Retirement portfolios - time for a more sustainable approach?

Part 1

Retirement portfolio challenges

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Creating more sustainable retirement portfolios

Portfolio construction – worked examples

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Learning objectives

By attending this webinar you'll be able to:

- Understand the impact of the economic environment on retirement income portfolios
- Discuss the impact of markets on financial resilience and sustainability
- Recognise the market developments in guaranteed income

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?

In the headlines

The Telegraph

Retirees lose years of pension income as inflation and markets collide

Taking money out of savings pots when markets are falling does permanent damage to retirement dreams

Bank of England says inflation will hit 11% after raising interest rates to 13-year high..

Telegraph 12th June 2022., MSN 16th June 2022

Financial resilience

One
in four UK adults are in financial difficulty or could be if they suffered a financial shock

4.2m
people missed bills or loan payments in at least 3 of the last 6 months

FCA Financial Lives 2022 survey

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

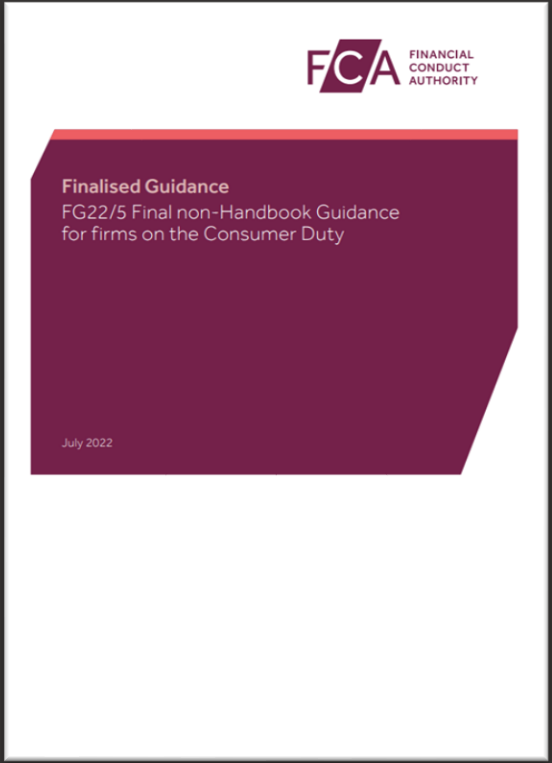
Foreseeable harm

"Firms must take proactive and reactive steps to avoid causing harm to customers through their conduct, products or services where it is in a firm's control to do so.

This includes ensuring that no aspect of their design, terms and conditions, marketing, sale of and support for their products or services cause foreseeable harm"

www.fca.org.uk/publication/consultation/cp21-13.pdf

Foreseeable harm


FINANCIAL CONDUCT AUTHORITY

Finalised Guidance

FG22/5 Final non-Handbook Guidance for firms on the Consumer Duty

July 2022

Firms should proactively consider how consumers' **behavioural biases**, such as inertia, might lead their products or services to cause foreseeable harm.

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Nowhere to hide in 2022

- The negative correlation between equities and bonds broke down in 2022

2022 60/40 portfolio performance
-8.86%

- Following 15 years of close to zero interest rates and massive quantitative easing programmes there's little precedent to how markets will react moving forward
- Rising inflation and rising interest rates is putting significant pressure on traditional investment models
- Leaving retirement income clients nowhere to hide

