

# The different stages of retirement planning

## A case study

The Consumer Duty rules and guidance means advisers need to continually analyse their advice processes to ensure clients are receiving good outcomes. Through different stages of retirement planning advisers will need to consider different solutions for their clients, aligned to the relevant target market. The fundamental difference between accumulation and decumulation makes it likely that advisers need to construct a centralised retirement proposition in addition to a centralised investment proposition. The Consumer Duty builds on existing PROD rules, which were introduced in 2018.

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 adviser's 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.

## Consumer Duty and target markets

Let's remind ourselves of what the Consumer Duty has introduced:

- act in good faith
- avoid foreseeable harm, and
- enable and support retail customers to pursue their financial objectives.

No adviser can say categorically that an investment strategy is going to work 100%. Volatility over recent months and years caused by unpredictable events has shown us that. So it naturally follows to avoid foreseeable harm the risks of volatility need to be identified and a plan created to deal with them. In this document we look at different stages of retirement and how the client types might suit an investment into the PruFund range.

For more information on PruFund and how it works, check out our **PruFund hub**.

## 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.

As a client nears or enters retirement they enter the 'retirement risk zone'. This is where sequencing risk increases as a client approaches and then enters retirement, and any fall in their fund could have an impact on their retirement income.

### The retirement paradox



Source: Financial Express

### 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 though 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

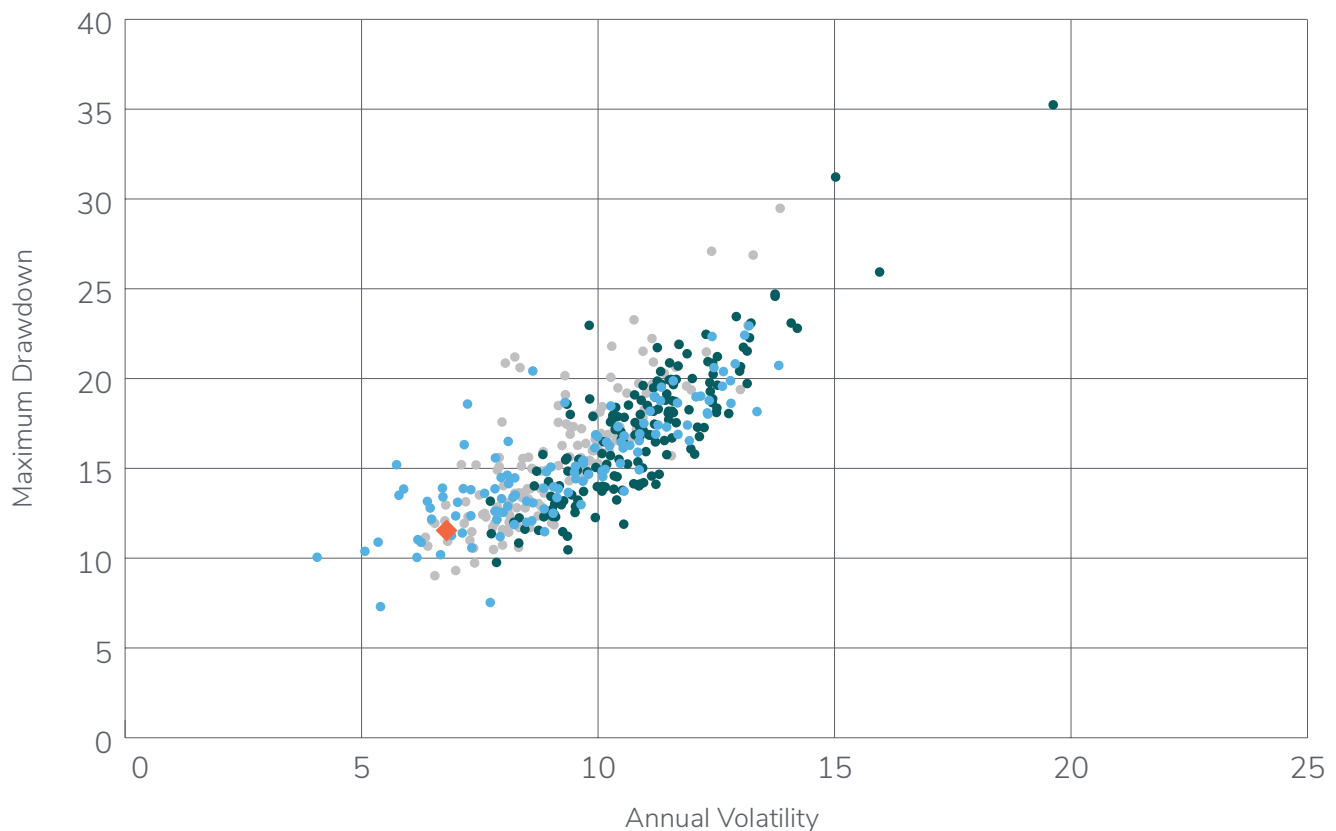
After discussion with her adviser Michelle invests in PruFund Cautious which suits both her attitude to risk and her capacity for loss. The modelling her adviser conducts shows that the income Michelle needs to be achieved should be sustainable using this fund's Expected Growth Rate, and the adviser 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.

## 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 28 Feb 2019 to 29 Feb 2024. Grey represents the IA Mixed Investment 20-60 Sector, green represents the IA Mixed Investment 40-85% sector and blue 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.

## How the PruFund range can help your clients

- The Expected Growth Rate (EGR) gives your client some expectation of future growth. This can be used for cashflow modelling for example.

Please note that the EGR isn't guaranteed and can change quarterly, up or down.

- 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. There may be occasions where we have to suspend the smoothing process for one or more PruFund funds for a period of consecutive days, to protect our With-Profits Fund and the clients invested in it.
- 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.

[pruadviser.co.uk](https://pruadviser.co.uk)

'Prudential' is a trading name of Prudential Distribution Limited. Prudential Distribution Limited is registered in Scotland. Registered office at 5 Central Way, Kildean Business Park, Stirling FK8 1FT. Registered number SC212640 Authorised and regulated by the Financial Conduct Authority.

Prudential Distribution Limited is part of the same corporate group as the Prudential Assurance Company. The Prudential Assurance Company and Prudential Distribution Limited are direct/indirect subsidiaries of M&G plc, a company incorporated in the United Kingdom. These companies are not affiliated in any manner with Prudential Financial, Inc, a company whose principal place of business is in the United States of America or Prudential plc, an international group incorporated in the United Kingdom.