

The different stages of retirement planning

A case study

Through different stages of retirement planning advisers will need to consider different solutions for their clients. The fundamental difference between accumulation and decumulation means that advisers need to construct a centralised retirement proposition in addition to a centralised investment proposition.

The purpose of this guide is to highlight some of the typical stages of retirement and where the PruFund range may be appropriate. It's not designed to make specific recommendations but rather suggest where the PruFund range may form part of an advisers centralised retirement proposition, and what type of clients it may be appropriate for with consideration to PROD rules and suitability processes. It's not intended to be a definitive, all encompassing guide to retirement solutions.

What is PROD?

The Product Intervention and Product Governance (PROD) sourcebook refers to the systems and controls firms have in place to design, approve, market and manage products throughout the products' lifecycle to ensure they meet legal and regulatory requirements.

You know that you need to be able to make sure that you are ensuring that you are able to deliver the best solution for your client.

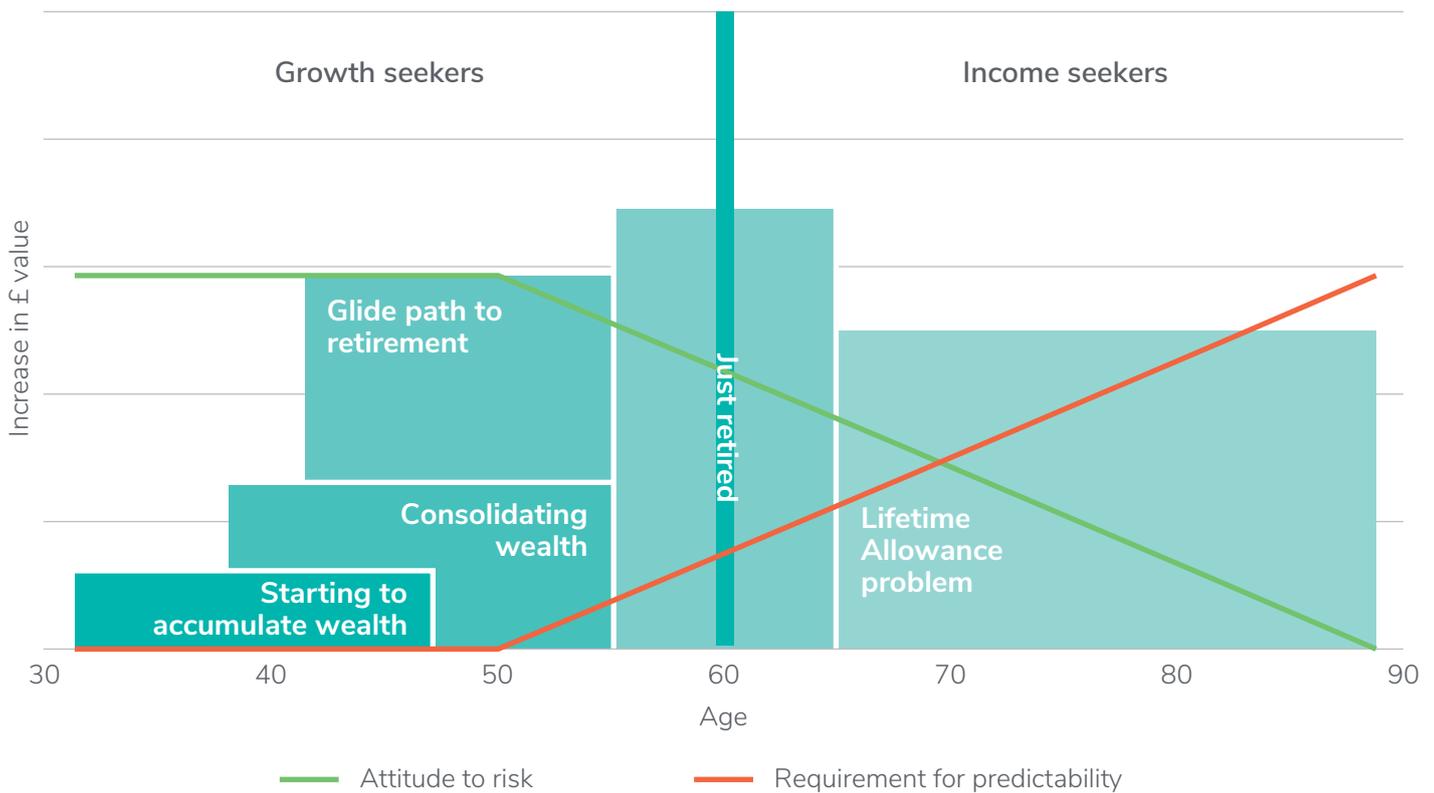
We've prepared some scenarios to help you think about how our proposition can support your clients when you're designing solutions to meet their demands and needs. Whilst these scenarios are fictional they are based on how our solutions could be used to support your client's financial journey.

Example stages of retirement planning and how needs may change

The different stages a typical pension client might look like are covered in the image below. Obviously, every client is different, so this is simply a case of trying to identify the more typical client type and consider some of the issues an adviser might consider in these circumstances.

