CAPITA

Financial software

Does technology offer the only hope to retirees?

Of the 400,000 that are due to retire in 2015 the average they have saved is £26,000. Technology may offer the only hope to future retirees who cannot afford an adviser.

Pete Bayliss

Product & Marketing Director
Capita Financial Software

We are only a few months away from April 2015, which heralds the much debated pension changes and we know that according to the Office of National Statistics, at least 400,000 individuals per annum within the UK will reach retirement age. We are also told that the UK has 18 million people with a pension plan of some description and if we take into account all the individuals who have postponed retirement pending the April changes. All this leads to a very exciting and challenging time for us in the industry and a very important but potentially confusing time for consumers.

We are juggling many timescales, decisions, processes and challenges but as an industry we must keep at the forefront of our minds that retirees have a, if not the, most important decision in their lives (so far).

Against all this excitement, however is a stark reality in that the average pension pot is going to vest at roughly £26,000. Earlier in this edition, you will have read Blackrock's excellent article, which identifies a consumer's required income, their perception of the size of fund required to meet the income requirement and the size of fund they actually need to meet the income goal. In Financial Services we have a responsibility to build long term strategies to help consumers prepare for their retirement more robustly, while helping retiring consumers through the retirement conundrum.

For the 90% of retirees who have a fund of £50,000 or less, it is possible they may choose the guidance route. They are promised a free 20 minute telephone call and a face to face discussion with the Citizen Advice Bureau, but we believe they will still be left to decide their next steps and to find a delivery mechanism to fulfil. We are building solutions to help in this arena.

What is clear, however, is that regardless of the size of the retirees fund, their challenges and issues are the same:

- Will my decision affect my tax situation?
- Do I want a guaranteed income?
- If I do invest the money, can I afford to lose it or part of it?
- What is inflation going to do over the next *n* years?
- What happens if I live too long?
- What happens if I die too soon?

They will also have to consider the following changes coming into play in April 2015:

- If the policyholder dies before 75, the death benefits paid by the scheme or plan will be free of all taxes
- If death occurs after 75, the beneficiary will be subject to marginal rates of income tax or 45% if the entire fund is paid out
- While public sector retirees will be unable to switch from defined benefit to defined contribution, other DB members can if they so wish.
- Access to the pension will be available from age 55
- Scheme retirement age of 55 will be increased to 57 from 2028. Going forward it will always be 10 years below state retirement age
- Drawdown restrictions will be removed
- From April 2016, the new state pension is likely to be £148.40 per week.

We have utilised our skill and expertise to look at this very exciting and demanding area and would welcome a discussion. Great tools, quality guidance, appropriate education and fantastic advice will go a long way to help retirees meet their own retirement income goals. Meanwhile, as Product Providers / DFMs / IFAs / Aggregators / Research or quote and apply portals, we will all have some immediate challenges to deal with in the lead up to March 2015.

We at Capita FS have built tools that can be white labelled for you to build a service for your customers. Please call us on **0800 783 4477**

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MetLife

Certainty is central as retirement rules change

The pensions revolution rages on with new developments coming almost every week – and this is likely to continue until we April 6th 2015.

There has been over-excited talk about using pensions as bank accounts and headlines about the end of the "death tax" spurring debate. The Citizens Advice Bureau and the Pensions Advisory Service (TPAS) have been confirmed as the organisations delivering the Government's guidance service – with the Treasury in charge of the website.

It is refreshing to see technical pension issues being debated and there is a genuine sense of excitement about the retirement income market. Personally I haven't been this excited since A Day!

It is very clear there is real optimism about the changes that are on the way in the pension market and MetLife research among advisers shows this.

In the immediate aftermath of the Budget announcement in March there appeared to be a lot of caution by advisers – and clients – unwilling to commit until they knew more detail about what was on the way so MetLife conducted research* among advisers to take the temperature of the market; the results are encouraging.

Around 83 per cent of all advisers we spoke to are optimistic about the changes with 38 per cent very optimistic. More than a third (34 per cent) of advisers reported an increase in the number of at-retirement clients they have seen with just 12 per cent saying business has decreased.

Increased optimism and a rise in the number of clients asking for advice is a strong foundation for the market to build on – but of course increased optimism and more clients asking for advice does not necessarily translate into more business.

It's not all change

When there is uncertainty about new rules the best advice is often to wait and see and some advisers were taking that approach. Our study found 63 per cent of advisers have told some of their clients to delay their retirement decision until after April 2015. When it comes to recommendations, around two-fifths (38 per cent) of advisers have advised clients to take out drawdown plans when previously they would have advised them to take out annuities. After all, not every at-retirement client can afford to wait.

And the need for certainty in retirement and certainty in retirement saving will remain the same and savers will still value the need for protection of their pension funds and the prospect of growth. Plus there will still be a need for certainty over income in retirement.

But the options are changing

Currently retirement income options can be summed up as lifetime annuities of various types including enhanced, inflation-linked and investment-linked: capped drawdown or flexible drawdown for those with secure incomes of £12,000 a year; guaranteed drawdown and other variations on drawdown such as fixed-term annuities. People with small pots of less than £30,000 and/or up to three pots of £10,000 – can take the money as a lump sum now.

From April 2015 the options will include:

- **Annuity** offering a guaranteed income for life, which is usually fixed. Death benefits – such as spouse's pension or value protection – can be built in upfront. They can be investment linked or offer higher income for medical or lifestyle conditions
- **Flexi-access drawdown** where income is taken as and when needed from the fund, which remains invested in the market but could run out
- **Guaranteed drawdown** which is drawdown with a guaranteed level of income for life. The fund can be accessed at any time if needed

MetLife

Charlotte Cowell

Head of Product, UK Wealth Management
MetLife

About MetLife

Since entering the UK market in 2007, MetLife Europe Limited has been focused on bringing our clients a genuine alternative to all the other retirement and investment solutions out there.

