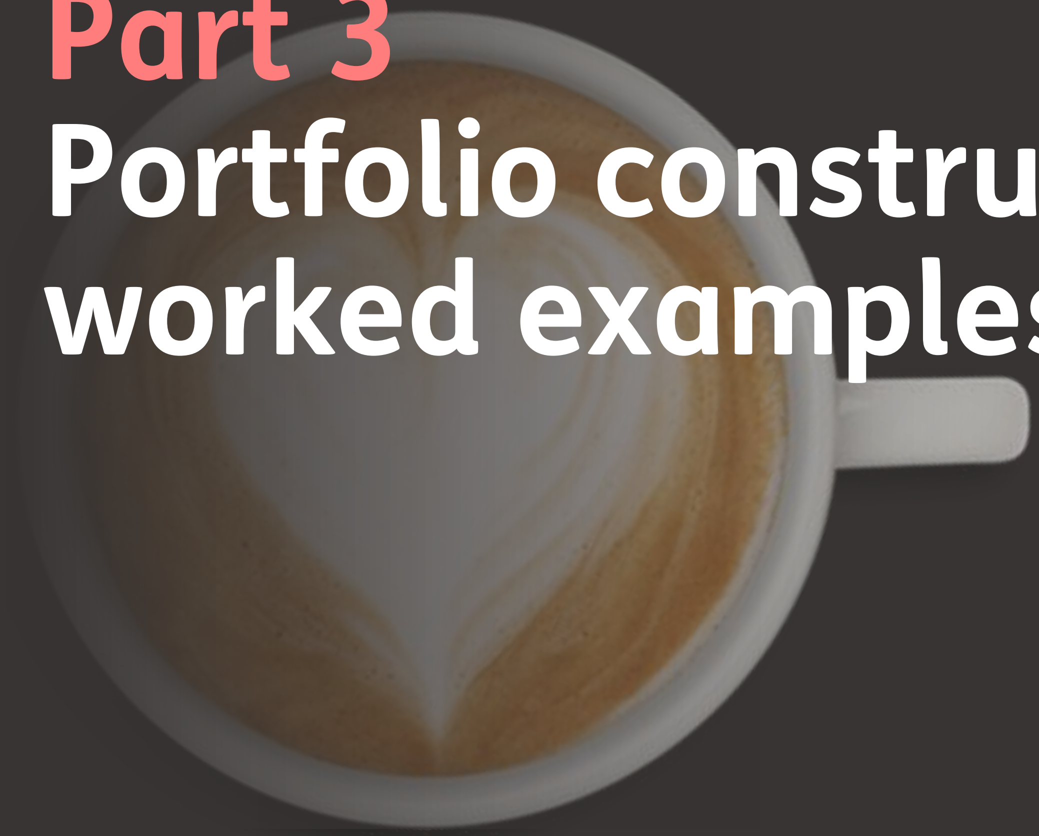
Retirement portfolios - time for a more sustainable approach?

Part 3
Portfolio construction – worked examples



Retirement portfolios -
time for a more sustainable approach?

Retirement portfolio challenges

Creating more sustainable retirement portfolios

Portfolio construction – worked examples

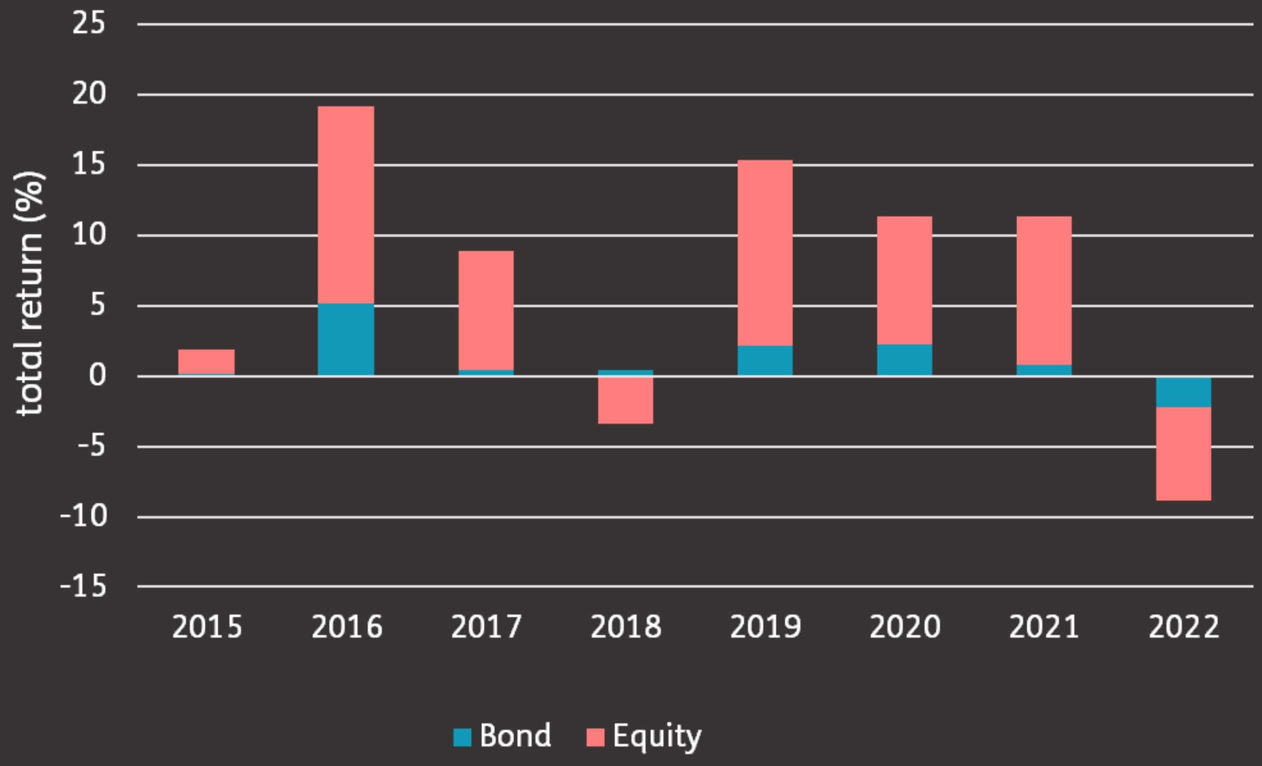
Learning objectives

By attending this webinar you'll be able to:

- Understand how legacy provision can be improved
- Consider how higher levels of income can be sustained
- Explore how retirement plans can be made more resilient

What happens in drawdown portfolios now?

Annual returns in a 60:40 equity-bond portfolio



- Annualised total return of 5.62% between 01/01/2015 – 31/12/2022
- Clients have been reliant on equity allocations
- High inflation and rising interest rates are putting significant pressure on traditional investment models
- Leaving retirement income clients nowhere to hide

The 'triple threats' to portfolios of **inflation**, rising **interest rates** and **asset volatility** are heightened by the increasing correlation between equities & bonds

