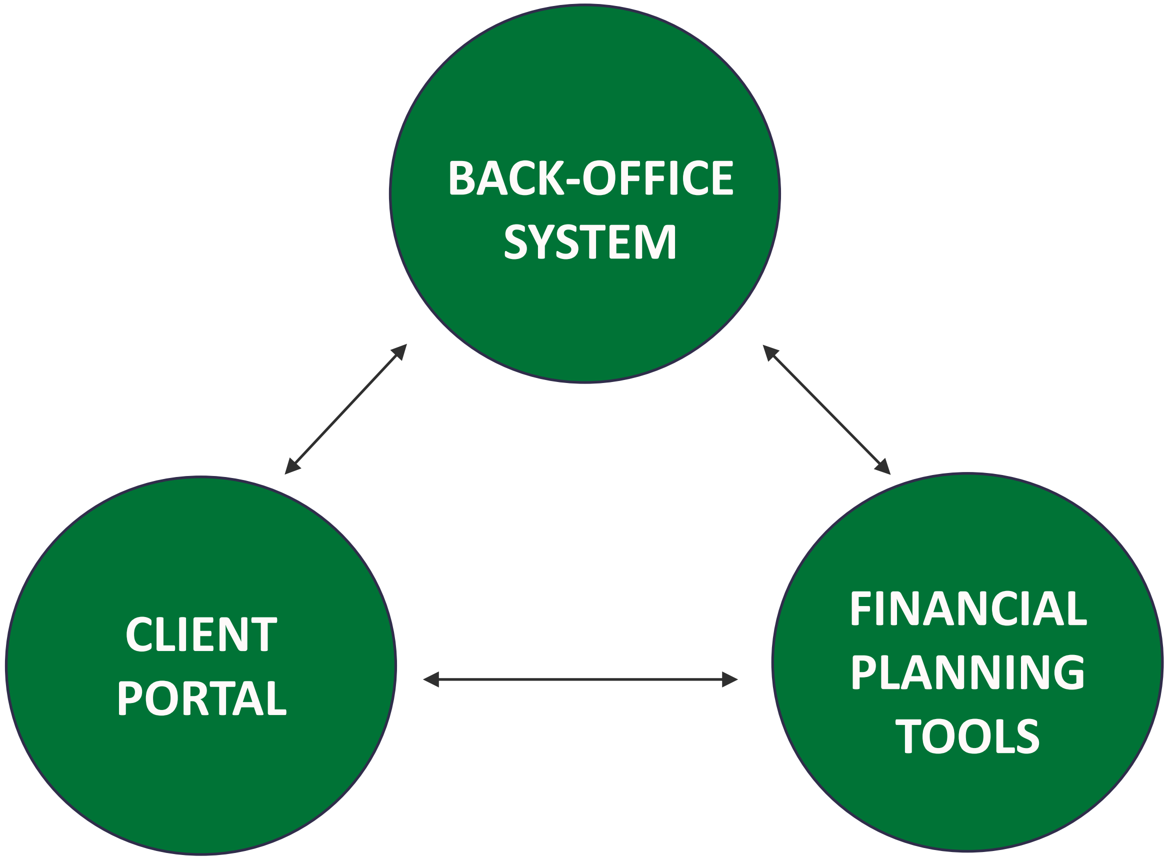
See replay recoding

FINCALC

What is the next evolution in cashflow modelling?

The next evolution in cashflow modelling?

- Eco-system incl. Back-Office, Client Portal and Financial Planning Tools. <u>Huge time-savings for advisers & consistent data!</u>
- Client Portal => Client reviews, fact finds, document uploads, DocuSign, secure messaging.
- Advisers can review data and update or create in Back-Office.
- Data available to use within cashflow, IHT modelling & financial calculators.
- Reports uploaded to Back-Office.