This means providing innovative, award-winning products for changing generations – as well as delivering exceptional, award-winning service. And crucially, there's our range of ground-breaking products, protecting our clients' investment against life's many unknowns.

No other insurer offers what we do. We know people want to protect their investment against a fluctuating market – but we also know they don't want to sacrifice growth. So we offer a unique range of products that give real growth potential, plus security for our clients' money.

MetLife wants to see guaranteed drawdown included as a category in any list of retirement income solutions because our research shows that people do need an income in retirement.

Contact details:

0845 370 6040
www.metlife.co.uk

- **Fixed term annuities** which guarantee a set level of income over a chosen term and a maturity value at the end of the term which can be reinvested or withdrawn
- **Uncrystallised funds pension lump sums** which offer 25 per cent tax-free and where the remainder is taxable at the client's marginal rate. Clients can take all or part of the fund in this way.

There is also likely to be other retirement income solutions launched to market.

And the market will change

Tucked away in all the excitement of the Treasury talking about using pension funds as bank accounts there was an announcement from HMRC headlined Pensions Flexibility 2015.

It outlined the potential benefits for the Exchequer – or taxpayers – from the new rules with total revenue increasing by £320 million in 2015/16 and by £1.22 billion in 2018/19.

It also set out how big the flexi-access drawdown market could be. Currently around 5,000 people a year chose flexible drawdown where there is a minimum income requirement. After April 2015 it is estimated that this number will increase to 130,000 a year though more recent surveys suggest 200,000 people may take advantage.

MetLife wants to see guaranteed drawdown included as a category in any list of retirement income solutions because our research shows that people do need an income in retirement. Drawdown will be appropriate for some, but they need to be able to tolerate a drop in income or income ceasing altogether and longevity is usually underestimated.

It might not be quite as exciting as using your pension fund as a bank account but it does provide certainty and advisers will be crucial to the process.

For further information on MetLife products please visit **www.metlife.co.uk** or speak to your MetLife representative on **0845 370 6040**

* Research conducted via NMG July Financial Adviser Census for MetLife among 284 financial advisers specialising in retirement planning

The value of value-protected annuities

Possibly the biggest criticism of annuities in the past has been that if an individual purchases an annuity and then dies in the early years of their retirement, any cash that remained in their original pension pot was lost: it stayed where it was, in the hands of the annuity provider.

Value protection was designed to address this: any remaining money not received by way of income throughout the life of the contract is returned to the individual's beneficiaries as a lump sum on death. This means that between them, the annuitant and their beneficiaries will receive the full amount of their pension fund invested. This idea might have held greater appeal though, were it not for the fact that the lion's share (55%) of the lump sum went to the taxman instead. As a result many individuals simply bypassed the value protection option altogether.

The proposal to "remove" what many saw as a disproportionately large death tax rate of 55% from pensions, was warmly welcomed when it was announced in September 2014. The changes actually mean that from April 2015 the remaining unpaid pension funds can be passed to your beneficiaries tax free should you die before your 75th birthday. If you die later, a lump sum will be taxed at 45% (this is due to reduce further to your beneficiary's income tax rates from 6 April 2016, which could be nil, 20%, 40%, or 45%)[1].

However, the question of 'value' remains a subjective one, depending largely on an individual's view of what they are looking for in a product. But this can be approached from a number of different angles. Here we look at two comparisons:

Weighing cost against benefit

Firstly, the cost of value protection is paid for in the same way as any other annuity option – through a reduction in the amount of income that the individual receives. For example, a 65 year old with a £50,000 pension fund could receive £3,311 a year, on a single life basis[2]. If 100% value protection is included, then the income would fall by around £33 a month – £400 a year – to £2,907 instead.

So, taking the example where the individual unfortunately dies in the first year, in this case – after April 2015 – the beneficiaries would receive a gross repayment of £47,093 (£50,000 less the first year's payment of £2,907). The process is continuous, meaning that, as more income is paid out over time, the value of the lump sum that's left for the beneficiaries reduces year by year. Of course, in the meantime the annuity continues to pay income for as long as the individual is alive to receive it, guaranteeing that between them, the annuitant and their beneficiaries will now receive the full amount of their pension fund.

Capacity for loss

Capacity for loss refers to an individual's ability to take risks with their finances – and be able to withstand a reduction in either the capital, income, or both, if investment markets fall.

The alternative to an annuity is often a drawdown product. This allows the individual to keep their pension fund invested and withdraw money straight from it. The income is not guaranteed for life as with an annuity, but the individual keeps their options open and can change the amount of money they withdraw. As the funds remain invested, there is a risk that their value could fall which could mean that the funds run out – similarly if the investments do well, the individual may be able to draw more income. On death whilst in drawdown, the remaining fund is available to your beneficiaries to either withdraw as a lump sum or to draw their own income from.

So, if we're going to compare an annuity to a drawdown product, then capacity for loss must be factored into the mix when looking at what happens to the pension fund on death.

If drawdown can produce an investment return that's greater than the income being withdrawn, or sufficient return to deliver an income at an acceptable level throughout life, then that all

Tony Clark

Product Marketing Manager
Just Retirement

A value-protected annuity is unique in its ability to deliver a secure, guaranteed income that won't run out before death, and then deliver the balance of your fund to your beneficiaries in the event of early death.

points to a well-managed retirement plan. But what happens if there's a sustained drop in the stock market?

We've just seen the FTSE 100 fall by more than 600 points in the three months or so between the beginning of July 2014 and mid-October. Whilst an annuity is not subject to investment performance risk, drawdown products are. Of course markets and funds could increase just as easily, and therein lies the conundrum.

All things to all people?