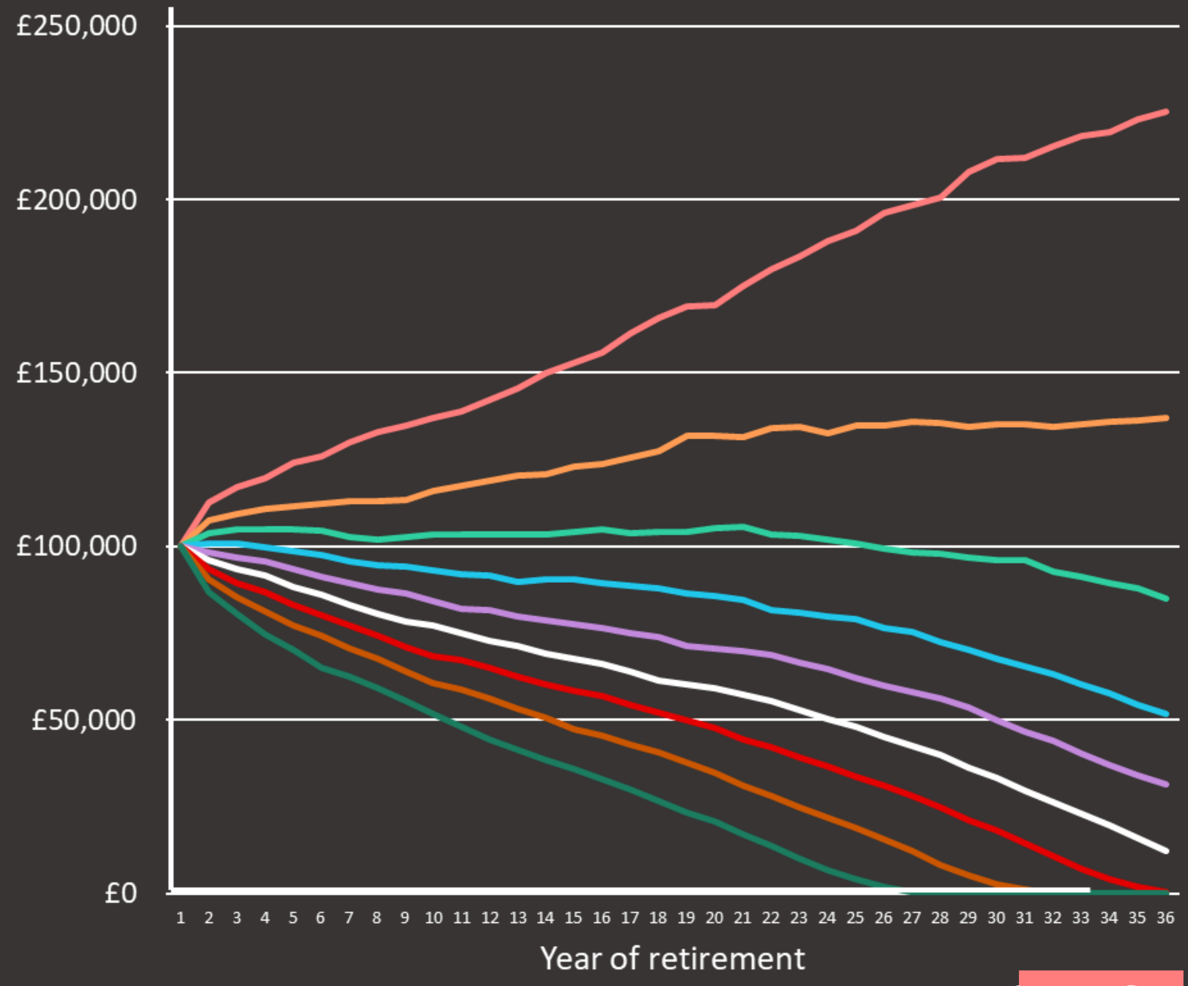
Performance of hypothetical portfolio based on IA Global TR and IA Global mixed bond TR, 01/01/2015 – 31/12/2022 data sourced from FE analytics

Three key questions

- How do I get a higher income, given inflation?
- How do I improve sustainability / financial resilience?
- How can I improve legacy benefits?

Is the best outcome the right income?

- We may expect equities to outperform bonds over the longer term but we can't guarantee if and when these returns will materialise
- Increased investment risk forces conservative clients to spend less at the start of retirement in case they experience a poor sequence of returns
- To meet the requirement of evidencing sustainability of income I have to create a plan with a high probability of success
- Stochastic simulations with a high probability of success assume lower investment returns and lower the sustainable withdrawal rate



How can we dampen volatility?

Partial SLI purchase example

- 70 years old, married
- £500,000 portfolio
- Has been taking £20,000 pa but now needs £22,000 pa to meet rising expenditure
- Objective is to meet income needs whilst maximising legacy benefits
- Low capacity for loss, balanced attitude to risk
- Average health, non-smoker