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Evidence based income strategy

Adapted for a cashflow modelling process

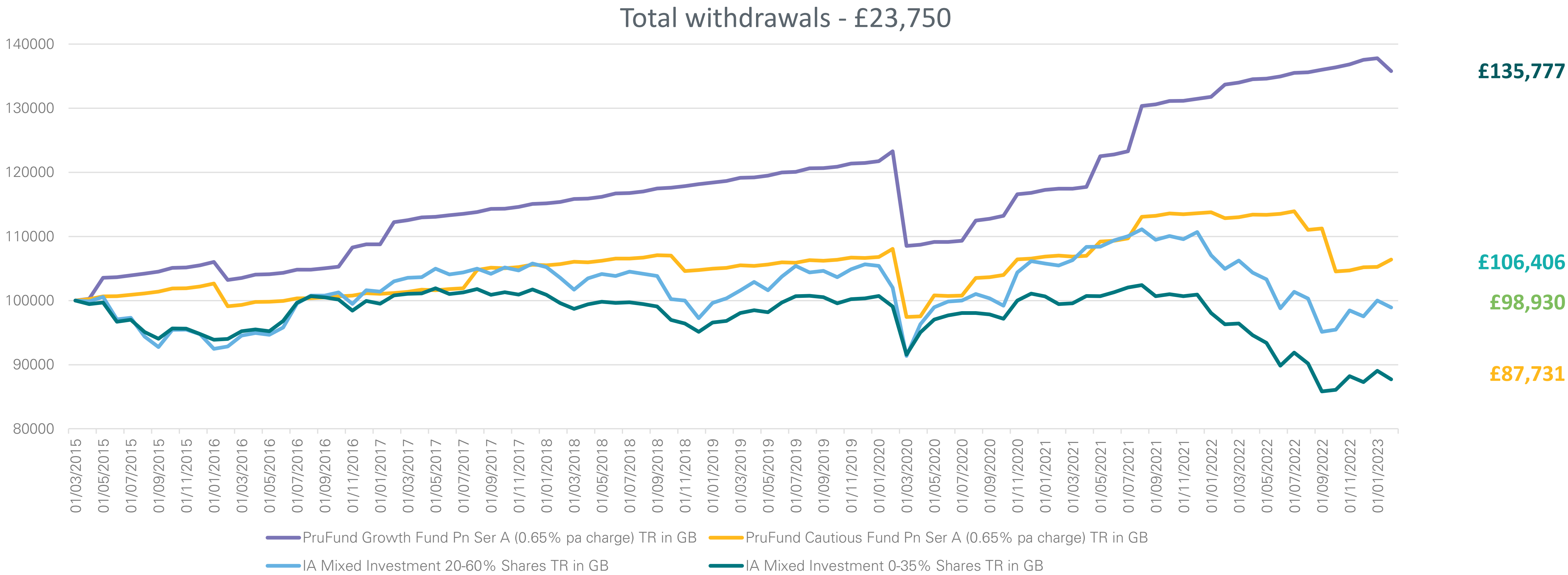
1	2	3	4	5	6
Client aims and objectives	Income needs analysis	Assess risk	Optimal withdrawal	Investment solution	Continually assess/review

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 Jan 2023. 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

Due diligence

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

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PruFund

Target Market Information

This is based on Prudential's opinion and doesn't take into account individual circumstances.

What are the PruFund Funds?

The PruFund funds aim:

- grow your client's money over the medium to long term (5 to 10 years or more).
- protect customers from some of the short-term ups and downs of direct stock market investments by using an established smoothing process.

PruFund funds are invested in the Prudential With-Profits Fund, which is one of the largest with-profits funds in the UK. 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.

Your client's capital is at risk.

What type of investor is this suitable for?

Retail investor	✓
Professional investor	✗

How much knowledge does your client have?

We've based these on the standard definitions of types of investors included in the European Financial Management Association (z).

		Target customer
Basic investor	• Basic knowledge of how investments work • Can make decisions based on regulated and authorised documents or with the right advice • No experience of the financial industry • Usually a first-time investor	✓
Informed investor	• Average knowledge of how investments work • Can make an informed decision based on regulated and authorised documents or with their own knowledge • Understands specific factors or risks • Some experience of the financial industry	✓
Advanced investor	• Good knowledge of how investments work • Good financial industry experience • Has access to professional investment advice	✓

Key: Yes ✓ No ✗ In some circumstances /

What's your client's capacity to lose capital?

