The why, the what and the how of a Centralised Retirement Proposition (CRP)

A practical guide to developing a CRP and future-proofing your business

For adviser use only

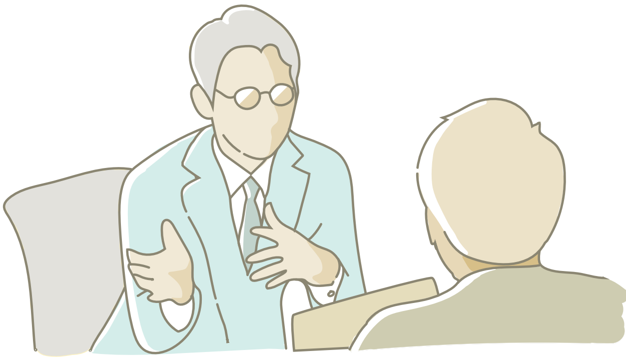
Overview

Advisers have been successfully working with a Centralised Investment Proposition (CIP) for many years now. But, despite retirement planning becoming an increasingly important part of the advice lifecycle, most advisers are yet to develop an equivalent Centralised Retirement Proposition (CRP).

We shouldn't underestimate the importance of having a robust, clearly segmented and well documented approach to retirement advice. The Product Intervention and Product Governance Sourcebook (PROD), issued by the FCA in January 2018, alongside the 'Dear CEO' letter to adviser firms are examples of the regulator's increasing focus on this part of the market.

From a client perspective, significantly more people are entering drawdown, even those with smaller pots, and they are staying in drawdown for longer. Having a clear strategy for different client segments means you can help both your clients and your firm mitigate the risks which emerge as clients move through later life. It may also help you find ways of simplifying and bringing to life complex topics such as income sustainability and longevity in a way that clients can understand.

There are increasing demands on firms including the need to ensure the cost to the client is appropriate, detail those costs on an annual basis, demonstrate they fully understand the products they're recommending, and evidence that those products are in the best interests of their client. Making sure all of that is done on a consistent and efficient basis across a firm may lead some advisers towards establishing a CRP to sit alongside their CIP. The Yin of decumulation to the Yang of accumulation.



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Why do you need a CRP?

There is no regulatory requirement to have a CRP but it can help you build a framework that enables you to manage the various interrelated risks of giving retirement advice, while helping you address the issues your clients face as they enter retirement.

There are three key reasons why a CRP is important:

- regulation
- de-risking your business
- enabling better client outcomes.

Here we discuss these in more detail.

1. Regulation and the FCA's direction of travel

The FCA has made it clear that advisers have an obligation to tailor solutions to customer segments and identify and protect vulnerable clients.

In January 2018, the FCA's Product Intervention and Product Governance Sourcebook (PROD) rules came into force alongside other MiFID II provisions. In simple terms, PROD is intended to ensure products are distributed to, and meet the needs of, the appropriate target market.

An extract from the FCA PROD rules:

Purpose

The purpose of *PROD* is to improve *firms'* product oversight and governance processes and to set out the *FCA's* statement of policy on making *temporary product intervention rules*.

Product oversight and governance refers to the systems and controls *firms* have in place to design, approve, market and management products throughout the products' lifecycle to ensure they meet legal and regulatory requirements.

Good product governance should result in products that:

(1) meet the needs of one or more identifiable target markets;

(2) are sold to *clients* in the target markets by appropriate *distribution* channels; and

(3) deliver appropriate *client* outcomes.

In addition to PROD, the FCA's 'Dear CEO' letter early in 2020 confirmed their focus on the retirement sector. This was a multipage letter but some of the key aspects are shown below.

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21 January 2020

Dear CEO/Director

Portfolio strategy letter for financial advisers

As set out in our Approach to Supervision, we assign firms to a portfolio based on their primary business model. We regularly analyse each portfolio and agree a strategy to take pre-emptive action on the firms and issues posing the greatest harm.

Your firm is part of the portfolio of firms categorised as financial advisers. I am writing to all firms in the portfolio to set out our approach to tackling key areas of concern with financial advice firms and summarise the action we expect you to undertake.

Why financial advisers are a key FCA priority

Consumers are being asked to take more responsibility for an increasing number of complex financial decisions. Financial advisers have a valuable role to play in helping consumers navigate these choices and deliver the right solutions for their needs and objectives. However, we are seeing an increasing number of cases where the actions of firms are resulting in significant harm to consumers' financial well-being. Preventing harm in this portfolio is therefore a key priority.