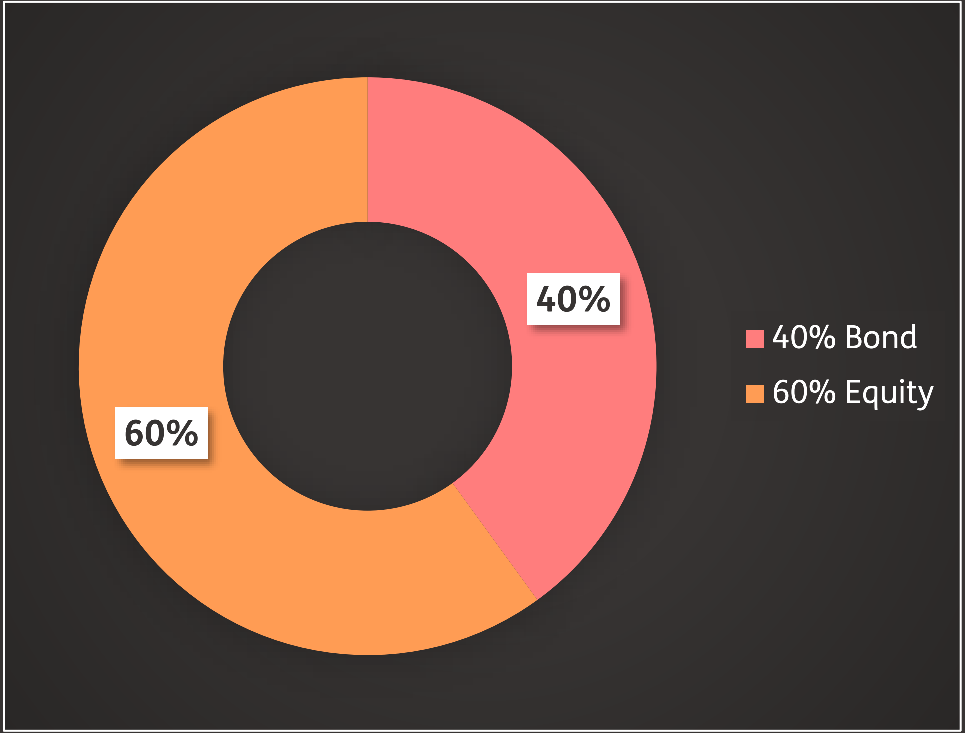
Partial SLI purchase example

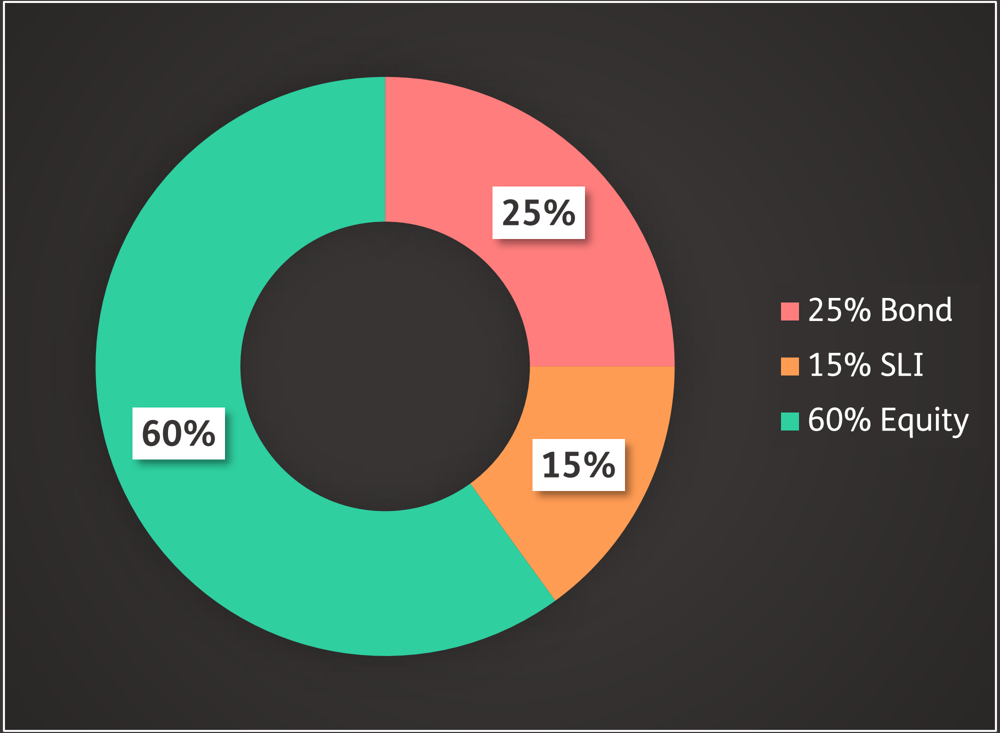
	Drawdown only	Drawdown with SLI allocation
SLI allocation	£0	£75,000 (15%)
SLI income	£0	£5,105
Remaining drawdown portfolio	£500,000	£425,000
Income from remaining drawdown portfolio	**£22,000** @ 80% probability of success to age 95	**£16,895** @ 91% probability of success to age 95
Remaining drawdown portfolio withdrawal rate	4.4%	4%
Total income	£22,000	£22,000

Example based on a 1,000 economic simulations. Drawdown only assumes 60% mature equity, 40% investment grade bonds, Drawdown with SLI assumes 70% mature equity, 30% investment grade bonds. 1.75% total fees. SLI rate date of 21/06/22, age 70, average health non smoker persona.

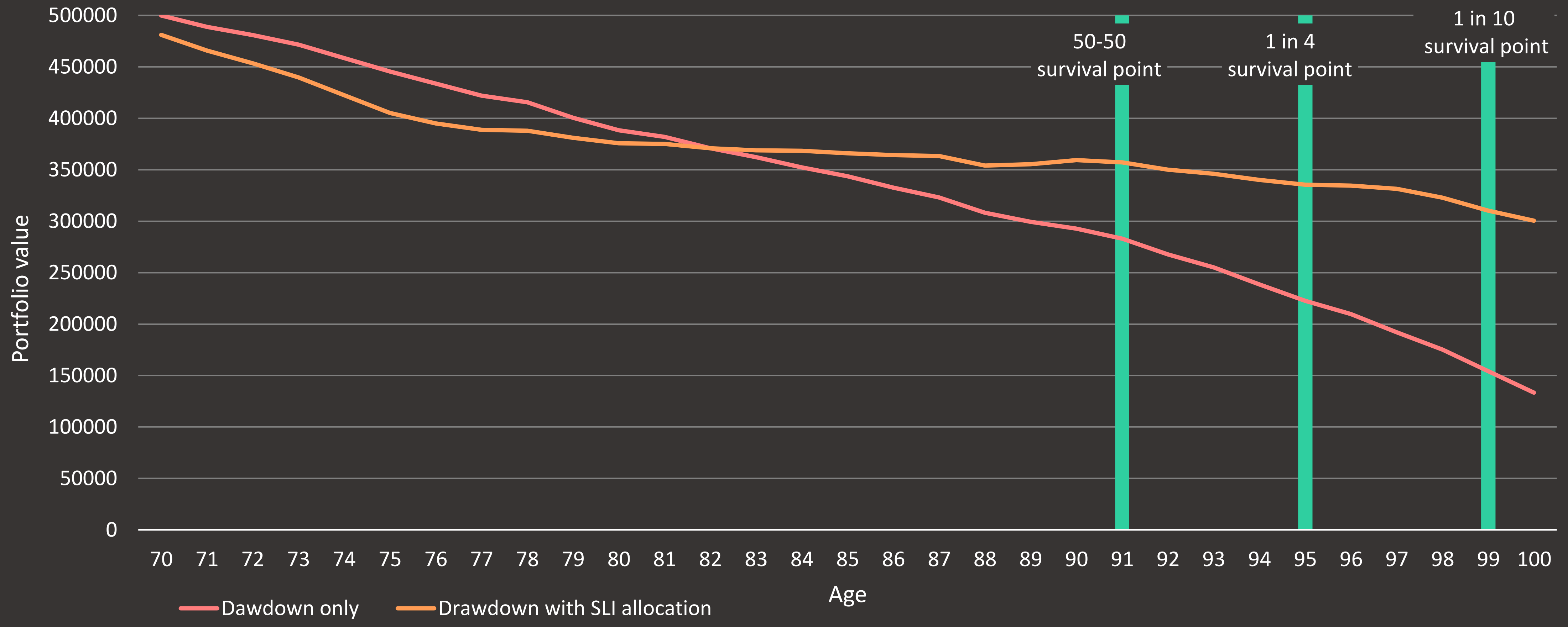
Partial SLI purchase – portfolio allocation

- Allocating 15% of a client's assets can help significantly improve client outcomes





Partial SLI purchase - improving long term portfolio values



Example based on 70 year old, average health non-smoker persona, with a £500,000 total portfolio value, taking £22,000 non escalating income pa 1.75% AMC/ongoing adviser charge, SLI scenarios assume a £75,000 SLI purchase price and include the cash- in value within total portfolio value, graph shows median scenario of 1000 stochastic projections

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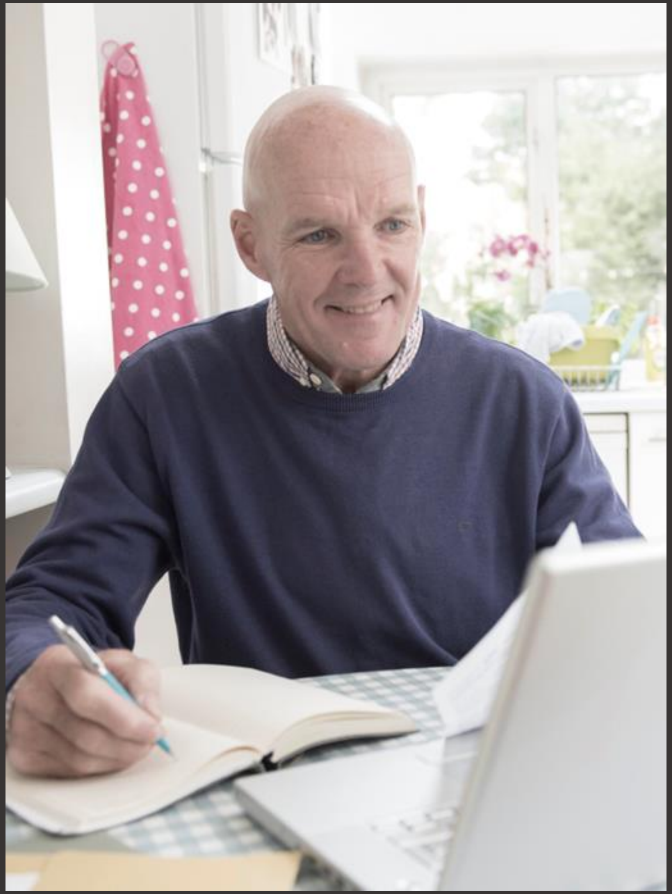
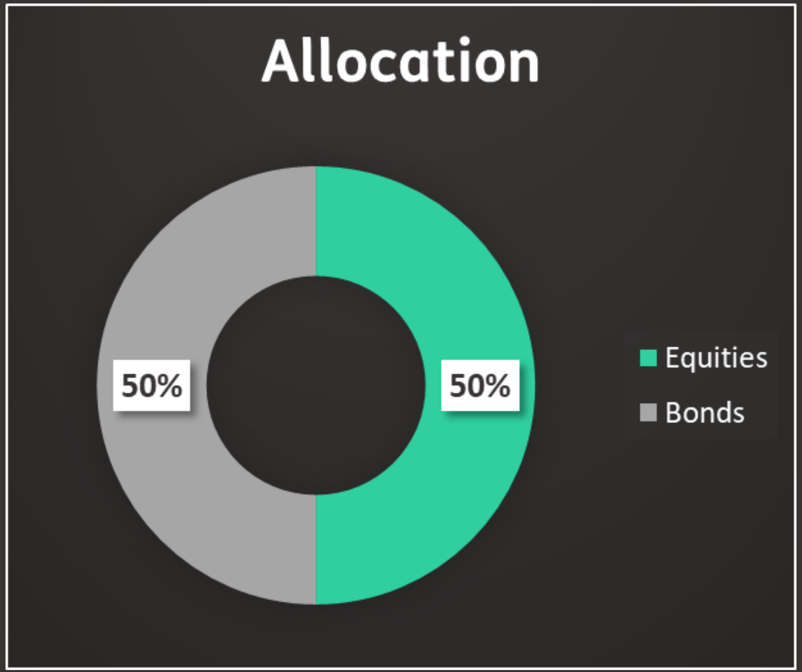
Example - John