Data provided by FE Analytics, bid-bid TR, 01 Jan 2022 to 31 Dec 2022, in GBP

This wasn't just a 2022 challenge

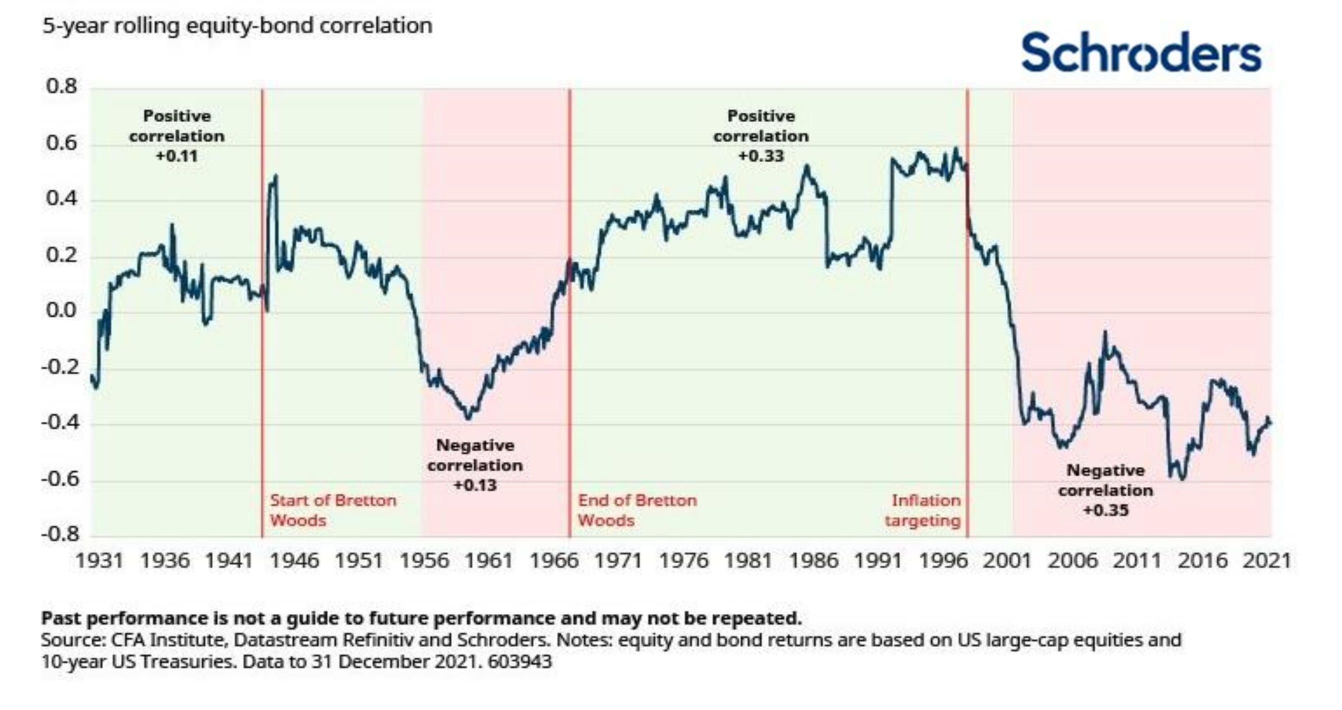
An example drawdown portfolio, 60% equity, 40% bond:

	Weight	Ann. 5yr	Contribution %
IA Global	60	6.63%	3.98%
IA Global Mixed Bond	40	1.01%	0.40%
Portfolio total	**100**	**4.38%**	

- Despite a 40% allocation the fixed income exposure has contributed little to overall performance whilst adding volatility to the portfolio
- The potential for more volatile equity markets markets in the short to medium term will leave many retirement income clients exposed
- Balancing income needs against macro-economic uncertainty is now a real challenge

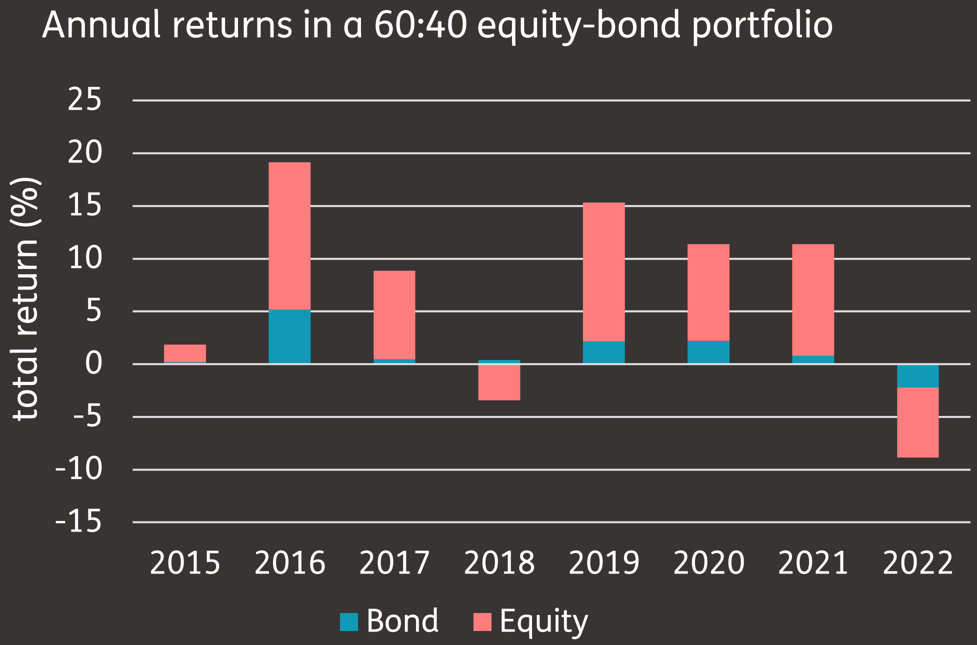
Data provided by FE Analytics, bid-bid TR, 01 Jan 2022 to 31 Dec 2022, in GBP