We're using pension funds for simplicity here. The reality is that most of your clients are likely to have a variety of tax wrappers they're saving into, and other needs and objectives outside of retirement based decisions.

The retirement paradox



Daniel, aged 22 – Starting to accumulate wealth

Daniel has recently left University and has started working as a self-employed graphic designer. He has little experience in investing but is keen to start saving. Given the long period of time before he starts to draw on the fund, his adviser tells him it would pay him in the long run to take a reasonable amount of investment risk, and also invest in a fund with daily fluctuations in value to give him

the benefit of pound cost averaging. But as a new investor he's still a little concerned by daily changes of this nature.

After a discussion with his adviser, Daniel invests in PruFund Risk Managed 5, which gives him the potential for growth to meet his attitude to risk, but will help to control the day to day fluctuations in volatility.

Investment in PruFund Risk Managed 5 gives significant exposure to real assets, but also has the smoothing element to help control day to day volatility. This could be ideal for a long-term investor (in this example Daniel has well over 30 years before he can draw on his fund), but is concerned over continual day to day fluctuations in value.

Kathryn – aged 35 – Consolidating wealth

Kathryn is a self-employed marketing consultant and has been paying into a pension scheme for 15 years and has accumulated a pot of approximately £120,000. Whilst she's always been quite a speculative investor. With the help of an adviser she feels she has reached the point where she wants to take a little less risk with the fund she has built up, compared to her ongoing contributions.

This way she retains the advantages of pound cost averaging but provides an additional level of security for the accumulated lump sum.

Kathryn's adviser recommends a transfer of the existing fund to PruFund Risk Managed 4 fund, with her monthly contributions going into a multi-asset collective fund.

PruFund is being used as a consolidating core for existing funds. Regular contributions will continue to benefit from pound cost averaging, by investing in an unsmoothed fund and which is likely to fluctuate in value from day to day. The multi-asset nature of PruFund combined with the smoothing mechanism and the Expected Growth Rate give more diversity and predictability over future returns.

Paul – aged 55 – Glide path to retirement

Paul has saved hard from his well-paid job in engineering. He's accumulated a substantial fund of £500,000. Though he anticipates retiring at least partially at age 60, he plans to continue to pay into his Self Investment Personal Pension (SIPP) until this time. His adviser has spoken to him about the different retirement income options he will have, and it seems drawing his Pension Commencement Lump Sum in stages to top up his income without incurring any additional tax charge would work really well in his circumstances. The amount taken won't breach the recycling limits. However, Paul has made some good

investment gains in his SIPP, and both he and his adviser agree that now is the time to consolidate his gains and remove some of the day to day volatility in the existing fund value. This is important as with Paul is planning to start drawing from his fund in five years' time. His time horizon for part of his existing value is relatively short. Paul invests both existing funds and ongoing contributions into the PruFund Growth fund. Both Paul and his adviser think this gives him a higher degree of 'predictability' than leaving the fund invested in a basket of more specialist, tactical collective funds as per the current arrangement.

PruFund is being used as a means of consolidating existing gains and giving a level of predictability for both the existing fund and new contributions. The Expected Growth Rate for the PruFund range are a useful element here as they can be used in cashflow modelling by the adviser.

Michelle – aged 65 – Just retired

Michelle is at the point of retirement having spent a successful career at a large pharmaceutical firm. A few years ago, with the help of her adviser Michelle transferred her defined benefit scheme into a SIPP, as that met her needs and objectives. Having seen her fund value fall and then recover she wants to try and avoid that happening now she is about to start drawing on the fund. Her adviser has discussed with her the dangers of sequencing

of return risk, where losses are 'crystallised' when income is taken. This means that even though returns overall can be identical, taking income can lead to very different outcomes.

All the returns in the second table below are based upon the returns in the first six years in the first table below. The returns from A,B & C are identical – however they are delivered in a different order for each.

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
A	25%	5%	20%	-15%	-20%	-5%
B	-5%	-20%	-15%	20%	5%	25%
C	25%	-5%	5%	-20%	20%	-15%

The table below demonstrates how the fund value changes as the returns from each year are added. However, as the overall returns are the same, when no income is taken the end result for A,B & C are identical.

6 years ago the pension fund was £275,000 – No income

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
A	£343,750	£360,937	£433,125	£368,156	£294,525	£279,978
B	£261,250	£209,000	£177,650	£213,180	£223,839	£279,978
C	£343,750	£326,562	£342,890	£274,312	£329,175	£279,978

This changes though once an income is introduced. This is because any losses or gains are 'locked in' when income is taken. This results in 'B' having the worse end result, as returns in the early years are poor so losses are 'locked in'

when income is taken. Increasing the level of income taken from £250 per month to £1,500 per month exacerbates this problem further, resulting in stark differences in value at the end of year 6.