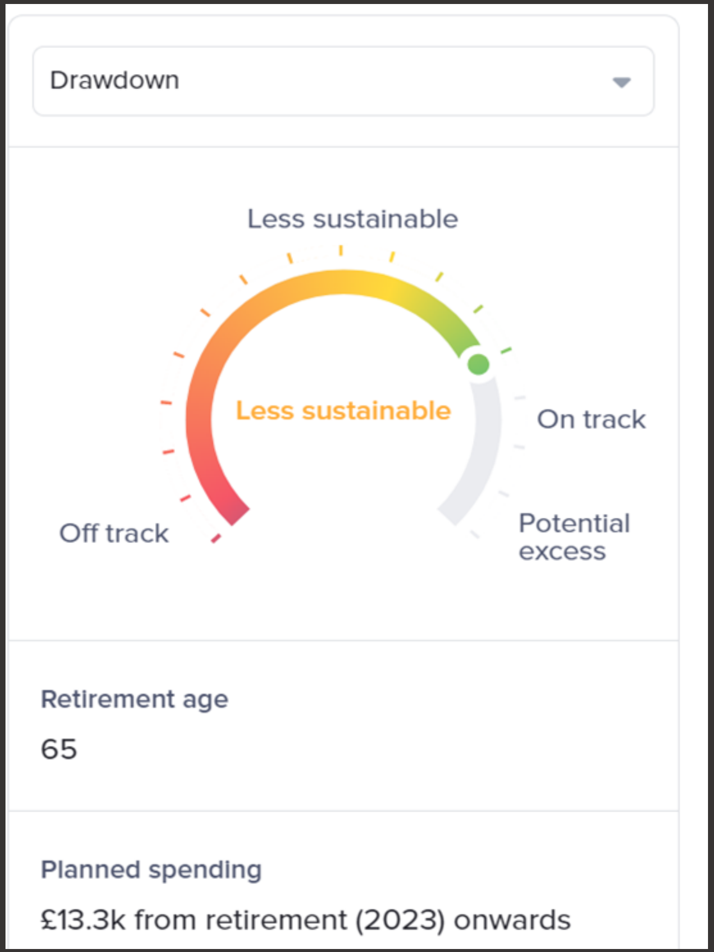
- Age 65
- Balanced investment portfolio of £380,000
- Main objective - meet income requirement
- Secondary objective - maximise legacy
- He now requires additional £13,300 a year income
- He will sell down a small GIA portfolio making use of CGT allowance to support income until state pension starts

Income sustainability

- £380,000 invested
- Income need £13,300 pa



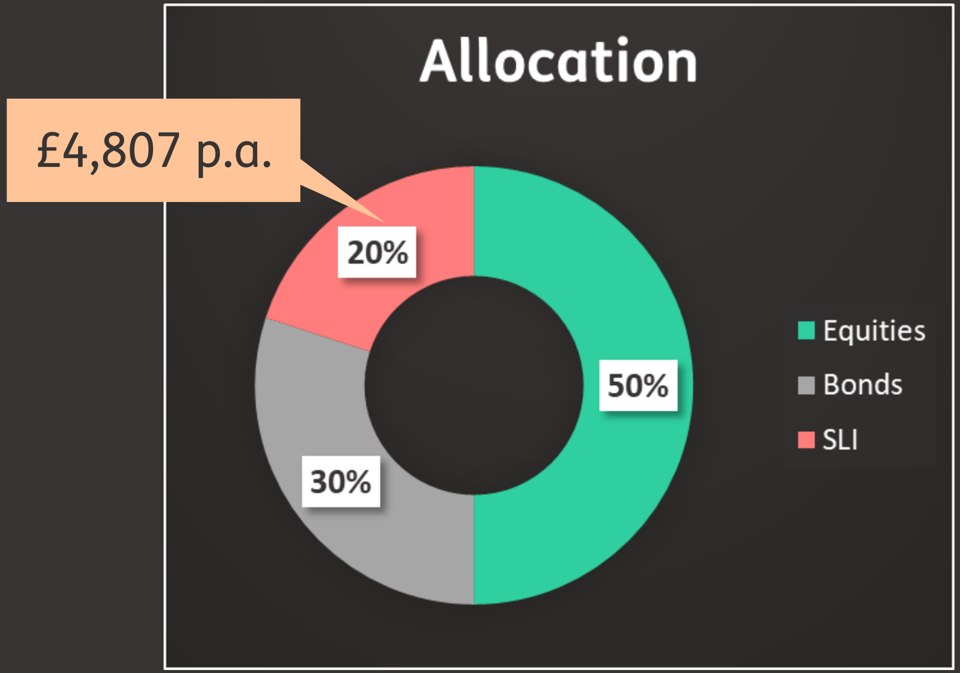
On track in
77%
of scenarios to age
97



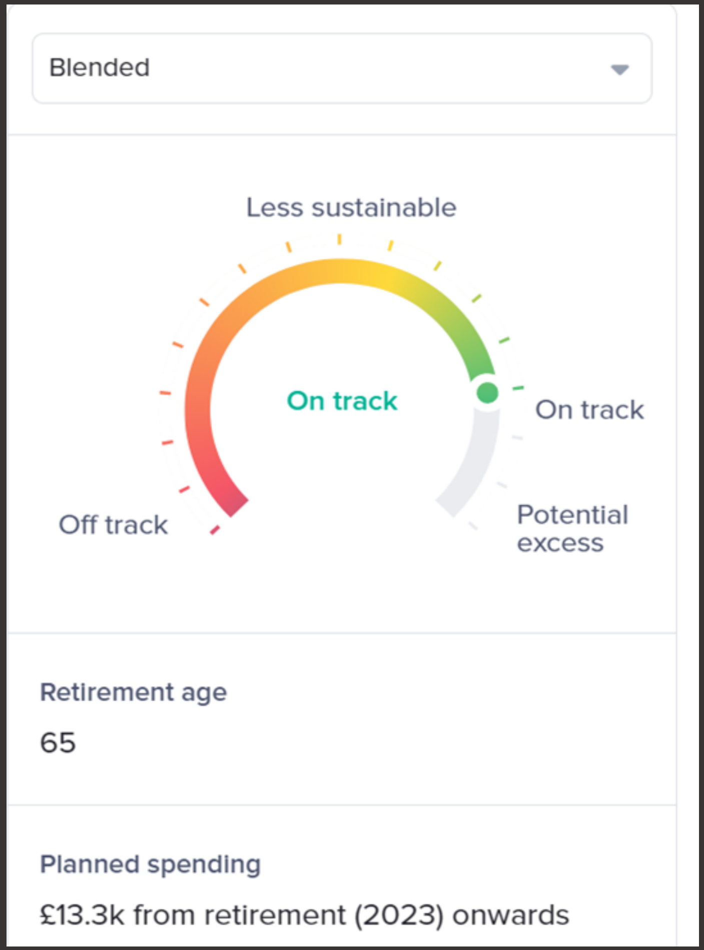
Figures sourced from Timeline 1 March 2023. Secure Lifetime Income based on good health, client aged 65. Global equities, UK bonds. Median projection using Timeline modelling (800 scenarios)