Changing equity/bond correlation



The persistently negative equity-bond correlation is a relatively recent phenomenon

What happens in drawdown portfolios now?



- 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

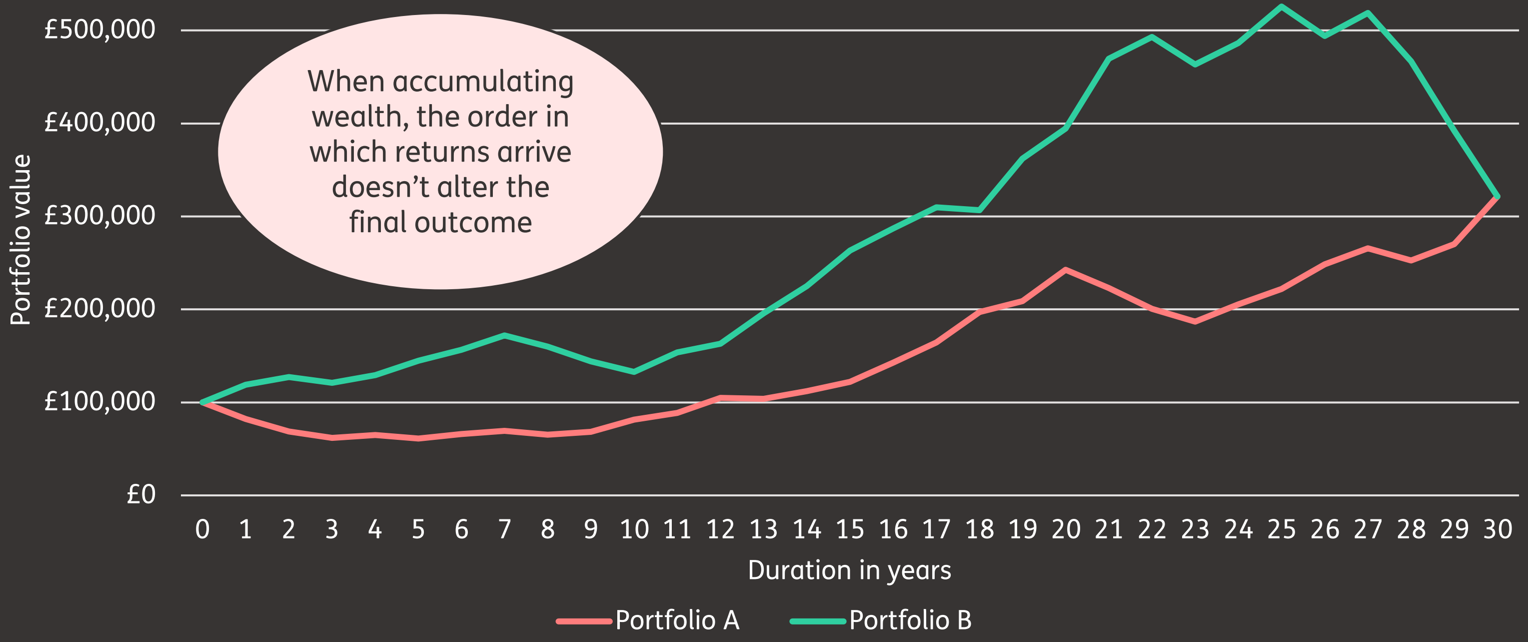
The ‘triple threats’ to portfolios of **inflation**, rising **interest rates** and **asset volatility** are heightened by the increasing correlation between equities & bonds