The changes to the tax charge means that value protection now makes more sense than ever before, but it should also trigger a re-think about the benefits that an annuity can offer. Three components that you need to consider when planning your retirement income stand out, although there's no common solution and the answers will all be unique to each individual:

- **Provision of income during retirement** – does this need to be secure and guaranteed; completely unaffected by stock market volatility? Or do you have the ability to soak up a certain amount of loss?
- **The chance of outliving the pension fund** – is your pension fund the main or only source of income, and can you afford to risk this money ever running out? Do you need the guarantee the income will never stop in your lifetime, or even pass a balance on to your beneficiaries?
- **Value for money** – do you stand to get your money back on your initial investment, either as income over time, or through death benefits provided to your loved ones?

A value-protected annuity is unique in its ability to deliver a secure, guaranteed income that won't run out before death, and then deliver the balance of your fund to your beneficiaries in the event of early death.

It ticks all three boxes, making it – potentially – all things to all people.

For more information please speak to your financial intermediary or visit us at **justretirement.com**

1. This is based on Just Retirement's understanding of current proposals as at 1 October 2014, which are subject to change.
2. These illustrative figures are based on an individual aged 65 (who suffered a heart attack three years ago and is currently prescribed one daily medication for the heart), a £50,000 pension fund, payable monthly in arrears, based on RH2 7RT postcode. Source: Just Retirement annuity rates, 04.07.14

Life's big moments require a plan

Our latest advertising campaign was launched in the UK in early October. Focusing on some of the key life moments people are likely to face, the campaign looks at peoples approach to saving and investing and asks whether people are preparing in the right way for the future.

Sanjay Gohil
Vice President
BlackRock

The campaign draws on the findings from our global Investor Pulse survey[1], which showed last year that people are hoarding high amounts of cash relative to their other investments. Cash is an essential part of anyone's portfolio, but the low recent returns from most savings accounts could mean that some people will not be able to grow their capital enough to meet their long-term aspirations.

It is not always easy to anticipate what might happen over the course of your life, but there are some eventualities that are common to many of us. BlackRock has researched how people feel about these big life moments and also how they react to them.

Retirement

The one life moment which is inevitable for most is retirement. Increased life expectancy means the average person in the UK can now expect to live for around twenty years after retiring[2].

At the same time, expectations around retirement lifestyles have changed. Through Investor Pulse, people told us they expect to travel, exercise, start new hobbies and even continue to do some paid work during retirement.

But, despite such ambitions, the Investor Pulse Survey indicates that more than half of UK investors are simply not saving for retirement and many are unaware of how much it will cost to fund a comfortable retirement. For many people at or approaching retirement age now, generous company pension schemes may provide them with the comfort they need (especially when bolstered by the state pension). But for the next generation down, the retirement picture is not as certain.

In the past, the company or the state took on all the risk for providing a pension. Now, the onus is very much on the individual to have saved a sufficient retirement pot and to manage those savings or investments into retirement. Knowing we're likely to live longer than our forebears makes the challenge of investing for the right amount of growth, and then finding the right balance of income, even more demanding.

On top of this are the changing behaviours in our society – people no longer accept that they will 'shut down' in retirement, simply pottering around in a garden or allotment. People nowadays have firm ideas about the types of activities they'll continue to do or take up in retirement.

However, building up enough of a nest egg and finding the right places to draw an income can be a major challenge. People worry that they will not save enough and then might outlive the savings they have when they can no longer rely on a salary.

Children's future

Another life moment which will affect many people is children. The cost of raising a child is something most people bear as part of their ongoing cost of living. But many parents are now finding that the cost of children doesn't stop once they reach adulthood. The costs related to further education and getting on the property ladder in particular – two foundational life moments – have become almost prohibitively expensive.

A full-time student on a three-year university course might come out the other end with debts of up to £50,000. Raising a decent deposit on a first home might cost upwards of £10,000, taking into consideration the Government Help to Buy scheme. For young people looking forward to their first decade of adulthood, the potential financial demands can appear daunting. So what can parents do to prepare for these potential demands from their children as they move into adulthood? Would it be handy to have slowly-but-steadily accumulated, say, £25,000 by the time the child is 18 years old? Would the knowledge that putting aside just £100 a month could achieve this goal change a parent's approach to saving? What if they knew that they could achieve this amount with a growth rate of just 1.5% per year? Or that taking a long-term approach to investing by using shares (equities) might earn them a much stronger return than cash or bonds. For instance, that a 5% growth rate would have boosted that £25,000 after 18 years to almost £35,000. Or that using a diversified strategy – which takes in the best ideas from bond, equity and other markets (multi-asset) – would probably not have generated returns as strong as equities but would have given a smoother investment ride? You should be aware that moving out of cash in search of higher returns will involve accepting a greater risk of capital loss.

New Business

The bottom line is that we should all do our best to be prepared financially. Whether it's the longer-term goals above or an opportunity to start one's own business, being financially prepared can make the going much smoother when a life event happens.

For those of us brave enough to start our own business, having enough of a financial buffer is clearly the biggest concern and this is reflected in the top tips from people in the UK who have taken the entrepreneurial plunge.

Nearly two-thirds say their top tip is to think about how you will support yourself if you start a business, while a third say not to ignore other aspects of your finances when focusing on the new business. Cashflow is the main challenge for new businesses and 41% say that you should save as much as you can before starting the business, while one in three say that you should focus on the working capital that is the lifeblood of any business.

Life never goes exactly according to plan. This is what makes it exciting and challenging. But with the financial burden of providing for oneself today and in the future increasingly on the individual, some investors may need to reassess how they are preparing for their own futures and the life moments they will inevitably face.

Please take time to look at the BlackRock Plan for Income and see if there is anything which you could be doing differently with your client's investments.

Visit our website **blackrock.co.uk/plan**

1. The results of the survey are provided for information purposes only. The conclusions are intended to provide an indication of the current attitude of a sample of UK citizens to saving and investing and should not be relied upon for any other purpose. Source: BlackRock research conducted from 24 August to 27 September 2013 amongst a nationally representative sample of 17,600 individuals aged 25 to 75 years old. Sample per market is as follows: UK (n=2,000), Germany (n=2,000), Italy (n=2,000), France (n=1,000), Netherlands (n=1,000), Switzerland (n=600), Belgium (n=1,000), US (n=4,000), Canada (n=1,000), Hong Kong (n=1,000), Taiwan (n=1,000), Australia (n=1,000).
2. Source: Office of National Statistics, 2013.