Income sustainability

- £380,000 invested
- Income need £13,300 pa



On track in
83%
of
scenarios
to age
97



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Poll question 1

What is the impact on legacy benefits at the end of the planned term (to 97)?

a. Reduced significantly

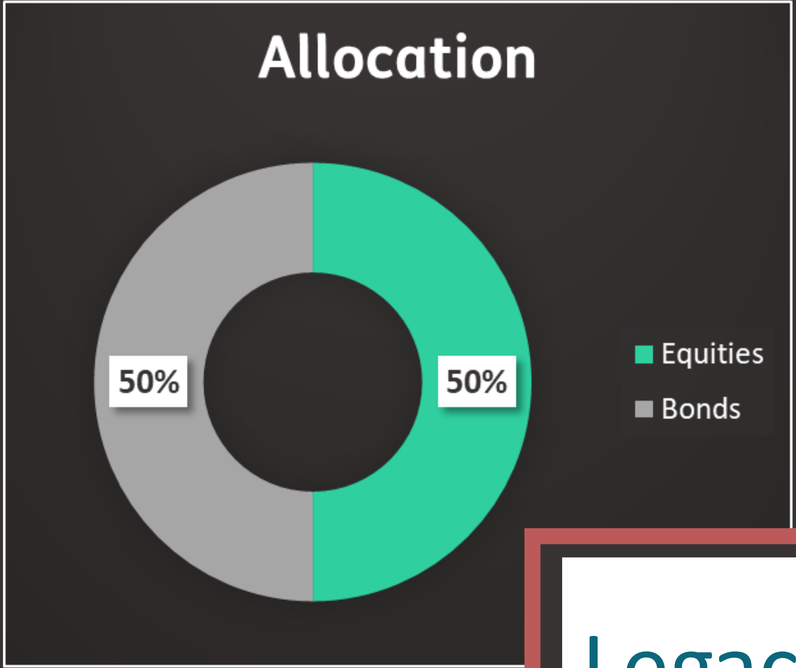
b. Reduced marginally

c. Similar levels as previously predicted

d. Increased marginally

e. Increased significantly

Legacy – no Secure Lifetime Income



Legacy

£115,814.94

Retirement age
65

Planned spending
£13.3k from retirement (2023) onwards

Goals
None

Legacy
£115,814.94

Age 97

Figures sourced from Timeline 1 March 2023. Secure Lifetime Income based on good health, client aged 65. Global equities, UK bonds. Median projection using Timeline modelling (800 scenarios)

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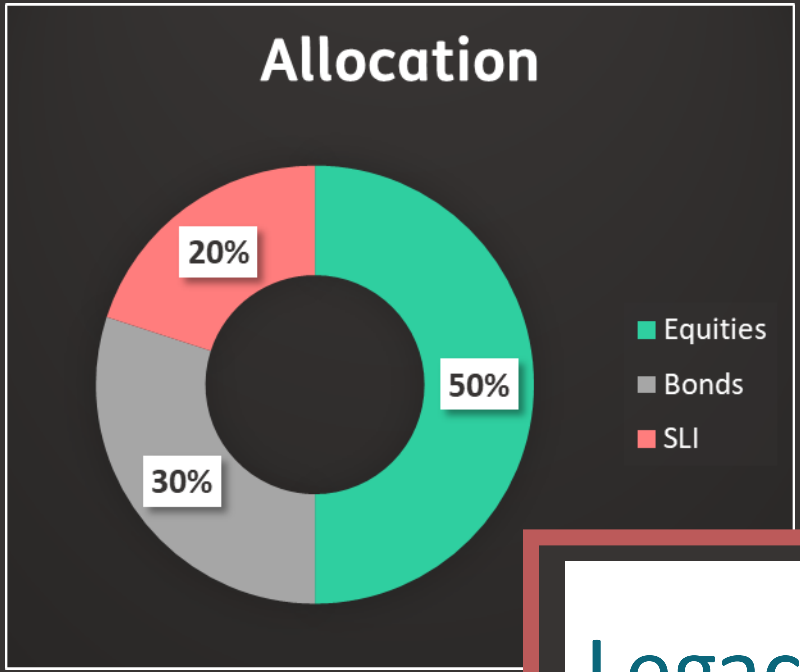
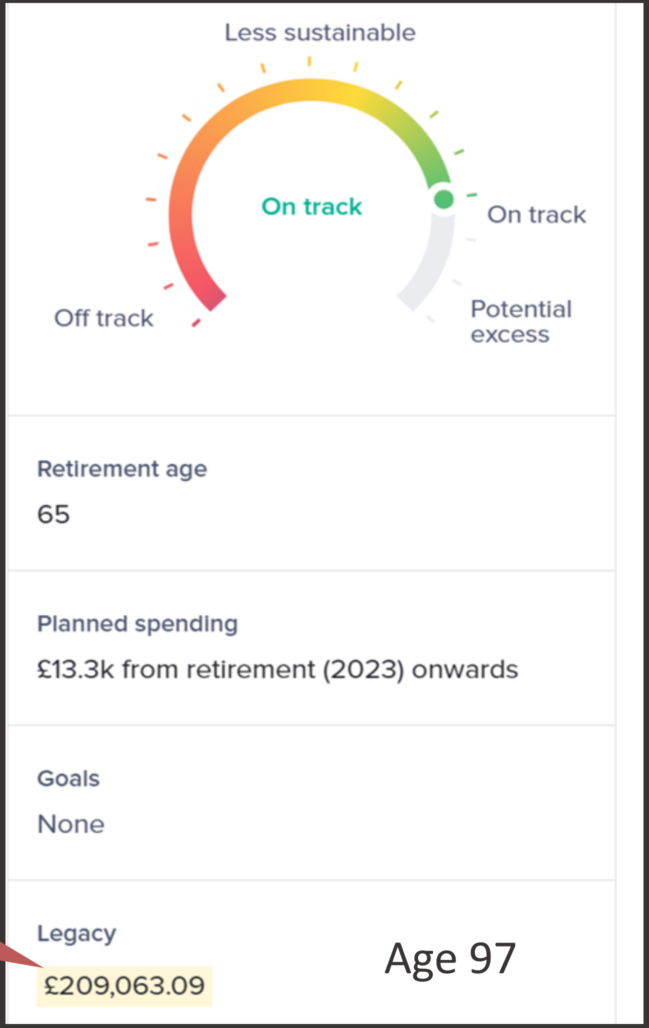
Legacy – with Secure Lifetime Income



Legacy

£209,063.09



Figures sourced from Timeline 1 March 2023. Secure Lifetime Income based on good health, client aged 65. Global equities, UK bonds. Median projection using Timeline modelling (800 scenarios)

