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Capacity for Loss in changing times



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Hello!



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What is 'Capacity for Loss'?

Providing a suitability report: MiFID business

COBS 9A.3.3

UK

01/01/2021

54(12) When providing investment advice, investment firms shall provide a report to the retail client that includes an outline of the advice given and how the recommendation provided is suitable for the retail client, including how it meets the client's objectives and personal circumstances with reference to the investment term required, client's knowledge and experience and client's attitude to risk and **capacity for loss**.

Key points

Capacity for loss is **not** a defined term in regulation (but note CONRED 4 Annex 21)

FCA distinguish it from attitude to risk (see CONRED 2 Annex 13)

Suitability reports need only provide 'an outline' of the advice!!

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Greater clarity in BSPS DBAAT

6.7 G 'Capacity for loss' refers to the *consumer's* ability to absorb falls in the value of their investment. If any loss of capital would have a materially detrimental effect on their standard of living, this should be taken into account in assessing the risk that they are able to take.

Observations

Consideration of potential impact on 'standard of living' is forward looking*

Does 'loss' mean permanent loss? Not volatility?

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Who needs forward looking assessments most?



Business owners



Complex needs



DC retirement



Rainy day money

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So we are discussing...

$$\frac{\textit{Risk to Lifestyle less Secure Income}}{\textit{Net Present Value of Wealth}}$$

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Cash flow modelling Present Value of Wealth

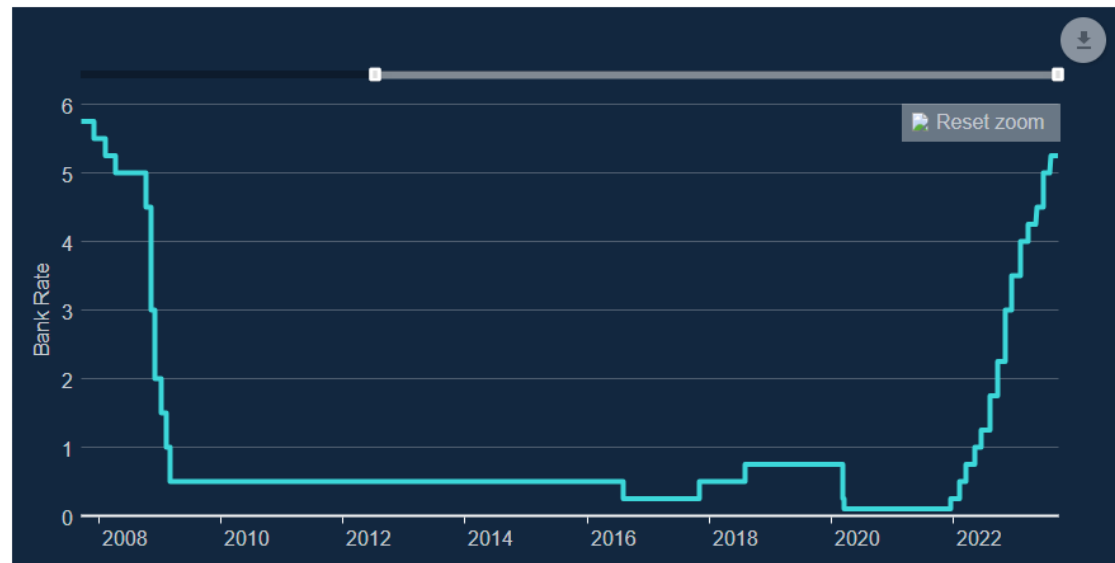
$$\text{Net Present Value of Wealth} = \text{Balance sheet} + \frac{\text{Future cash flows}}{\text{Discount factors}}$$

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Where are the big changes in assumptions?