Most investors are likely to be let down by their pensions pot

HOPES

How much people in the UK hope to have as an annual household income when retired[1]

EXPECTATIONS

The retirement pot people think they will need for a comfortable retirement[1]

REALITY

The retirement pot that people actually need to guarantee the retirement income they hope for [2]

1 Source: Investor Pulse Survey, research conducted amongst a nationally representative sample of 2,000 individuals in the UK, aged 25 to 74 years old, in August – September 2013. The results of the survey are provided for information purposes only. The conclusions are intended to provide an indication of the current attitude of a sample of UK citizens to saving and investing and should not be relied on for any other purpose.
2 Source: William Burrows. Joint-life annuity calculation based on UK actuarial aggregate rates data – Male age 65, Female age 60, £100,000 purchase, joint-life 2/3rds, guaranteed five years, level payments. This estimate does not take into account any other savings, sources of income from state benefits which you may receive in retirement.

COST OF LEARNING

It typically costs a student **£16,580** per year to attend university[1]

COST OF NEW HOME

The average price paid for a first home is **£204,000**[2]

COST OF FIRST CAR

Parents can pay anything up to **£8,000** for their child's first year on the road[3]

1 Source: National Union of Students, 2013.
2 Source: ONS, House Price Index, June 2014.
3 Source: Estimate compiled by BlackRock based on several independent sources.

About BlackRock

BlackRock helps millions of people, as well as the world's largest institutions and governments, pursue their investing goals.

We offer:

- A comprehensive set of innovative solutions
- Global market and investment insights
- Sophisticated risk and portfolio analytics

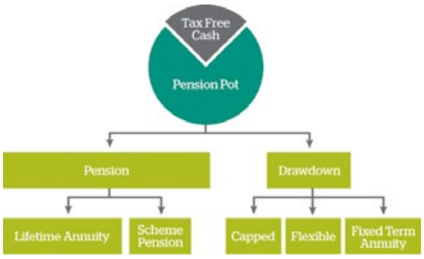
We work only for our clients, who have entrusted us with managing $4.6 trillion*, earning BlackRock the distinction of being the world's largest fiduciary investment manager†.

*AUM as at 30 June 2014.
† Source: Pensions & Investments as at 31 December 2013.

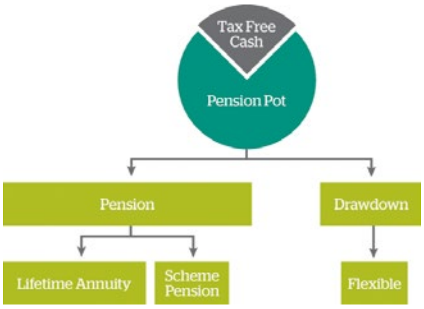
Retirement income or retirement outcome?

It is often said that clients don't want to take any risks in retirement so they choose products which they see as being risk free.

To understand the risks in retirement, the different options available on retirement must be considered and the way in which they work – Pension or drawdown.



The Budget proposed that this model will change next year. The idea is that this will create a level playing field. People with funds under £30,000 (£18,000 pre 27 March 2014) can take a trivial commutation lump sum with 25% tax free cash and the rest of the fund as a lump sum at their marginal rate of tax. Those who have larger funds and can satisfy the Minimum Income Requirement of £12,000 (£20,000 pre 27 March 2014) can take their tax free cash and the rest of the pot at their marginal rate of tax. So essentially everyone will have the same options. What change is there to the above model then?



In the "new world" will the door appears to be open for product innovation but will there be a revolution in product options or will the existing solutions simply evolve? The planner's job will essentially be the same, except there will be more flexible options. How can this pot of money be managed to supply the customer with the retirement outcome they are looking for within a level of risk they are willing and able to take? What about the change in risks?

What are the risks?

Given the different income rules and drivers of income it is important to think about the risks which annuities, drawdown and the proposed third option have.

Credit risk

This is the risk that any provider could go bust. All providers have different financial strengths and broadly speaking, the higher the financial rating, the less chance of failure. This risk should not change although all money may be withdrawn from the provider, which in itself will have risks. There may of course be some element of protection from the Financial Services Compensation Scheme.

Mortality risk

Mortality risk is the risk that a client could die prior to "getting their money back". In the drawdown space this is different as it is about mortality drag. However, could this be less of an issue as fully underwritten annuities become the norm? Where there is a continued link between annuity income and investment performance, the returns may need to be higher to maintain income levels dependent on that particular insurer's mortality experience. If a client cannot accept the longevity risk then they may seek to insure against this i.e. buy an annuity, after all the point of an annuity is to ensure that there is a level of income until the client (and dependant) dies.

Annuity rate risk

This is the risk that annuity rates may decrease in the future. This will normally disappear when the client purchases an annuity so it is more of a risk for drawdown (including fixed term annuities) and the April 2015 option. However, it is also a risk for variable annuities due to the continued link to annuity rates. Annuities will continue to exist so annuity risk must still exist if an alternate to annuity purchase is chosen prior to annuitisation.

Capital risk

This is the risk that capital may be eroded. When an annuity is purchased capital risk disappears as the capital has been spent. However, some variable annuities may have continued links to a notional fund value and therefore have a capital risk and clearly drawdown has capital risk. This will not change in the new world, how a client's capital is managed will dictate the outcome they receive. After all, if the whole fund can be taken then there is significant risk of capital erosion.

Investment risk

This is the risk to future benefits due to investment performance. This risk only applies where there is an investment link, so conventional annuities are not affected by this. There will of course be risk within the risk

Les Cameron

Head of Product & Sales Technical
Prudential

depending on type of investment. Clearly this remains the same.