Replacing guarantees and the added benefits

More than just an underpin

Expenditure examples (FCA)

Essential:

- bills that the client must pay
- very hard or impossible to reduce

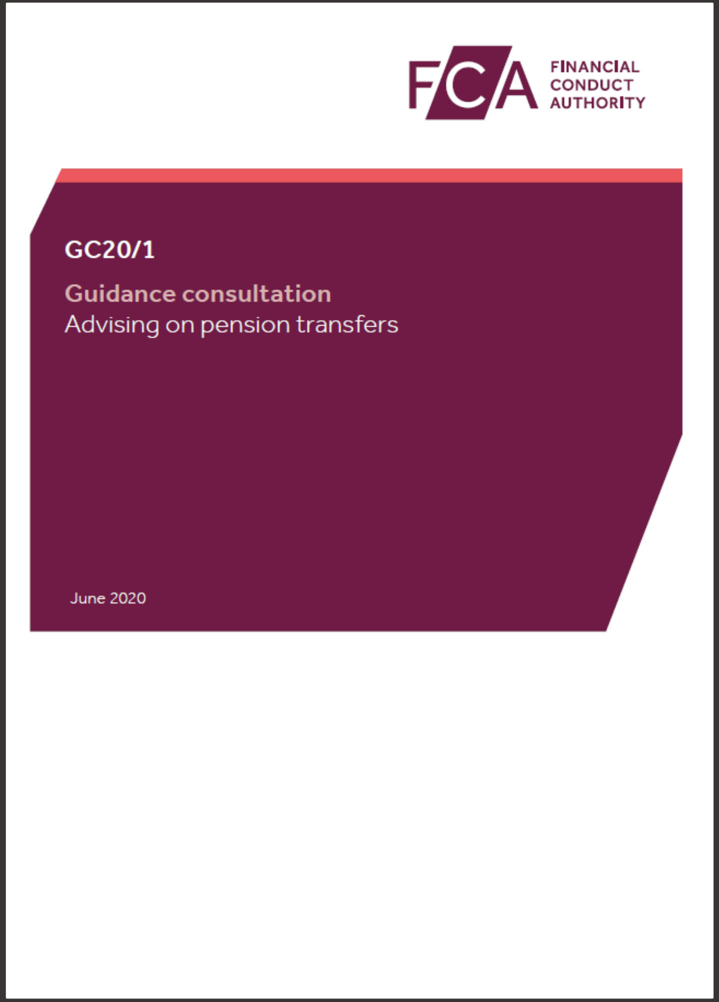
Lifestyle:

- holidays
- eating out

Non-discretionary

Discretionary:

- luxury items
- gifts
- savings


FCA FINANCIAL CONDUCT AUTHORITY

GC20/1

Guidance consultation
Advising on pension transfers

June 2020

DBAAT – replacing income

The client may not be reliant on income from the scheme if they can produce the same income via a suitable alternative, with or without a guarantee, and this income is able to meet their needs throughout retirement.

For example, if the recommendation is to transfer to a personal pension and the cash flow modelling (in real terms) evidences that with a sustainable withdrawal rate the client will not run out of money in retirement, allowing for beyond average life expectancy and stress testing of returns.

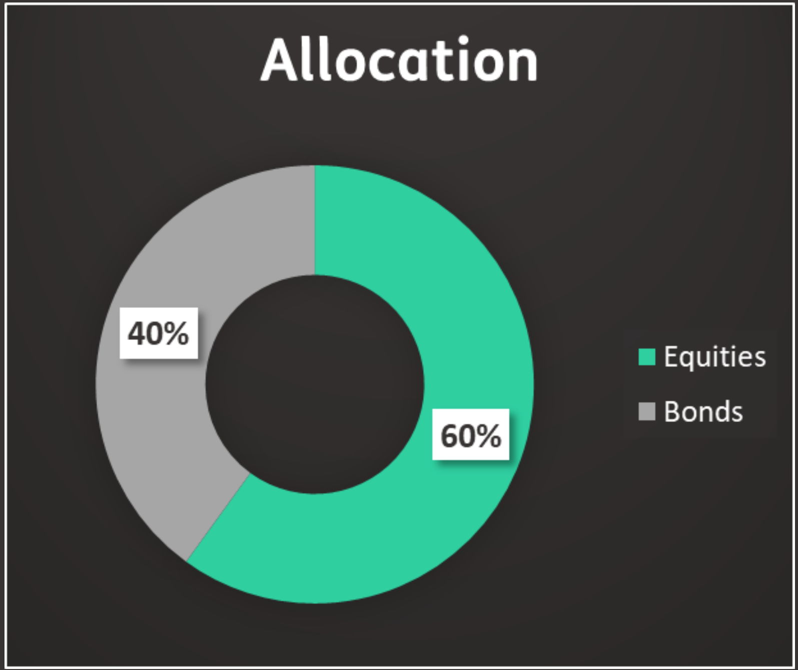
FCA DBAAT instructions

Example - Cynthia

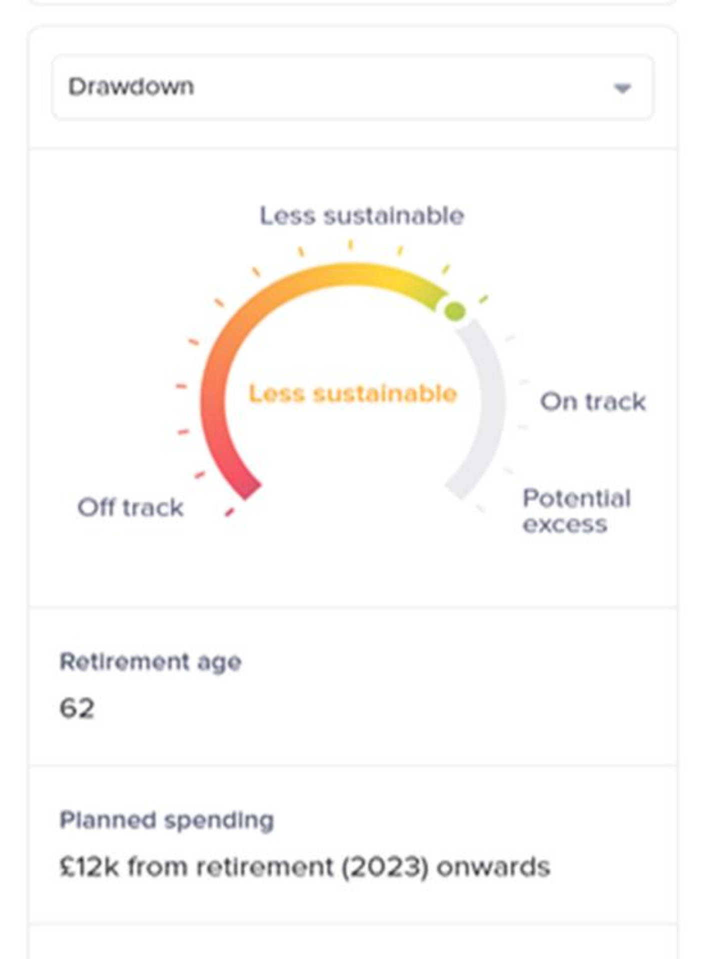
- Age 62
- Moderately adventurous attitude to risk
- Will use ISA portfolio to support income until state pension starts
- Main objective - meet income requirement
- Secondary objective - maximise legacy
- Cynthia transferred out of DB several years ago
- She now requires £12,000 a year income adjusted for inflation.
- After a difficult 2022 the portfolio has fallen in value to £326,000