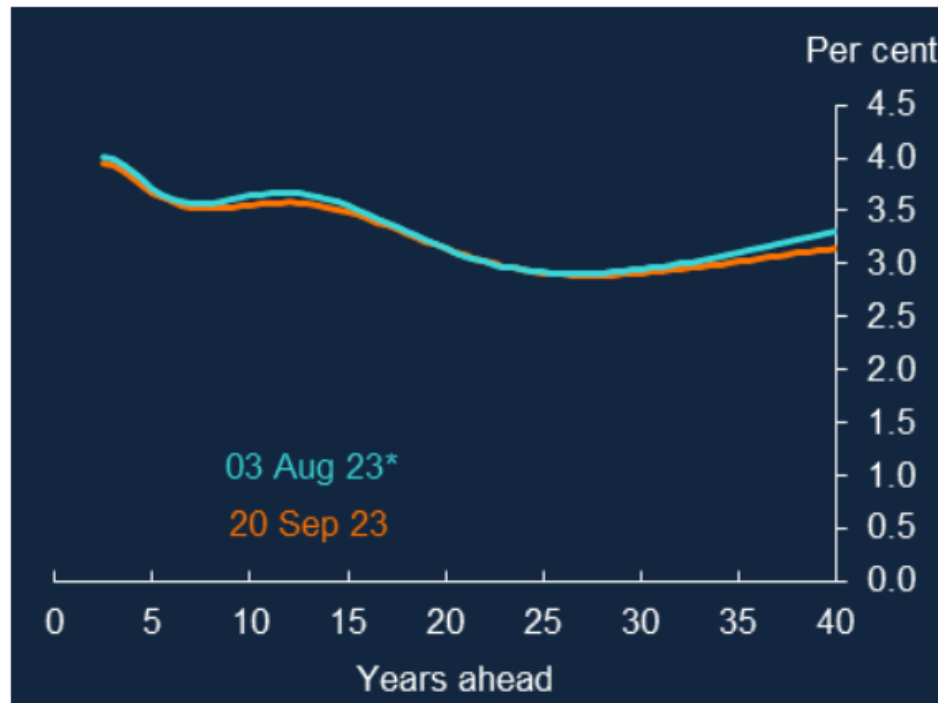
Interest rates
Inflation
Market returns
Longevity

Official Bank Rate



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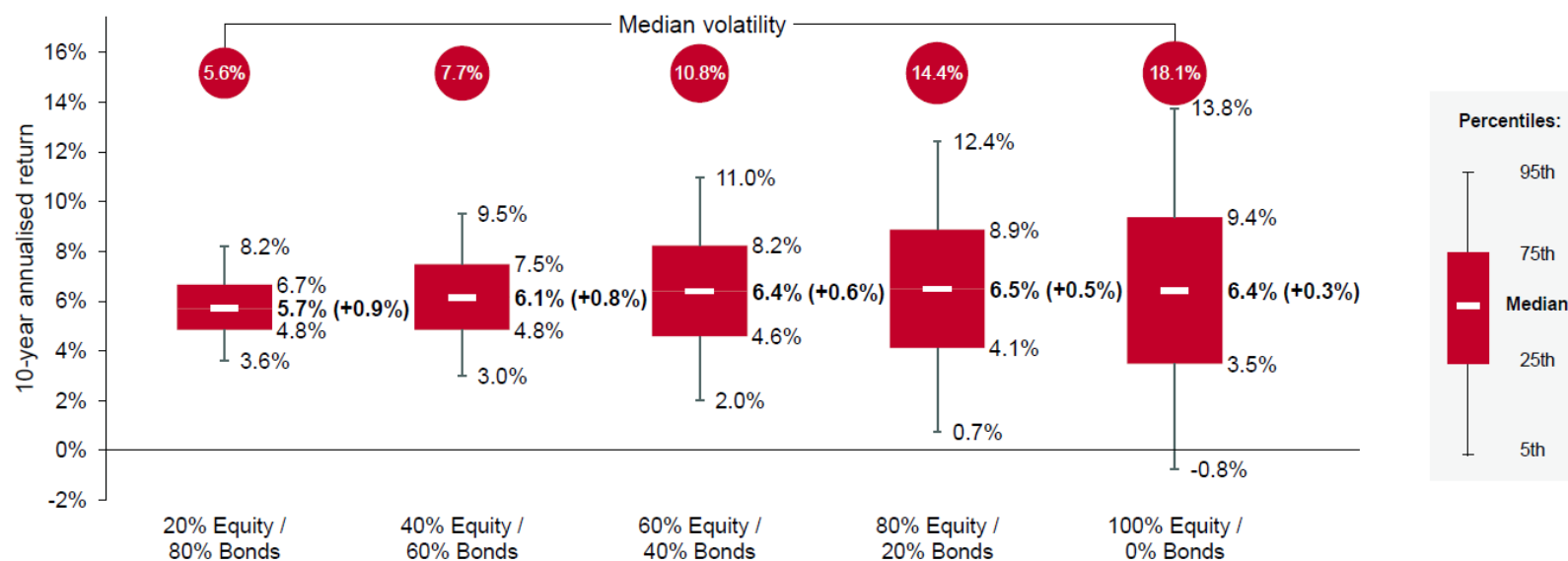
Inflation



Bank of England forward inflation
21.9.23

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Where are return forecasts?