Inflation risk

This is the risk that the real value of income may be eroded by inflation. This risk could apply to all of the retirement solutions although this risk can be mitigated by having escalation. However, inflation could be above the escalation rate chosen. Adding investment risk to generate rising incomes can mitigate the inflation risk. Again, this risk remains but more ways of managing it may or may not materialise.

Summary of risks

So the risks in relation to annuities and in relation to drawdown are clear aren't they? Maybe not. From the table it is clear that there are three retirement options where the outcomes have a drawdown risk profile.

Products and options may change but planning should be the same in the new world. All the risks of the old world exist. The method used to generate a client's retirement income will determine the risks which the client will be taking and ultimately the retirement outcome.

Of course there is the "riskier option" of exhausting the whole pot if the proposed changes go ahead. Will clients do this? Or will it be like flexible drawdown and this did not happen as was expected? If a client withdraws all their money and spends it then the risk is that they have no money in retirement. However, if they invest it in another financial product then each of the risks mentioned above still apply.

The aim of the Government was to level the playing field and this means all clients with DC pension funds have the same options. It also means clients with pension funds have the same options as clients who chose to save for their retirement in a different way.

Why income rather than outcome?

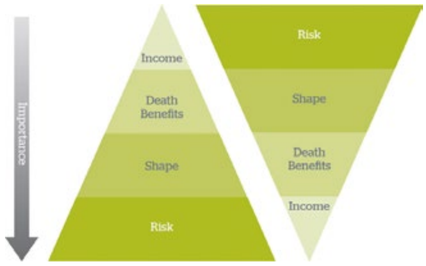
Clients are often most interested in the highest possible starting income (see the right hand triangle on the following diagram) and this often means that risk is not considered. Clients also have interesting attitudes when purchasing an annuity. They think that they won't live long so want the most income now although longevity is increasing. There is also a concern about getting good value from an annuity. This is an interesting thought. Most people don't complain about the fact that they haven't died even though they have been paying for life insurance most of their life – an annuity assures that there is an income for life! Too many clients consider the annuity purchase price and don't actually think about what they paid for the fund and the positive effects of employer contributions, tax relief, tax free cash and growth.

In the new world, will there be an obsession with receiving the highest possible income when the only constraint is the size of the pot? Any returns should still be based on what was paid to accumulate the pot – not what the value of the pot is.

The increase in GAD rates means that more income can be taken by clients in drawdown (which is also good news for clients who are currently doing income recycling to maximise vtax free cash and IHT planning). However, the same issues are still relevant and will be after April 2015. Is the income sustainable? Are dependants catered for? Will the pot of money last? Will the client get their money back? The four key factors will still be yield, size of fund, income and the time frame over which the income is to be paid.

Critical yields may not be relevant next year but yields will still be critical.

Therefore, for annuities, drawdown and the option to remove the whole fund risk is still the most important issue (see left hand triangle in the following diagram). It not the management of risk as opposed to the size of the income that determines whether the retirement outcome is good or not.



The FCA doesn't look at a customer's bank balance for unsuitable outcomes – they look at the suitability report.

Risk free retirement?

There is no risk free retirement and there will not be a risk free retirement in the new world.

Should clients choose the risks they want to take or the income they want to make?

Focussing on income and not on the risk can lead to unwelcome outcomes.

However, choosing the correct retirement income solution should provide the client with the correct retirement outcome. This has not changed with the Government's proposed changes.

For more technical articles from Prudential, please see the Oracle editions or visit pruadviser.

	Credit Risk	Annuity Rate Risk	Mortality Rate Risk	Capital Risk	Investment Risk	Inflation Risk
Conventional (non escalating)	✔	✗	✔	✗	✗	✔
Fully Linked – RPI	✔	✗	✔	✗	✗	✗
Investment	✔	✗	✔	✗	✔	✔
Investment Linked (AGR)	✔	✗	✔	✗	✔	✔
Variable (120/50%)	✔	✔	✔	✔	✔	✔
Drawdown (inc Fixed Term Annuity)	✔	✔	✔	✔	✔	✔

Cash is the enemy

In the M&G Multi Asset team, our key observation today remains the unattractiveness of cash – which still offers a negative real return in most major developed economies. In our view, this is certainly the investor's main enemy at present and we continue to stress the importance of putting money to work in this environment. Fortunately, there are compelling and diverse areas across assets today which we believe are attractive in an absolute sense, as well as periodic bouts of short-term volatility, which suggest a good environment in which to generate returns.

Conservative household portfolios

Against a backdrop of mainly slow but steady economic growth and low inflation around much of the world, the global investment landscape today appears to us a pretty encouraging environment for long-term, active investors across almost all asset classes. However, the one thing that continues to look deeply unattractive is cash.

Despite the fact that cash has been offering a negative real return in recent years in most developed economies, household portfolios across much of the world – particularly in Europe – remain heavily weighted toward the perceived 'safety' of cash.

Figures for the UK for 2011 (the most recently available data), published by the Organisation for Economic Co-operation and Development (OECD), show that although the proportion of cash in household portfolios is not the highest among developed countries (see figure 1), it is still on par with several other European nations which have higher cash holdings than countries such as the US and Australia.

Cash holdings accounted for 29% of household assets – the largest allocation to financial assets, except for life insurance reserves, within UK household portfolios (see figure 2).

Given the turbulence experienced across global financial markets in the wake of the 2008 financial crisis, it is not surprising that many investors have been cautious about taking on 'risk'. However, what if the biggest risk is misunderstanding risk itself?

We believe that when analysing the future and thinking about risk, it is important to differentiate between short-term volatility and the risk of permanent loss. The latter represents true risk, while the former should not distract us from our longer term fundamentals-based convictions.