Income sustainability

- £326,000 invested
- Income need £12,000 pa

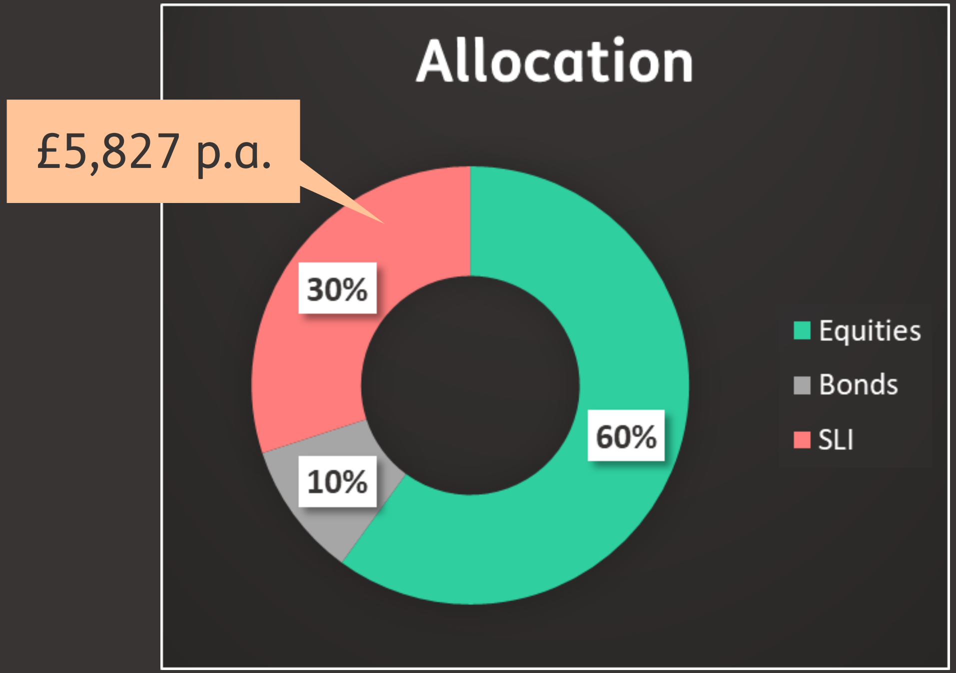


On track in
69%
of
scenarios
to age
99

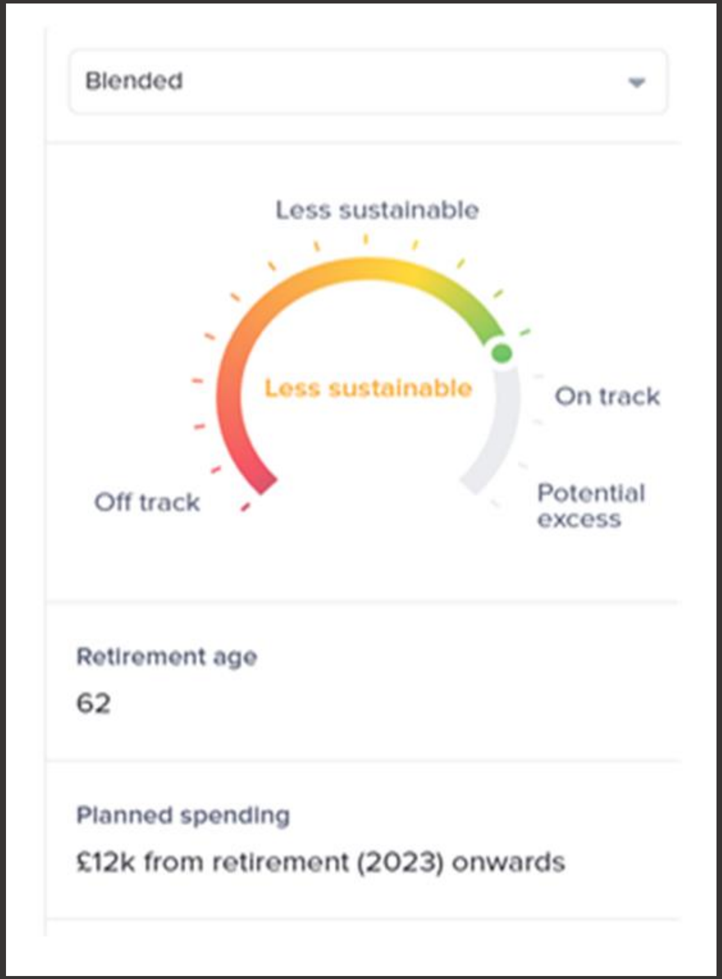


Income sustainability

- £326,000 invested
- Income need £12,000 pa



On track in
78%
of
scenarios
to age
99



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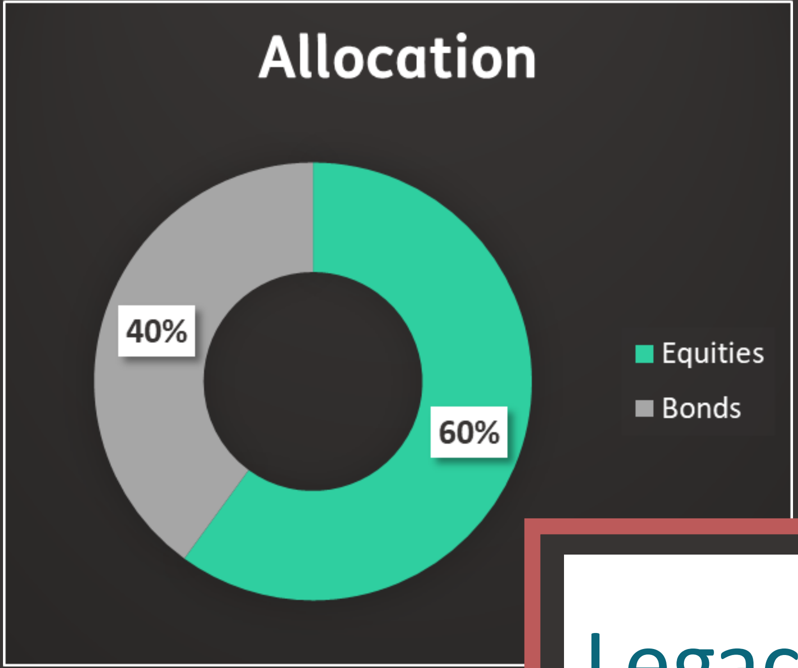
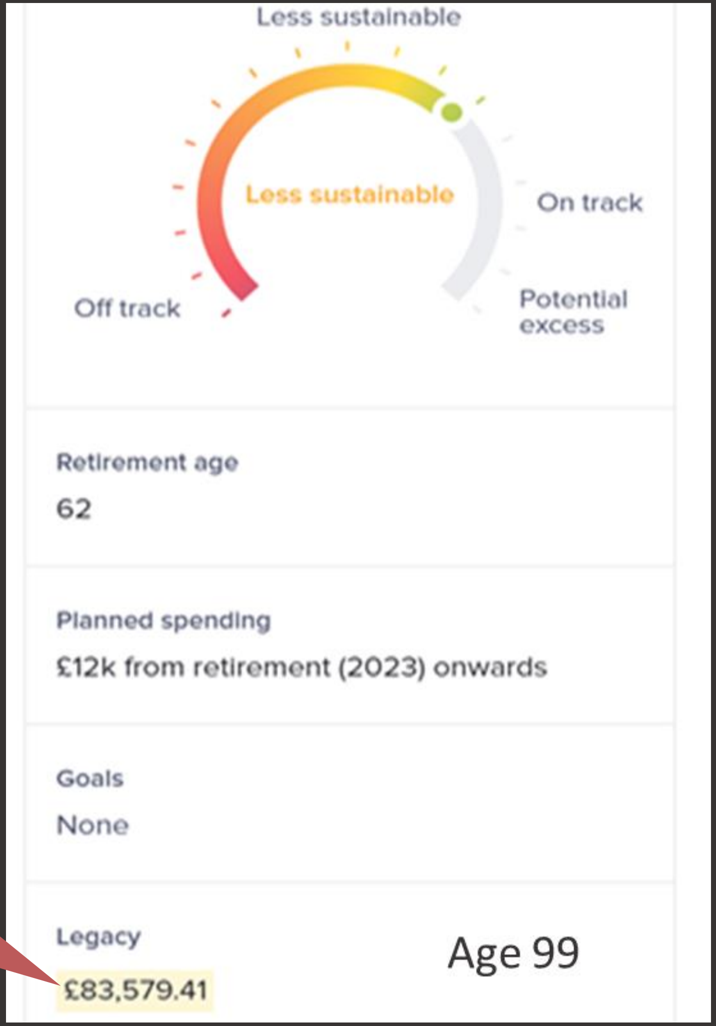
Legacy – no Secure Lifetime Income