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

Risks and risk management

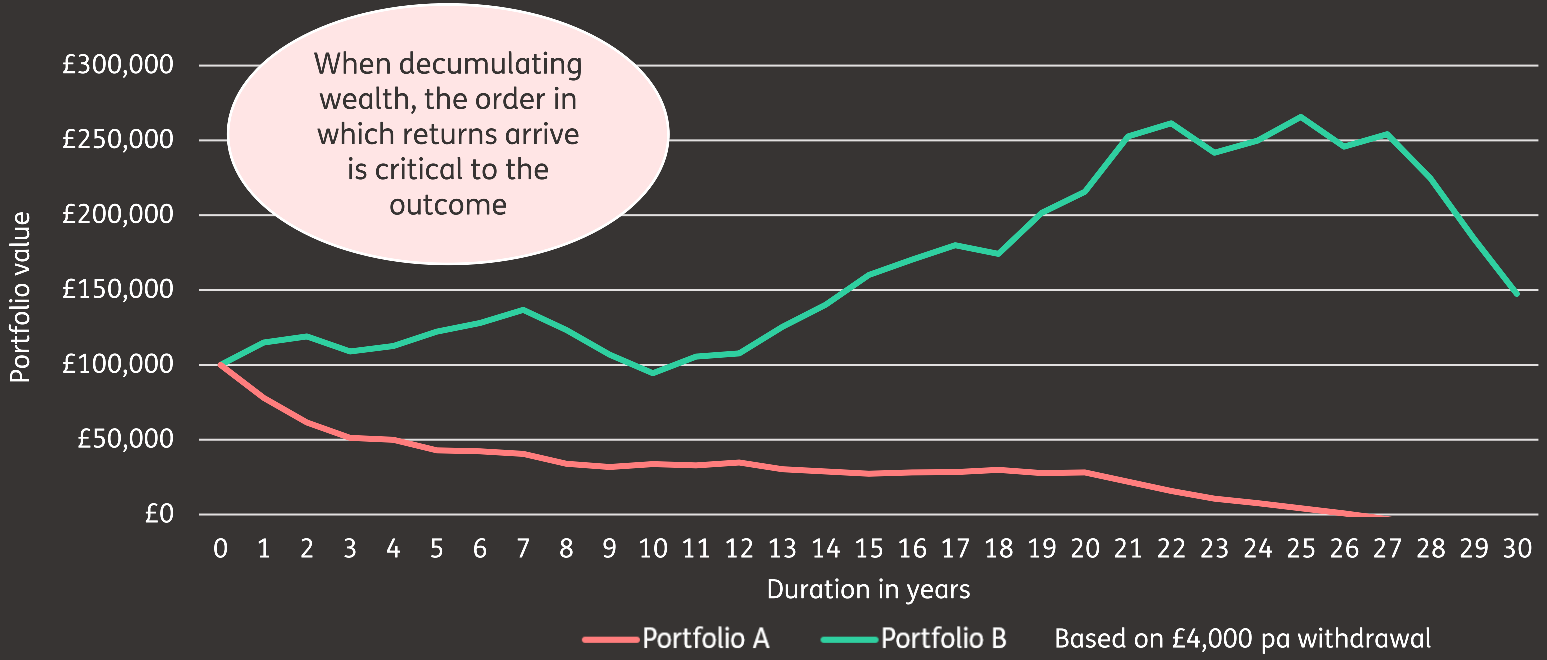
- Longevity risk
- Market and sequencing risk
- Inflation
- Changing circumstances
- Risk of ruin
- Emotional risk
- Cognitive risk

Wealth accumulators can ride out volatility



Portfolios A & B both have an average 5% pa investment return achieved over 30 years