6 years ago the Pension Fund was £275,000 – £250 per month

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
A	£340,357	£354,294	£421,837	£355,811	£281,985	£264,968
B	£258,331	£204,001	£170,651	£201,465	£281,985	£257,180
C	£340,357	£320,421	£333,362	£264,025	£313,514	£263,737

6 years ago the Pension Fund was £275,000 – £1,500 per month

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
A	£323,395	£321,081	£365,402	£294,090	£219,288	£190,815
B	£243,741	£179,009	£135,656	£142,892	£131,553	£144,087
C	£323,395	£289,717	£285,719	£212,591	£235,214	£183,430

After discussion with her adviser Michelle invests in PruFund Cautious which suits both her attitude to risk and her capacity for loss. The modelling her adviser conducts shows that the income Michelle needs to be achieved should be sustainable using this fund's Expected Growth Rate, and the adviser demonstrates further the suitability by stress testing the level of income being drawn using cashflow modelling. Her adviser explains how PruFund can help alleviate (but not eradicate) sequencing of return risk with smoothed returns.

PruFund can be useful as a tool to help alleviate sequencing of return risk both through its diverse asset allocation and also its smoothing mechanism. The adviser also explains to the client what the 'plan' is if the fund does drop in value early on.

Colin age 60 – Lifetime Allowance problem

Colin has recently sold his own business, having contributed significantly to his pension fund over the course of his lifetime. Being a speculative investor Colin has accumulated a large fund of almost £1 million. Colin plans to continue working part time as a consultant for the next five years, and then retire at 65 and start drawing on his pension fund, taking his tax-free cash all in one go to fund several years of travelling. Colin's adviser has warned him that he's likely to exceed the lifetime allowance by the time he starts drawing on the fund, especially with the news that the lifetime allowance is unlikely to increase in the near future. While it's always better to have a larger fund even if

it does mean paying more tax, Colin's adviser suggests with the use of this simple table that it may be worth taking less risk than Colin would normally take, as he will only partially benefit from the upside because of the lifetime allowance charge but will take the full hit if the fund reduces in value because of a speculative investment approach. The adviser demonstrates this to Colin by showing him that if he took the speculative approach highlighted below and achieved 8% pa but then suffered a 20% reduction in value just before retiring because of a market correction, he would actually end up with a net fund of just under 1.058m, – significantly less than the straight 4% pa figure.

	Fund at 65 assuming 4% per annum growth	Fund at 65 assuming 6% per annum growth	Fund at 65 assuming 8% per annum growth
Starting value £900,000	£1,094,988	£1,204,403	£1,322,395
Lifetime Allowance charge at 55% based upon existing LTA of £1,073,100	£12,038	£72,217	£137,112
Cash in bank	£9,850	£59,086	£112,183
Net fund (at LTA) and cash in bank	£1,082,950	£1,132,186	£1,185,283

All growth rates are net of charges.

After considering this Colin decides that he will invest into the PruFund Cautious fund which helps iron out the day to day fluctuations in values. The fund provides an Expected Growth Rate (though these are not guaranteed) giving Colin and his adviser the ability to model the likely outcomes with more certainty than might otherwise be the case.

Continuing to take high risk to achieve high returns, can in some circumstances lead to a high lifetime allowance charge and the client not benefiting fully from these returns. The Expected Growth Rate for the PruFund range are a useful element here as they can be used by the adviser to more accurately model future returns to minimise the potential impact of any lifetime allowance charge whilst still providing access to a diversified multi-asset fund. In short investing speculatively may end with a better result, but the upside is pared back by the lifetime allowance limit, but the full impact of any falls will apply.

Volatility and Drawdown correlation

As demonstrated in the above tables when considering income drawdown, it's important to consider the sequencing of return risk, and the volatility and potential for falls in the fund value. This is because income being taken after a fall in the fund value could significantly adversely affect the value by 'crystallising the loss', and impact on the future sustainability of income being taken.

The following graph demonstrates the PruFund Pension Series A fund against three different sectors, measured against both the maximum drawdown (the maximum loss from peak to trough) and annual volatility over a five year period. Generally speaking, volatility and maximum drawdown are highly correlated, – a more volatile fund is likely to have a higher maximum drawdown.



The chart shows annualised volatility and maximum drawdown over the period 31 May 2016 to 31 May 2021. Grey represents the IA Mixed Investment 20-60 Sector, blue represents the IA Mixed Investment 40-85% sector and green represents the IA Volatility Managed Sector. PruFund Growth Pension Series A is shown as the orange diamond for comparison purposes and includes a representative fund charge of 0.65% pa and any additional investment expenses, but not any product or advice charges. We can't predict the future. Past performance isn't a guide to future performance.

Source: FE Analytics

How the PruFund range can help your clients

- The Expected Growth Rate gives your client some expectation of future growth. This can be used for cashflow modelling for example.
- Smoothing helps to iron out day to day fluctuations in underlying value movements, giving peace of mind and helping to manage sequencing of return risk.
- By investing in a range of different assets the fund range is less susceptible to market movements in any individual asset class, helping to reduce the risk of dramatic falls.
- Access to a wide range of investments – including some which individual investors may not be able to access directly.
- Actively managed by skilled experts in asset allocation – the M&G Treasury and Investment Office (T&IO).
- A choice of funds to help suit different attitudes for risk.

The value of any investment can go down as well as up, so your customer might not get back the amount they put in.