Legacy

£83,579.41



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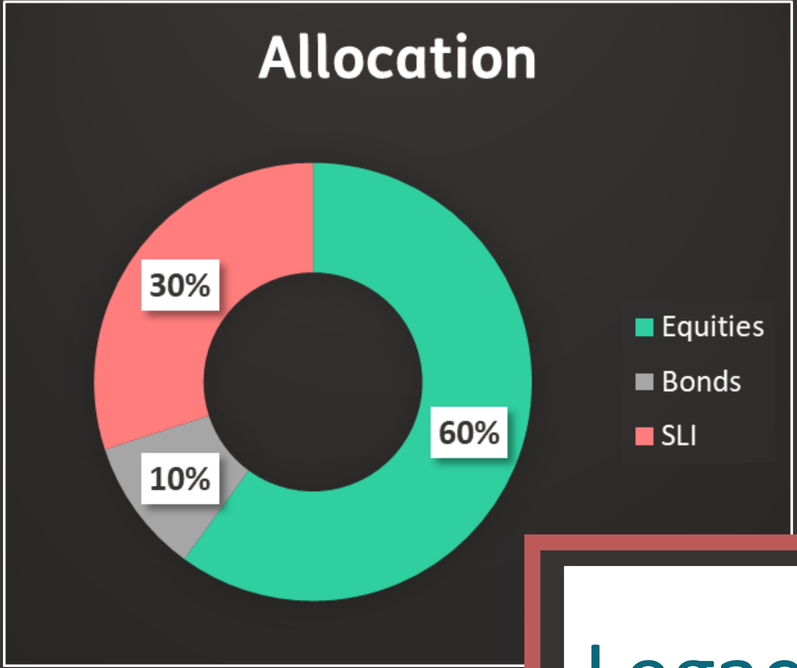
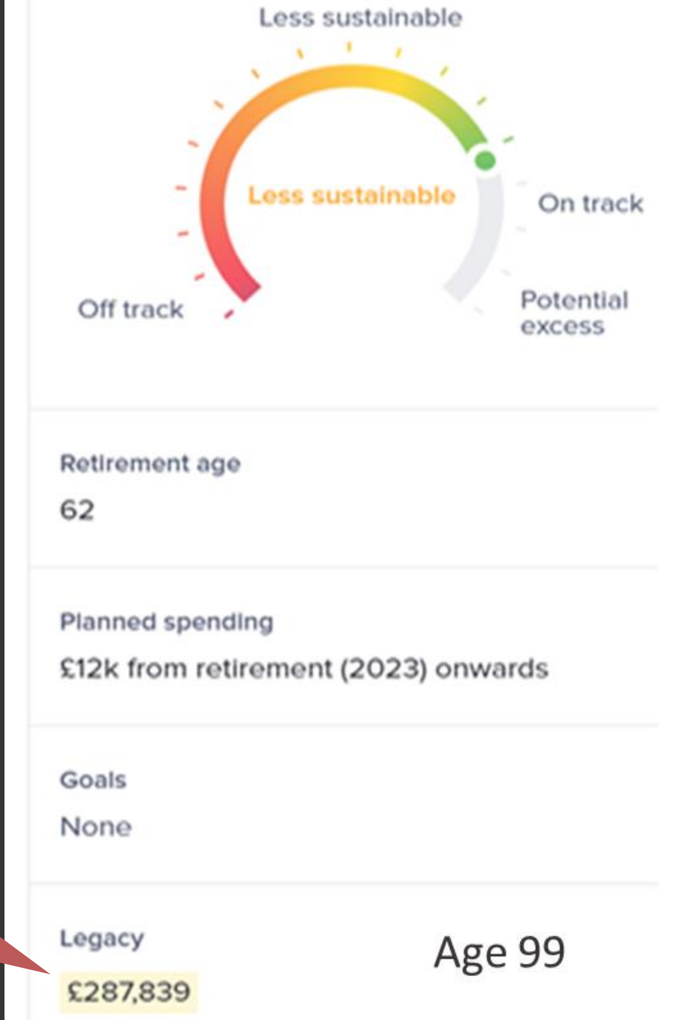
Legacy – with Secure Lifetime Income



Legacy

£287,839



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Further examples and other resources

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Consumer Duty

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Consumer Duty

Consumer Principle

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

Cross-cutting Rules

Firms must

1. act in **good faith** toward retail customers
2. avoid **causing foreseeable harm** to retail customers
3. enable and support retail customers to pursue their **financial objectives**

Four Outcomes

1. Products and services
2. Price and value
3. Consumer understanding
4. Consumer support

Look familiar?

Actions likely to be inconsistent with the Duty	Actions likely to be consistent with the Duty
A target market is defined so broadly that it captures groups of customers for whose needs, characteristics and objectives the product or service is generally incompatible.	The target market is defined at a sufficiently granular level to help avoid sales to customers for whose needs, characteristics and objectives the product or service is generally incompatible.
Products or services are marketed or distributed without considering whether they are designed to meet the needs, characteristics and objectives of customers in the target market.	A manufacturer considers if a product or service meets the needs, characteristics and objectives of customers in the target market and, where it does not, takes appropriate action to mitigate the situation and prevent any further harm.

Refining the target market - example

An investment fund might start with a target market described in terms of investment objective and investment risk.

..Should be refined and clarified if the product is generally incompatible with the needs, characteristics and objectives of people..

..who cannot commit to hold the investment for more than five years...

..or who cannot afford to bear potential investment losses.

Four outcomes

The governance of products and services

- Conflicts of interest
- Product understanding
- Understanding identified market
- Meet the needs, characteristics and objectives of the target market

Price and value

- Total price to customers over the lifetime of the product and client relationship
- Nature of the product or service including the benefits / qualities
- Product limitations

Consumer understanding

- Communication at every stage of the advisory process
- Appropriate information at the right time
- In a way that customers can understand including **vulnerable customers**

Consumer support

- No disadvantage to any group of clients
- Products and services provided as described at the costs agreed
- No unreasonable barriers during the lifecycle of the product
- Are clients using the product / services as expected ?

Learning outcomes

By attending this webinar you'll be able to:

- Understand how legacy provision can be improved
- Consider how higher levels of income can be sustained
- Explore how retirement plans can be made more resilient

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Vulnerable Customer Awards 2023

- Recognition for supporting people in vulnerable circumstances
- Full details including hints and tips
- Simple 800-word entry form
- Examples from last year's winners can be found at justadviser.com/justvca
- Any questions please contact the team at vulnerabilityawards@wearejust.co.uk or your dedicated account manager

Just Group 2023
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Vulnerable Customer Awards 2023

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