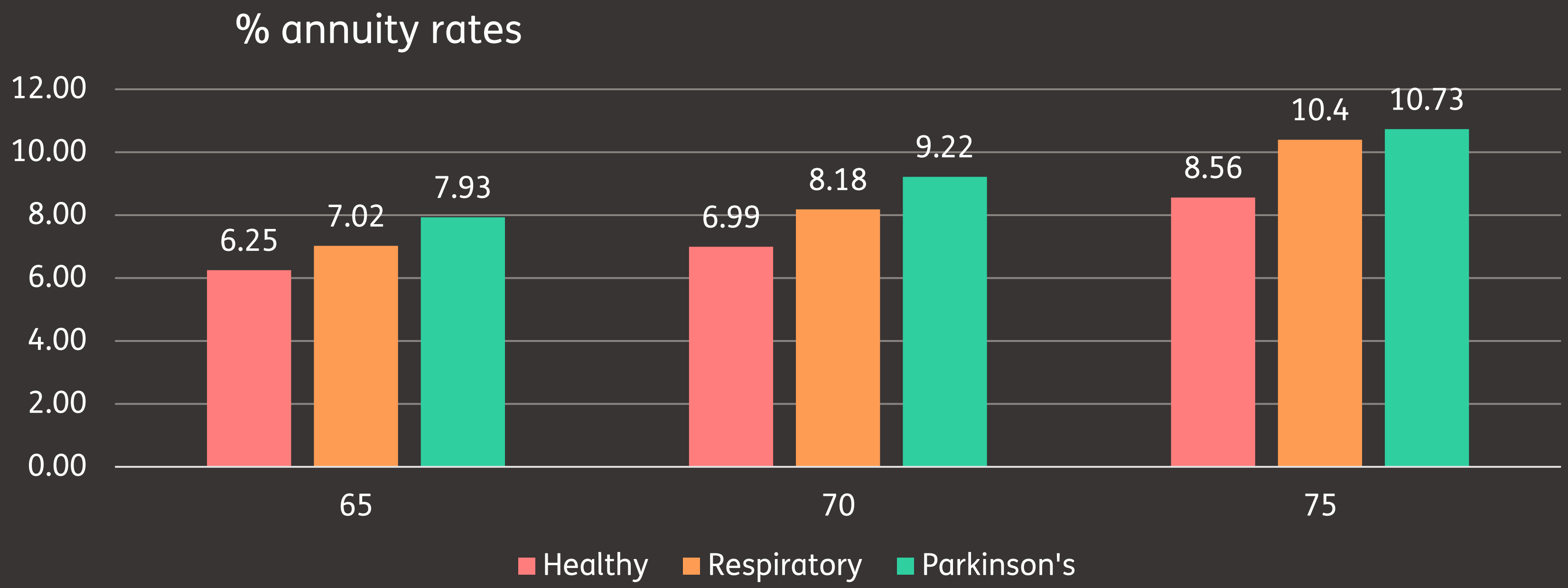
Sequence of returns matters in decumulation



Portfolios A & B both have an average 5% pa investment return achieved over 30 years

Role of annuities

Where do rates need to be?



*Based on an individual with a fund value of £100,000. An annuity being payable monthly in advance, no dependant's pension, no escalation, 10 year guarantee period, no value protection. Rates taken from Just, and cover August 2022 to January 2023.

Healthy Life – post code only.

Respiratory – COPD diagnosed five years ago, lung function moderately impaired, hospitalised a year ago, takes one medication.