We have identified four key ways in which consumers of financial advice may be harmed:

- receiving unsuitable advice for their needs and objectives
- falling victim to pension and investment scams
- not receiving redress as a result of the non-payment of FOS awards and/or failing firms being unable to compensate consumers
- paying excessive fees or charges for products and services

There will be increased focus on these areas as part of our wider supervision of firms over the next two years.

Assessing suitability of advice and disclosure

Following on from our Assessing Suitability Review in 2017, we will be carrying out further work on the suitability of advice and associated disclosure (known as 'Assessing Suitability Review 2'). The review will focus on initial and ongoing advice to consumers on taking an income in retirement. This evolving market has changed significantly following the pension freedom reforms and we want to assess the outcomes consumers are receiving.

FCA January 2020

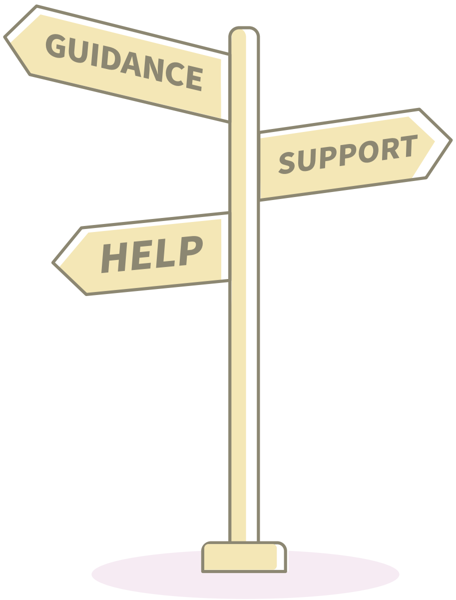
However, we are seeing an increasing number of cases where the actions of firms are resulting in significant harm to consumers' financial well-being

We expect you to consider and discuss this letter with your fellow directors and/or Board and agree what, if any, further action(s) you should take.

We will be carrying out further work on the suitability of advice and associated disclosure (known as 'Assessing Suitability Review 2').

Clearly the FCA is taking a keen interest in the fair treatment of retirement income customers and the product knowledge and reasons behind any product recommendation. The sooner advisers can evidence they are adhering to these guidelines, the better.

2. De-risk your business



Gone are the days when clients de-risk their savings and investments as they approach retirement, then fix an income that pays out until they die. The introduction of pension freedoms, increased longevity, and stubbornly low interest rates has culminated in many clients taking increased investment risk later in life.

As a result, the vast majority of advised clients are now opting to use drawdown rather than an annuity, which has ongoing repercussions for your business:

- If you're taking on more drawdown clients than ever before, your business model needs to have the capacity to deliver ongoing advice for these clients, and you need to find an efficient, structured way of doing that.
- Over time, the assets your drawdown clients have will likely fall as they withdraw tax-free cash and income. This could leave you with a growing book of clients with funds under £200,000. The income you receive in these cases may not meet the costs of carrying out comprehensive and robust yearly reviews.
- A consistent model and clear process is likely to give a more efficient management approach and easier transition of clients between advisers should that be necessary.
- From a management point of view, the FCA's Senior Managers and Certification Regime (SM&CR) was extended to most FCA-authorised solo-regulated firms, including financial advisers, on 9 December 2019. The FCA will be assessing compliance with the new SM&CR requirements as part of its ongoing supervisory work, and a clearly documented, robust, repeatable process for retirement advice may be a useful way of demonstrating your firm's ethos to the regulator.

3. Enable better client outcomes

Now that clients are requiring more than just a 'one-size-fits all' annuity in retirement, advisers need to ensure they are considering the individual needs of every client, and delivering a solution that can offer the best longer-term outcome for them.

A CRP can help you deliver robust investment and withdrawal strategies for resilient, sustainable income. It will also help in ensuring clients use their available tax allowances as they phase into retirement.

In particular, a CRP will help you:

Manage expectations on how much income your client can expect

By modelling the amount of income a client can reasonably expect to take – perhaps up to around age 100 – you can manage their expectations and flag any gaps or surpluses that exist. While it's impossible to predict the future, you can also factor in likely future events, such as paying for a wedding or university fees, and allow for any unexpected expenses.

Help them understand their capacity for loss

Understanding a client's attitude to risk is not as simple as it was in the accumulation phase. A client might consider themselves to be very risk averse, but in the decumulation phase this could leave them under-invested and in danger of not being able to sustain their income levels over time or suffering large irrevocable losses through investment under performance. Equally, if they take too much risk, they are open to volatility and sequencing issues. By modelling different scenarios whereby clients lose a percentage of their fund through poor investment performance, you can help them better understand the amount of risk they NEED to take, rather than the amount of risk they WANT to take. It's this understanding of your client's capacity for loss that should underpin the investment strategy.