How much capital loss can they take?	Definition	Target customer	Comments
Unlimited	Clients can afford to lose all capital.	✓	You can offer this fund to a client who is able to lose all capital.
Limited	Clients are looking to keep their capital or can afford to lose a certain amount, set by the product.	✓	You can offer this fund to a client who is able to accept a limited fall in capital.
None	Clients can't accept any capital loss.	/	You shouldn't offer this fund to a client that can't lose capital. A capital guarantee is available via the PruFund Protected Cautious Fund for those investing in our Onshore Bond products.

What's your client's risk appetite?

This is Prudential's view of investment risk and may differ from others.

High Medium – High	Can they invest?	✓	This fund may be suitable for a client who is able to accept a fall in capital.
Medium Low – Medium	Can they invest?	✓	This fund may be suitable for a client who is able to accept a moderate fall in capital.
Low	Can they invest?	/	This fund may not be suitable for a client who isn't able to accept a moderate fall in capital. This is dependent upon the fund selected.

How does this product meet your client's objectives and needs?

Preservation of capital	/	You can offer this fund to a client who is able to lose all capital where there are guarantees available to offer capital protection. A capital guarantee is available via the PruFund Protected Cautious Fund for those investing in our Onshore Bond products.
Growth	✓	You can offer this fund to a client who is able to accept a limited fall in capital.
Income	✓	Products which can access PruFund allow regular and ad hoc withdrawals; see individual product terms for further details.
Time Horizon		The recommended holding period is 5 to 10 years or more.
Maturity date		This is a fund and has no fixed maturity date.

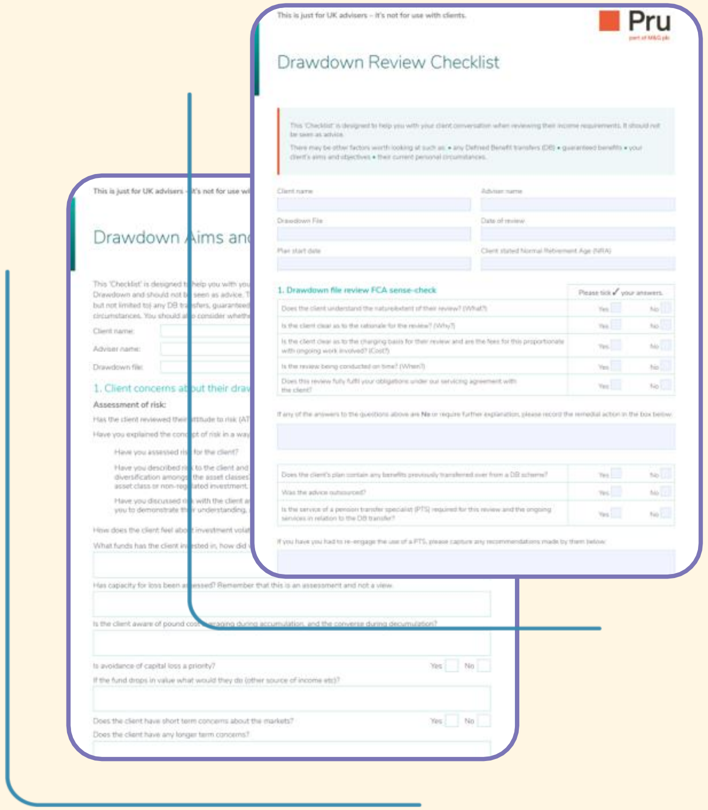
How do your clients invest in this product?