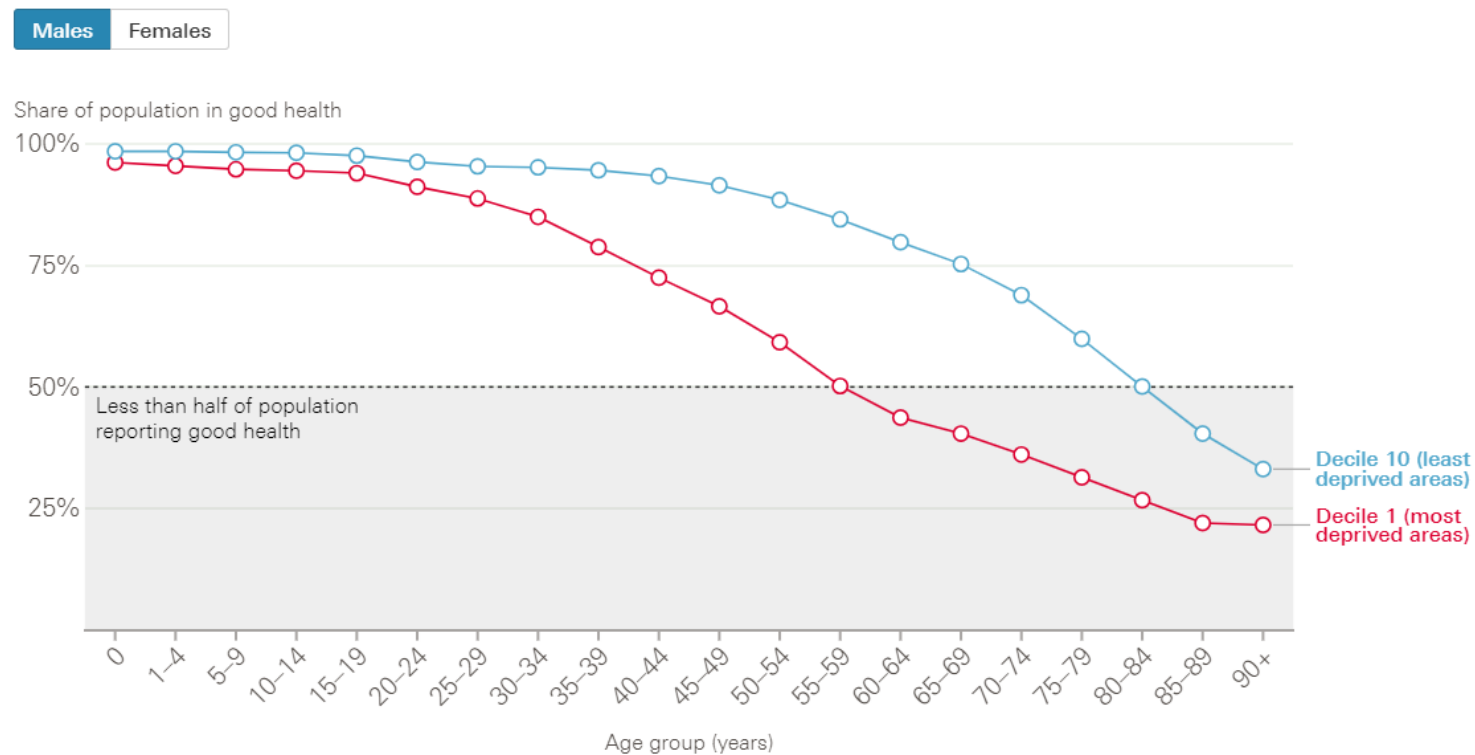


About 6.25% nominal, at mid risk, with an even chance of achieving
between 4% and 8%, on a 10-year view, but with 9% volatility

The wealth effect in later life. Averages mislead

Good health deteriorates faster for men and women living in the most deprived areas

Proportion of population in good health by sex, age group and deprivation decile: England, 2011



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Let's revisit our definition

- 6.7 G 'Capacity for loss' refers to the *consumer's* ability to absorb falls in the value of their investment. If any loss of capital would have a materially detrimental effect on their standard of living, this should be taken into account in assessing the risk that they are able to take.

Observations

What could we consider around a consumer's **ability** to absorb a loss of capital?

Should ability to adapt lifestyle and/or axe capital commitments be assessed too?

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Discussion



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Thank You

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