Assess if they are, or could become, a vulnerable client

As their adviser, you are well placed to understand how vulnerable your client is or could be in the future. This is of particular importance to the FCA and is one of the reasons they so vehemently advocate the need for regular reviews, and documentation of conversations and recommendations. Vulnerability comes in many different forms, and spares no one. It could relate to your client's health, certain life events (such as divorce), how resilient their finances are to unexpected losses, or even their level of financial knowledge. By assessing your clients against each of the FCA's drivers of vulnerability – both at outset and at their regular reviews - you can ensure your advice is tailored accordingly.

What should be included within a CRP?

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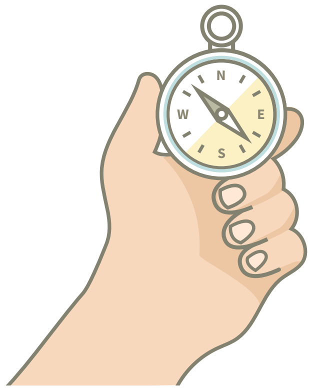
We suggest you split your CRP into five key areas:

- Business advice and risk statement
- Advice support process documents
- Investment philosophy inc, platform and or product solutions
- Tools and calculators needed
- Review process



1. Business Advice

This part of the CRP should include your firm's strategic views. For example, which platform or products you may use for different client segments, your views on withdrawal strategies and investment proposition, and links to any company policies, such as for vulnerable clients. Some of the documents you may want to include are:

- Client segmentation – how you have segmented your client bank and how often this is reviewed.
- Governance reporting – who and how you record Senior Management documents.
- Service proposition – do you have different levels of service and, if so, what are they? For example, transactional and holistic clients.
- A house view on areas such as sustainable withdrawal rates, investments you would use, and what strategies you use to deal with sequence of returns risk for those taking a regular income. These are likely to differ across different client segments.
- Which platform and/or product solutions do you prefer to use to meet business and client needs. Again, these may be different for some client segments.
- Your vulnerability policy (and any other relevant company policies) – income and consumer focused.
- Evidence of sector advice expertise, for example IHT and DB transfers. Your process in these areas and any evidence of special checking requirements.
- External or internal business support providers. For example, do you work with any Discretionary Fund Managers (DFMs), outsource to any third parties for certain areas (e.g. equity release advice, or DB transfers). Do you make use of external paraplanners? If so, what due diligence have you undertaken and how often do you review?
- A house view on guaranteed income, and for which clients it may be appropriate either at outset or later in life. And a view for those who may need an element of guaranteed income (e.g. a blended scenario) to cover essential expenditure alongside the State Pension.
- A house view on equity release, for which clients it may be appropriate, and in which circumstances. Any special measures in place, for example ensuring family members are present during discussions.
- A house view on long-term care planning and the methods for achieving this, for example, immediate needs annuity or care insurance.
- Any file checking you have as a business and who carries out that checking.

2. Advice support and process documents

This part of the CRP should detail the documents you use within your retirement process, any assumptions you follow, how often these are reviewed and by whom. If third parties are involved, then appropriate reference should be made.

Some of the documents you may want to include are:

- Client fact-find documents – how you find and record appropriate details for new clients and the questions you ask before/during ongoing reviews for existing clients.
- The way you measure attitude to risk, along with details of any external tools you use to facilitate this.
- The way you detail and discuss capacity for loss with your clients. This could be done via cash flow modelling, and stress testing an agreed strategy.
- Evidence that demonstrates a client specific, safe withdrawal strategy and associated risks. This may be linked through to cash flow modelling.
- Client engagement letter and fee agreement (pre and post retirement).

3. Investment philosophy

This part of the CRP should detail your investment strategy for different client segments. It is likely to differ based on whether clients are taking a regular income, what other assets they have, the balance between income and legacy planning and so on. If you have an investment committee or use your own model portfolios, details would be included here.

Some of the areas you may want to include are:

- How risk is managed and how that interacts with attitude to risk.
- Assessing volatility of investment options and how that sits alongside capacity for loss and views on the impact of sequencing risk.
- Philosophy re active/passive investing (does it vary by asset type and/or sector).
- Preferred investment propositions to meet all advised clients' needs and objectives during the various phases of later life. These may differ for client segments, but may include access to tax-free cash only; income (tax-free or taxable) to top up other income; higher income for a period as a bridging pension; regular and/or ad-hoc income during fully retired active phase; regular income during more passive phase; dealing with care needs.
- If you run an investment committee, link to how that is set up, who is on board, process they use etc.
- If you run your own model portfolios, you should include some detail on how these are constructed, reviewed and communicated. And for which clients/client segments they are appropriate.
- Document who the internal and external providers you use are and why you use them.
- Demonstrate alternative solutions and who, when and why circumstances will trigger their use. What is the process and is any special checking required, and, if so, by whom?
- Document how/when/by whom you regularly review these providers and solutions.