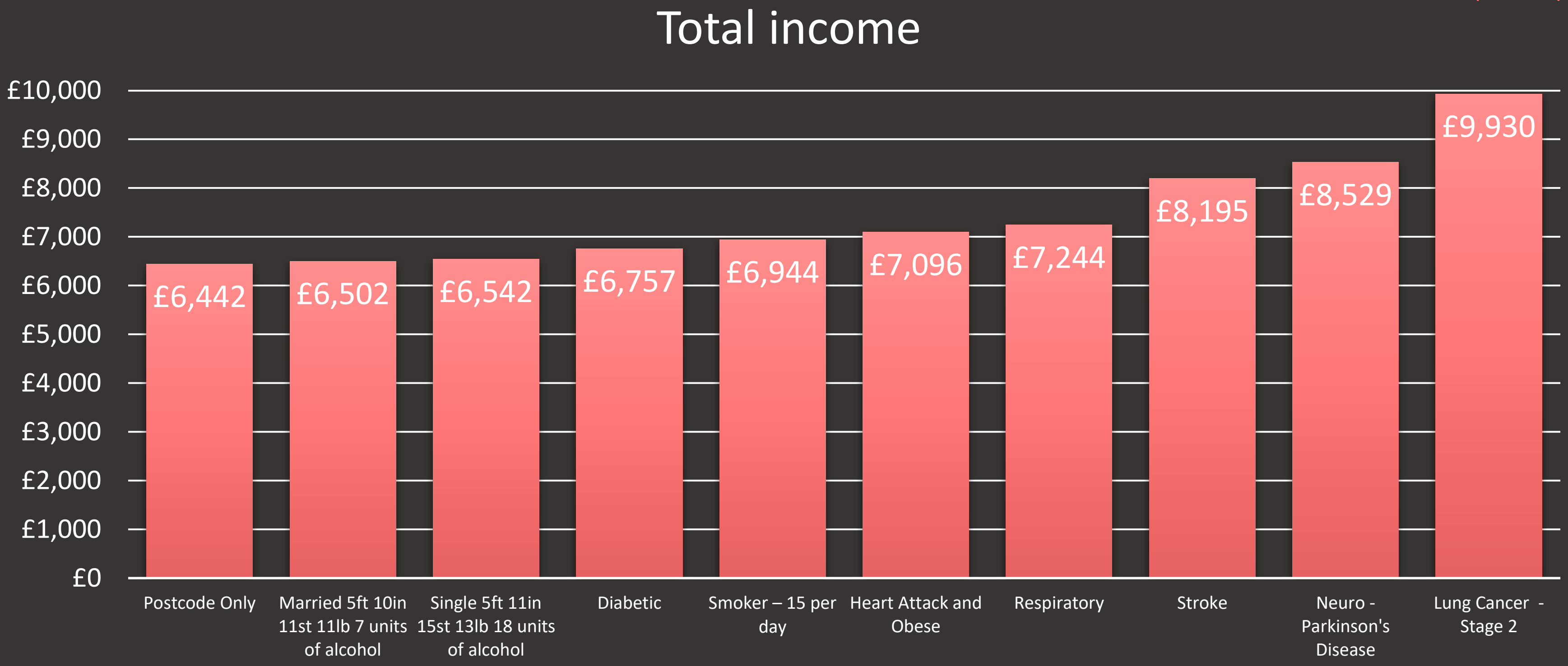
Parkinson's – diagnosed nine years ago, hospitalised a year ago, experiences falls, takes one medication, activities of daily living affected.

How much does it cost to buy £5,000 of income?

Health	In Oct 2019	In Feb 2023	% of funds needed
Good	£107,344	£73,500	-32%
Challenging	£81,125	£59,080	-27%
Critical	£70,626	£47,637	-33%

Source: Just rates, 1/10/19 & 3/2/23 rates based on £50,000 fund value, 5 year guarantee, level, paid monthly in advance
Good - married, admin clerk, RH2 7RT, 5ft 10"/10st 11lbs, 14 units,
Challenging - married, admin clerk, RH2 7RT, 5ft 10"/13st 10lbs, 7 units, Smoker 15 per day, HBP takes 1 med daily, High Chl takes 1 med daily, Parkinson's Disease diagnosed circa 9 years ago, last hospitalised 1 year ago, takes 1 med daily, ADL's affected,
Critical - married, admin clerk, RH2 7RT, 5ft 11"/9st 8lbs, 14 units, Stage 3 Bowel Cancer diagnosed 6 months ago, surgery, chemotherapy and radiotherapy.

Underwriting – personalised thinking



Basis – 65 year old married male £100K fund value, 5 year guarantee, level, paid monthly in advance. Just rates 4 Nov 2022

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Annuity death benefits

£50,000

No Death Benefit	£3,688
100% Value Protection	£3,331
50% Spouse + G5	£3,104
30 Year Guarantee	£2,626

Comparisons are based on an individual aged 65 with a £50,000 pension fund after taking a 25% tax-free cash lump sum. They are an ex smoker, diagnosed with Type 2 Diabetes 9 years ago which is managed by taking 1 medication daily, they have no complications. Where there is a dependant's income we have assumed the spouse is 62 and healthy. The above figures are based on an annuity being payable monthly in arrears, no escalation, no overlap where applicable, based on RH2 7RT postcode, where a facilitated adviser charge of 2% has been assumed. Just rates 3 Nov 2022