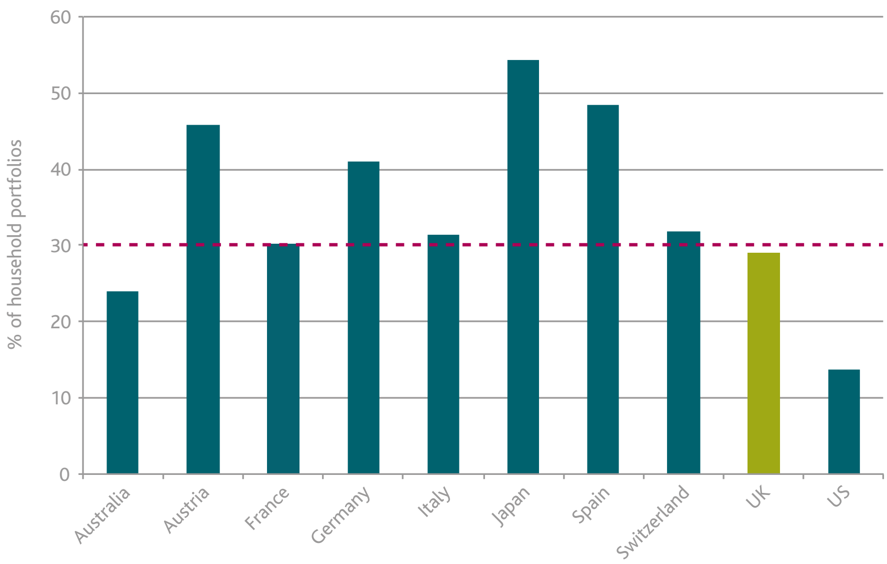
The cost of 'certainty'

Investors do not always act rationally, and deep-rooted human behavioural biases can affect the decisions of whether to invest and how to invest. One very human response that we have seen exert a powerful influence on investment decision-making in the years since the shock of 2008 is the grapple for certainty in the face of massive uncertainty. However, when investors begin to overvalue 'certainty' and consider an asset to be 'risk free', it is often at its riskiest.

As we can see, cash remains a popular asset among ordinary British people. This is despite the Bank of England cutting the core interest rate to historically low levels since 2008. Those who believed the 'certainty' of cash was still the safest option since the base rate was first cut

Figure 1: Household cash holdings

Source: OECD, National Accounts at a Glance 2014, 30 January 2014. Allocations to financial assets only.



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to 1% in early 2009 (and subsequently further, to the current level of 0.5%), have missed out on some considerable opportunities available to those who have been willing to tolerate some significant volatility in bond, and particularly, equity markets over the same period. As figure 3 illustrates, across most major asset classes, only cash has delivered a negative return over that period. Therefore, investors would have been better off in any other asset class. It is especially interesting to note that equities have broadly done very well, even during a period of huge economic crisis.

Diverse opportunities across global markets

Over the past 12 to 18 months we have begun to see a lessening in investors' aversion to volatility (despite considerable volatility over the year to date), as slow but steady global growth and low inflation has led them to become more comfortable with taking risk, and value has begun to reassert itself, creating potentially interesting opportunities to put money to work across asset classes.

In research published at the end of 2013, Pioneer Investments carried out some in-depth analysis on the profiles of regional household portfolios versus average mutual funds since 1996. They found that although very conservative portfolios have helped European households conserve wealth in shorter-term phases of market turbulence, over the period as a whole, the mutual funds each delivered a significantly superior outcome in terms of both risk and return.

Pioneer concluded that in order to take advantage of the more recent global economic recovery, "increasing exposure to higher risk

Figure 2: High cash levels in UK portfolios

Source: OECD, National Accounts at a Glance 2014, 30 January 2014.

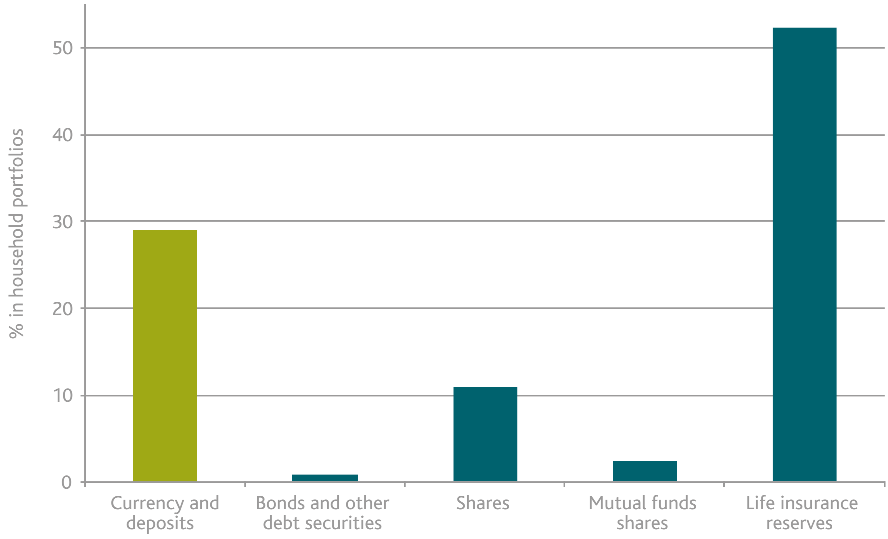
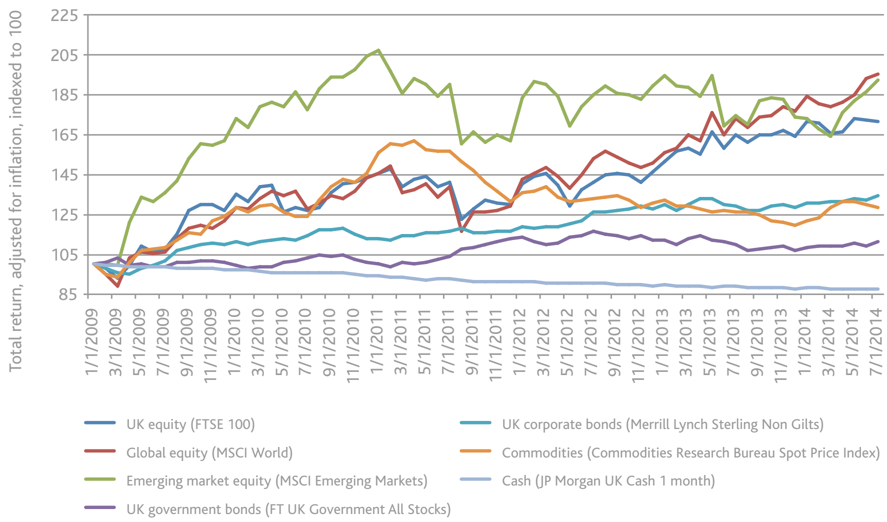