4. Tools and calculators

This part of the CRP should detail the tools and calculators you use, when they are used and by whom (e.g. paraplanners or advisers). It should also detail how often any assumptions are reviewed and by whom. Some of the areas you may want to include are:

- Investment solution research tools - These tools will provide data, knowledge and analysis to help you put in place a better, informed and robust investment decision making process with your clients.
- Savings tools such as annual allowance and carry forward calculators, and 'how much do I need to save?' tools. This will help clients work out how much they can/need to save to meet their retirement goals.
- Tax tools such as lifetime allowance and pension tax withdrawal calculators. These help clients understand and mitigate tax due.
- A portfolio management and review tool. This may form part of cash flow modelling and helps analyse and review the ongoing investment approach.
- Whether you use stochastic and/or deterministic cash flow modelling tools (for both complex and simpler client needs) and, if so, for which client segments. Detail any stress testing carried out, and how you have demonstrated this to clients to help them understand their capacity for loss.
- A budget planner to help work through required regular and ad hoc income requirements.
- Life expectancy calculator, or other method to help clients understand potential life expectancy.
- Detail the method of calculating income sustainability and provide evidence to support the basis used and if this differs across different client segments.
- Show which provider research tools are used and ensure consistency across the firm.
- Use an income optimiser tool to optimise the order in which income is drawn from different wrappers. Help clients understand that a different order of withdrawals can make a significant difference to their income and/or legacy planning.
- Lifetime mortgage, maximum loan calculator and research tools used for any equity release planning.

5. The review process

This part of the CRP should detail both your firm's review process and the client focussed review process. What are you doing on a regular basis to ensure your processes are up to date, and what do you offer your clients at their regular review (and how often these are carried out)?

At a firm level, you should refresh and update:

- All key components of the risk statement
- All support and process documents
- The investment philosophy adopted
- Platform and/or product solutions used
- Tools and calculators used

At a client level, you should detail:

- How often you carry out reviews (e.g. every 3 years) and does this differ for different client segments? Are all reviews the same, or are some more in-depth?
- How do you review income being taken, and the investment proposition at review? In what circumstances would changes be made?
- Do you always get and record revised client health details?
- Do you always get an annuity quote personalised to the client, discuss with them and record on file?
- Is cash flow planning used, and are models stress-tested?

How do I develop a CRP?

One of the big stumbling blocks to developing a CRP is knowing where to start. First and foremost, you should remember that there is no right or wrong way of going about this. There is no template to follow.

A CRP is your document and so should cover your firm's processes and views on the full range of retirement issues. In the last section we covered what should be included, and this is a great place to start. You can structure the document as you wish, ensuring these key areas are included.

For many of you it will build on a CIP you already have. A CIP is all about having a structured investment process that aims to deliver a robust solution that is both repeatable and consistent during the growth phase.

However, a CRP is much wider than just investment, and should include all of the risks clients face as they move through later life. There needs to be consistency and a working link between your CIP and CRP to reflect this. A CRP needs to evolve from a CIP.

We suggest you:

1. Segment your clients and detail your views on the appropriate strategies to help each of these segments. This should include withdrawal strategies, investment approach, which platforms or products you use, and your ongoing review process.
2. Include all assets a client might use in retirement, from pensions to ISAs, offshore and onshore investments, defined benefit and state income, and property, including equity release.
3. Link to your firm's policies in several areas, such as vulnerable customers.

Conclusion

To reiterate what we said at outset, there is no regulatory requirement for your firm to have a CRP. However, it is clear the FCA are going to be scrutinising advice in the retirement market like never before. And there can be clear benefits for your business and your clients if you clearly document the processes your advisers follow, and how you review these on an ongoing basis.

Never has it been so important for advisers and product manufacturers to work together in partnership. We can help you construct your CRP, as well as provide as much product and marketing support as you need – not just around our products, but for the range of products on the market. It's in all our interests that advisers are well-equipped to help their clients achieve a sustainable retirement income, with as little risk as possible for all concerned.

There is no correct answer for what a CRP looks like, and they will differ significantly from firm to firm. However, we hope the information we have detailed helps you as you consider the need for, and the content of, your firm's CRP.

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