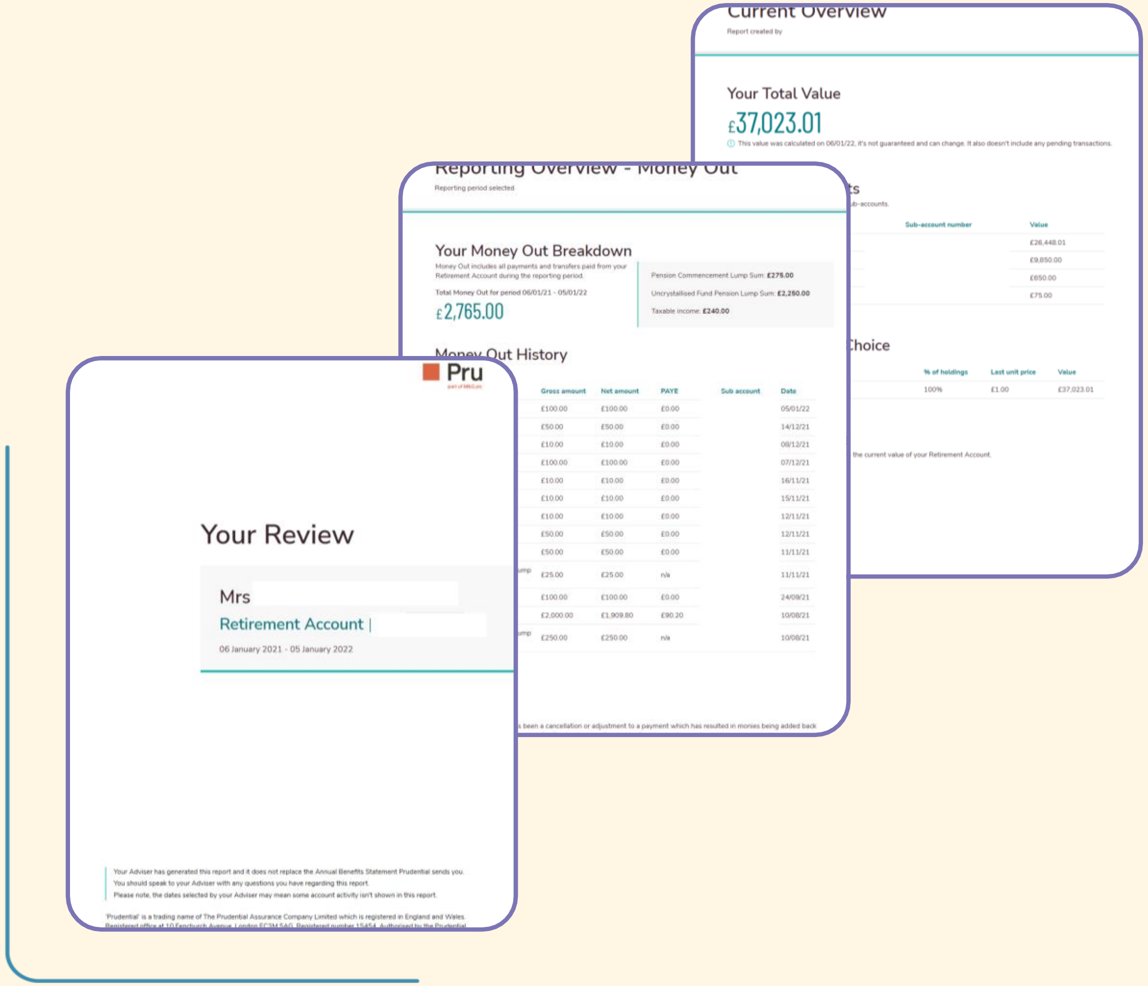
Execution Only	✓	This fund is available on an Execution Only basis.
Non-Advised	✓	This fund is available on a Non-Advised basis.
Advised	✓	This fund is available on an Advised basis.