Figure 3: The danger of being too cautious

Source: Datastream, 27 August 2014. Rebased to 100 on 1 Jan 2009.



investments would be advisable"[1]. We strongly agree with this and believe it remains the case that the cost of not taking risk by holding cash is extremely high.

Furthermore, while we do not attempt to predict the future path of interest rates, and there has been much speculation around potential UK interest rate rises recently, given prevailing global economic circumstances, it seems likely any rise in UK interest rates will be very gradual. Consequently, we might expect a prolonged period in which cash is giving us negative real returns, while potential volatility around any interest rate rise may present compelling investment opportunities across other assets.

However, while we feel the current environment should be broadly positive for many risk assets, a careful consideration of how assets are valued and an assessment of the economic regime are essential to selectively choosing the right assets, at the right time. This is not an easy task, which is why we feel our long experience and expertise in multi-asset fund management could prove very helpful to investors looking to navigate the interesting but challenging environment ahead.

[1] Savings and Wealth Trends 2007-2013, Pioneer Investments, December 2013.

Built for income – how to fund a long term retirement

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It would not be going too far to say that the demand for attractive and sustainable levels of income is one of the dominant investment issues of the day, and is showing no signs of diminishing.

Indeed, income is as valuable as ever to the nearly and recently retired generations for a multitude of reasons. For example, the increase in life expectancy as a result of advances in medicine and healthcare mean that retirement can often be measured in decades rather than years, thus increasing the need for income that can fund it. The significant changes to the pensions rules announced in this year's Budget mean that there will be more flexibility from April 2015 for retirees looking to generate an income from a defined contribution pension fund.

The harsh reality is that if your clients' money is sitting in a bank account, its value is probably shrinking in real terms. With interest rates stuck at record lows of 0.5%, retirees are unlikely to be able to use this as a means to sufficiently supplement their pension. Looking beyond cash, income investors have often turned to fixed income assets, such as bonds and gilts, as their next port of call. The problem here lies in the 'fixed' part. With the meagre level of income currently being paid out by bonds and gilts, retirees could effectively be freezing their income at very low rates for a significant period of their retirement.

Where can retirees obtain this income?

So, the key issue for these income-hungry retirees is how they can obtain a decent, long term level of income after they finish working which has the potential to last the duration of their retirement. The traditional choice of an annuity is still a key option and is likely to remain popular and a suitable income choice for many retirees, for some, or all, of their pension fund. However, the annuity may not necessarily be the most suitable income choice for everyone, and more investors are expected to consider other income investment options.

We believe that the Premier multi-asset income funds might be of interest to those retirees looking at alternatives. Both the Premier Multi-Asset Distribution Fund and the Premier Multi-Asset Monthly Income Fund have a very strong focus on delivering good levels of income for investors and offer a choice of quarterly income that is designed to rise over time or a starting higher monthly income.

As is suggested by their names, the Premier Multi-Asset Monthly Income Fund and Premier Multi-Asset Distribution Fund invest in a variety of assets, selected by our experienced multi-asset team for their potential to pay a regular and sustainable income. These assets include company shares, commercial property, fixed income, alternative assets (non-traditional types of investment) and cash (usually accessed via other investment funds).

The funds' underlying investments are typically funds managed by specialist investment teams and each of these underlying investments is chosen for its contribution to helping the portfolio pay income to your clients. By diversifying in this way, the multi-asset team aim to manage risk and open up the income opportunities, rather than relying on a single asset or a single fund to deliver the income.

About Premier Asset Management

Premier Asset Management is proud to be an independent asset management company that is not part of a larger financial services group, and we are wholly focused on asset management and client service. We stand for active asset management through **independent** thinking and we aim to offer value to our clients by delivering good investment outcomes that meet or exceed their expectations, through **relevant** products and with **open** communication.

Premier Asset Management manage over £3 billion of assets on behalf of our investors in a range of asset classes including multi-asset, UK equities, global equities and fixed interest.

Natural income v unit encashment

Another decision for many advisers and retirees is how to generate the desired income from their investment. For market-linked investments, we believe this decision essentially boils down to whether the income is natural or not.

By natural income we mean income generated by the underlying investments and paid out as a dividend per share, thereby maintaining the number of shares, whatever happens to the share price or price of units. The value of income will vary, but we believe that a diversified portfolio of good quality income investments has the potential to deliver attractive income over the long term, and even a growing income and some capital growth potential. We are seeing significantly increased demand for our natural income multi-asset funds.

Another popular method for taking income is by cashing-in units, which means the number of units held by an investor will be reduced to pay out the income they need. If investors are looking to maintain a certain level of income, the amount of units they need to cash in will be determined by the price of units. If unit prices rise, investors would cash-in fewer units to pay the same income. If unit prices fall, they would have to cash-in more units. In a long term retirement, investors may end up being dependent on a significantly reduced pot of units to cash-in for income.

Clearly, natural income means an income that can vary. The amount of income that retirees receive will vary depending on dividends flowing from the underlying investments, so the income level is not guaranteed. However, even in a falling market investors can still expect to receive regular income payments. Additionally, investors get to maintain the number of shares that can benefit from dividends paid per share over the long term and potential long term rises in the price of those shares.