Annuity death benefits 100% value protection

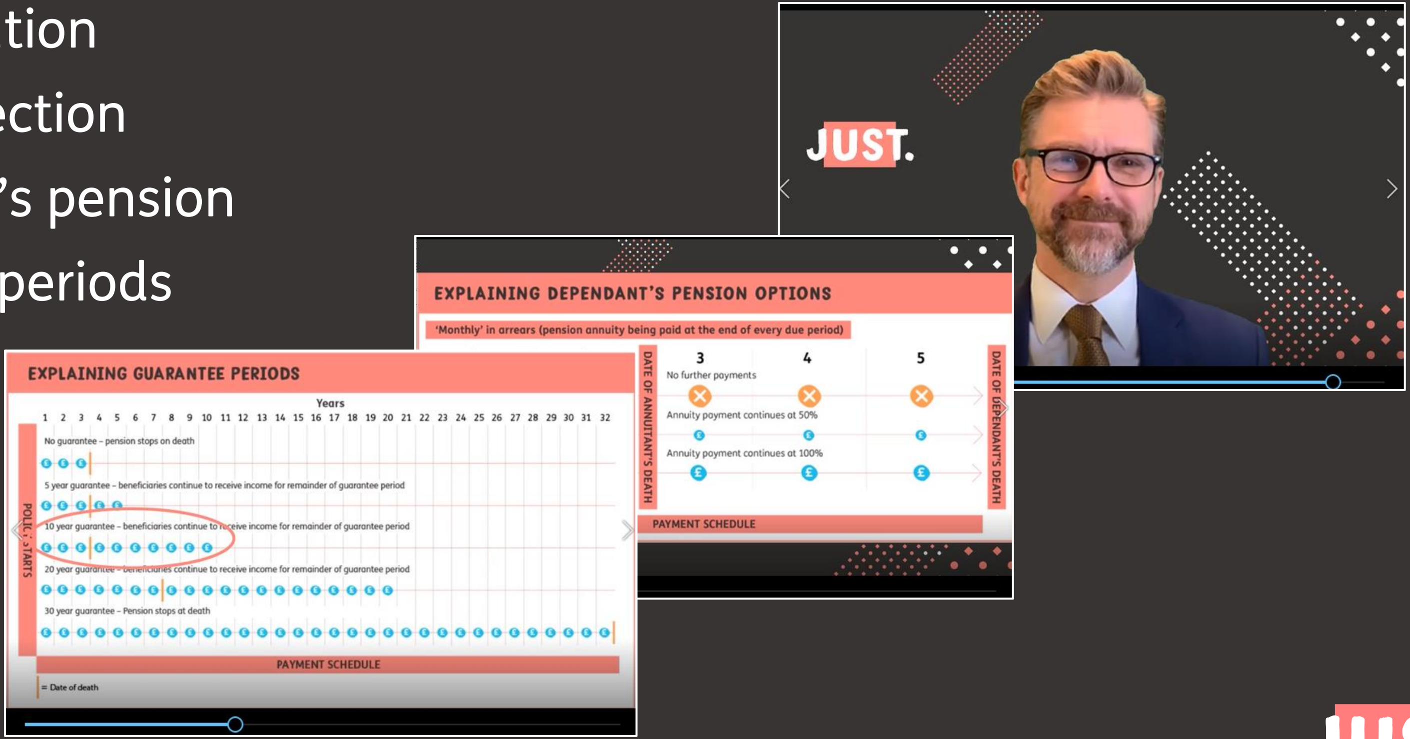
£50,000

Death after 6 months	£1,666	£48,334
Death after 5 years	£16,655	£33,345
Death after 10 years	£33,310	£16,690 (subject to tax)
Death after 16 years	£53,296	

Comparisons are based on an individual aged 65 with a £50,000 pension fund after taking a 25% tax-free cash lump sum. They are an ex smoker, diagnosed with Type 2 Diabetes 9 years ago which is managed by taking 1 medication daily, they have no complications. Where there is a dependant's income we have assumed the spouse is 62 and healthy. The above figures are based on an annuity being payable monthly in arrears, no escalation, no overlap where applicable, based on RH2 7RT postcode, where a facilitated adviser charge of 2% has been assumed. Just rates 3 Nov 2022

Annuity fundamentals videos

- Personalisation
- Value protection
- Dependant's pension
- Guarantee periods



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Best of both worlds?

- At what stage is the risk of running out of money too high?
- Is there a need to underpin the risk?
- How much capital is needed to do that?
- Does behavioural bias have an impact?
- How can the client be supported in achieving the balance?

Three key questions

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