For more information, please contact your Prudential Account Manager.

https://www.mandg.com/pru/adviser/en-gb/insights-events/news/customer-duty#undefined

Detailed support





Source: https://www.pruadviser.co.uk/pdf/FRPM10431.pdf

Source: https://www.pruadviser.co.uk/pdf/FRPF282601.pdf

PFS Good practice guide

8. Establishing a 'prudent' withdrawal rate

Linked to the above, advisers should have a robust framework in place when it comes to advising clients on what commentators often refer to as a Safe Withdrawal Rate (SWR). There is no such thing as a universal safe withdrawal rate, as every client is different and has different circumstances and objectives. Good practice should also extend to the use of more accurate words such as 'personalised', 'prudent' or 'reasonable' withdrawal rates. Any withdrawal rate should be established and supported by robust modelling and stress testing across a range of market scenarios. Taking into account the clients personal and financial circumstances..

9. Minimising Tax

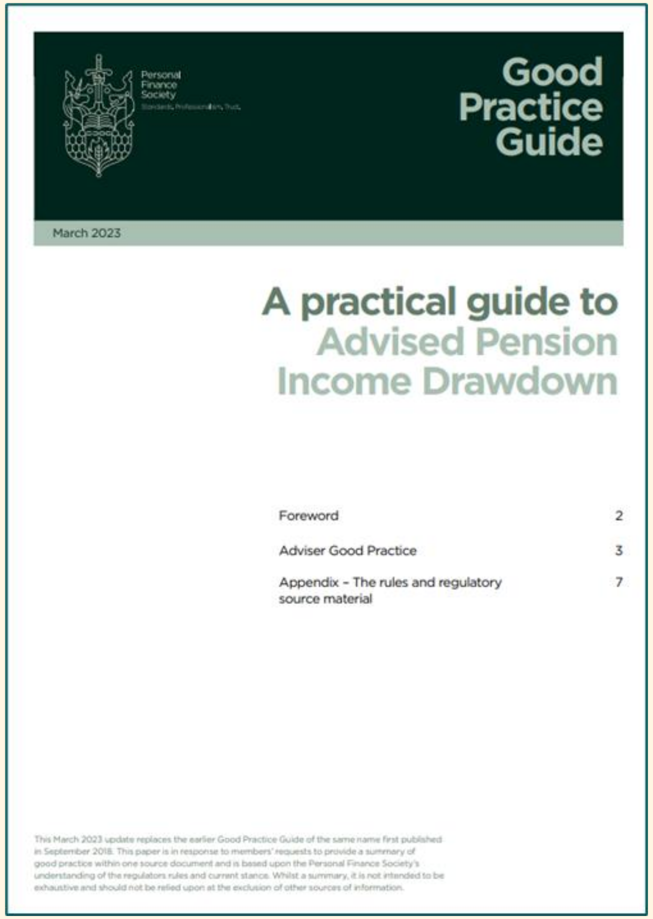
One of the key ways advisers can demonstrate value (and increase sustainability of income) is in respect of limiting tax on withdrawals. Tax rules on pensions are constantly changing, and the impact of these rules on retirement income advice is a subject that is beyond the scope of this guide. The PFS regularly hosts events (such as its investment, retirement and later life roadshows) which provide expert commentary on tax rules as they evolve and are an excellent source of up-to-date information on this subject.

10. Consideration of other opportunities

Where appropriate, adviser should consider other planning opportunities related to drawdown, including for example, the use of spousal bypass trusts, the recycling of income and the use of excess income to fund pension contributions (e.g. for children or spouse).

11. Creating a defined, repeatable process

Scoping out, documenting and following a defined process that is flexible enough to accommodate all types of clients' current and evolving needs, as well as predictable and unpredictable events will help ensure advice remains suitable and compliant. Such processes should cover onboarding both new clients and a robust review for existing clients.


Personal Finance Society

Good Practice Guide

March 2023

A practical guide to Advised Pension Income Drawdown

This March 2023 update replaces the earlier Good Practice Guide of the same name first published in September 2018. This paper is in response to members' requests to provide a summary of good practice within one source document and is based upon the Personal Finance Society's understanding of the regulators rules and current stance. Whilst a summary, it is not intended to be exhaustive and should not be relied upon at the exclusion of other sources of information.

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

Further information / contact us

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