Indeed, a familiar refrain amongst income fund managers is about being 'paid to wait'; if the underlying income investments are solid, investors can still expect a dividend to be paid, giving the investor time to wait for share prices to recover. The salient fact here is that it is not necessary to erode the number of shares held to pay income, as the investment will provide investors with regular income via dividends. The number of shares, and therefore the capital, can remain untouched and over the long term we would typically expect the capital to grow. To us, this represents an extremely attractive option for those who have retired and whose primary focus is a long-term income stream to enhance their pension.

Clearly there are many different ways to invest for income, but we would suggest that retirees carefully consider the potential long term advantages of natural income. Natural income can potentially provide investors with an attractive and steady income stream without eroding the capital base, even offering the potential to grow that capital over the long term.

For more information about Premier's multi-asset income solutions, visit the Premier Asset Management website; **www.premierfunds.co.uk**

Unit Encashment	Natural Income
Unit/shares encashed to pay an income	No units/shares encashed to pay an income
Amount of income paid will depend on number of units/shares encashed and their price	Amount of income paid will depend on dividends flowing from underlying investments (number of shares x dividend per share = income)
The level of income can be potentially "managed" but the amount of units/shares that need to be encashed to achieve a desired level of income will depend on their price	Dividends per share can fluctuate but are not dependent on the price of shares
During market stress investors will be forced to sell more shares to get the income they require	During market stress investors are not forced to sell more shares and are paid to wait for capital prices to appreciate
The number of units/shares will decrease – possibly very significantly over the long term	The number of units/shares will not decrease, even over the long term and dividends per share can increase over time

BE
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FE Research Income Portfolio

Designed for stable income and capital preservation, fully supported by FE Analytics.

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One of the biggest shake-ups to the UK financial services industry in the past decade has been the implementation of RDR at the start of 2013, which saw the regulator shift its standards toward a more outcomes-based approach rather than strict rules-based policies to govern the management of investments.

What this means for IFAs is that clients' best interests must now be at the forefront of all investment decisions, which is good news for the end investor and has done wonders to promote transparency and reduce fees across the board.

However, from a practical point of view, the requirement to assess the vast range of products available to UK investors and decide which is most suitable for the end client is a daunting task and one that takes a huge amount of time on top of maintaining existing client relationships.

Enter the outsourced portfolio. Outsourcing is an excellent way to get exposure to a range of investment products and asset classes without incurring all the costs.

Since RDR, outsourcing investment propositions has become a popular choice for IFAs looking to add a robust investment process and free up their time to focus on clients. While the benefits to the IFA are obvious, the benefit to the investor is often overlooked or poorly communicated. A crucial part of any outsourced service is the level of transparency it provides; advisers still have a duty to communicate important details about their service, including any parts they've subcontracted, to the client and demonstrate the value of the whole proposition, not just the parts they've kept in-house.

Unfortunately, service providers are still behind the curve in this regard. Many Discretionary Fund Managers (DFMs) fail to effectively communicate what is going on behind the scenes in a client's portfolio. This doesn't do the IFA, who needs to communicate their findings to the end investor, any favours.

Traditionally, most DFMs have viewed the IFA as their client and left the investor base in the hands of the adviser. Because these types of businesses are much smaller than major UK asset managers, they don't have big marketing and communications departments and even simple things like factsheets and key investor documents are hard to come by.

While the advice market has evolved following RDR, DFMs have failed to adopt the client first mentality the FCA has been pushing for.

Fees can have a material impact on the return an investor will receive, but without standardised reporting for performance, many DFMs display the performance of underlying holdings without taking into account the effect of charges. This is problematic because even if the IFA can compare the relative performance of various DFM portfolios, the actual return an investor receives is likely to be different.

Rob Gleeson

Head of Research
FE

Many Discretionary Fund Managers (DFMs) fail to effectively communicate what is going on behind the scenes in a client's portfolio. This doesn't do the IFA, who needs to communicate their findings to the end investor, any favours.

FE Research has been at the forefront of this revolution, going so far as to provide performance for our model portfolios net of fees, showing the investor exactly how much they'll have in their pocket.

FE Research's recently launched income portfolio, for example, includes details of the actual income paid to an investor rather than just the top line yield.

FER Income has been designed to produce a stable level of income whilst prioritising capital preservation. Again it is important to make it clear investors are getting the income they expect, so for this reason we're only reviewing the portfolio once a year in September, to ensure every fund has had a chance to pay its income out to investors before we consider selling it; although we will of course monitor the portfolio on an ongoing basis for any unforeseen events.

Our analysis indicated that income investors were not well rewarded by taking on extra risk, in fact income investors very quickly reached a threshold where the more risk they took the less income was returned. We believe therefore that investors looking for income cannot be risk profiled using traditional risk profiling tools. In light of this the portfolio has been designed to reach an objective, which is to return between three and three and a half percent yield whilst maintaining the capital in real terms.

When it comes to producing a natural income we believe that it is important the income portfolio produces a sustainable and repeatable level of income, rather than chasing a high yield that will be difficult to maintain going forward. It is for this reason that we have set the yield target at three to three and a half per cent.

Coupling our investment proposition with our class-leading investment research software, FE Analytics, IFAs have the ability to analyse model portfolios against each other much in the same way they would a fund. Using the service, IFAs can produce the same in-depth reports, scans and analysis that they would for their own portfolios, along with the high quality factsheets provided by FE's team of analysts. Access to this type of information means the adviser is back in the driver's seat when it comes to communicating investment decisions to their clients, rather than at the mercy of the DFM.

While outsourcing has a number of key benefits, the difficulty for the IFA lies in determining the suitability of an opaque investment and clearly communicating the performance, without much help from the DFM.

It is vital for advisers to choose a DFM with openness and transparency at the heart of their investment process. By prioritising the client, investors can be better informed and advisers can provide a more suitable solution.