PROFESSIONAL ADVISERS ONLY

The 7IM Retirement Income Solution

A technical guide

Succeeding together

CONTENTS

This document describes how the 7IM Retirement Income Solution (RIS) is built and provides information about our research. It should be read in conjunction with the '7IM Retirement Income Solution' brochure and our easy to digest introduction piece The 7IM Retirement Income Solution'.

An introduction

It's time for something better

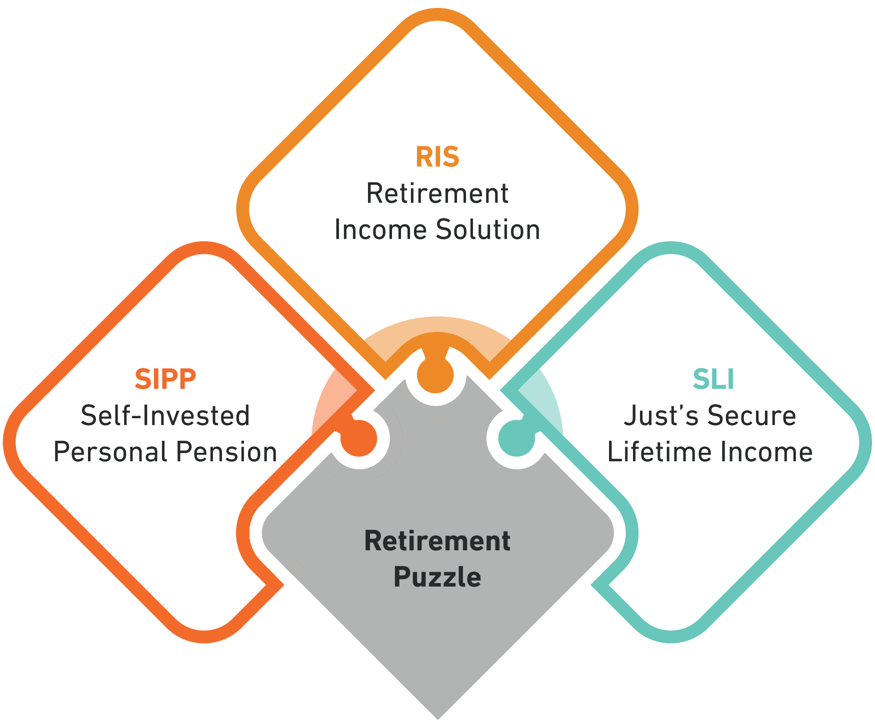
The introduction of Pension Freedoms in 2015 dramatically changed retirement planning forever, offering retirees unprecedented flexibility with what they could do with their pension pots.

Feel confident that your clients' money will last the distance and can adapt to the ever-changing world with our Retirement Income Solution – managed by you, underpinned by our methodology.

This newfound freedom means people now have more control than ever over how they use their pension, but it has also resulted in the retirement puzzle becoming far more complicated and creating a number of pitfalls, chief amongst which is the danger of your clients' pension savings not lasting the distance.

That's why we created the 7IM Retirement Income Solution (RIS) – a key piece in helping solve the retirement puzzle. It is a bespoke solution designed to support the retirement plans that you've created for your clients.
It provides greater control over income in retirement while mitigating many of the pitfalls associated with income drawdown. It is important to understand that as with any investment your capital is at risk and returns cannot be guaranteed.

Above all, the 7IM RIS allows you and your clients to have greater confidence that their retirement income will last by providing you with a clear view of how the plans are progressing, as well as the tools to adapt them to ensure they stay on track.



A robust, repeatable process

When constructing an income drawdown plan, it is essential to put in place an arrangement which is suited to the client's immediate requirements and has the potential to be sustainable in the future.

However, the only thing we can really be sure of in relation to drawdown is that things rarely work out quite as planned.

Whether it's because of changes in the client's circumstances or external factors such as poor investment markets, taxation or legislative and regulatory changes, from time to time the plan may need to be adapted.

For this reason, it is essential to have a robust and effective review mechanism to ensure the plan remains suitable.

The 7IM RIS is built to ensure that both at outset and review your client's drawdown arrangement is aligned with their requirements.

The client inputs

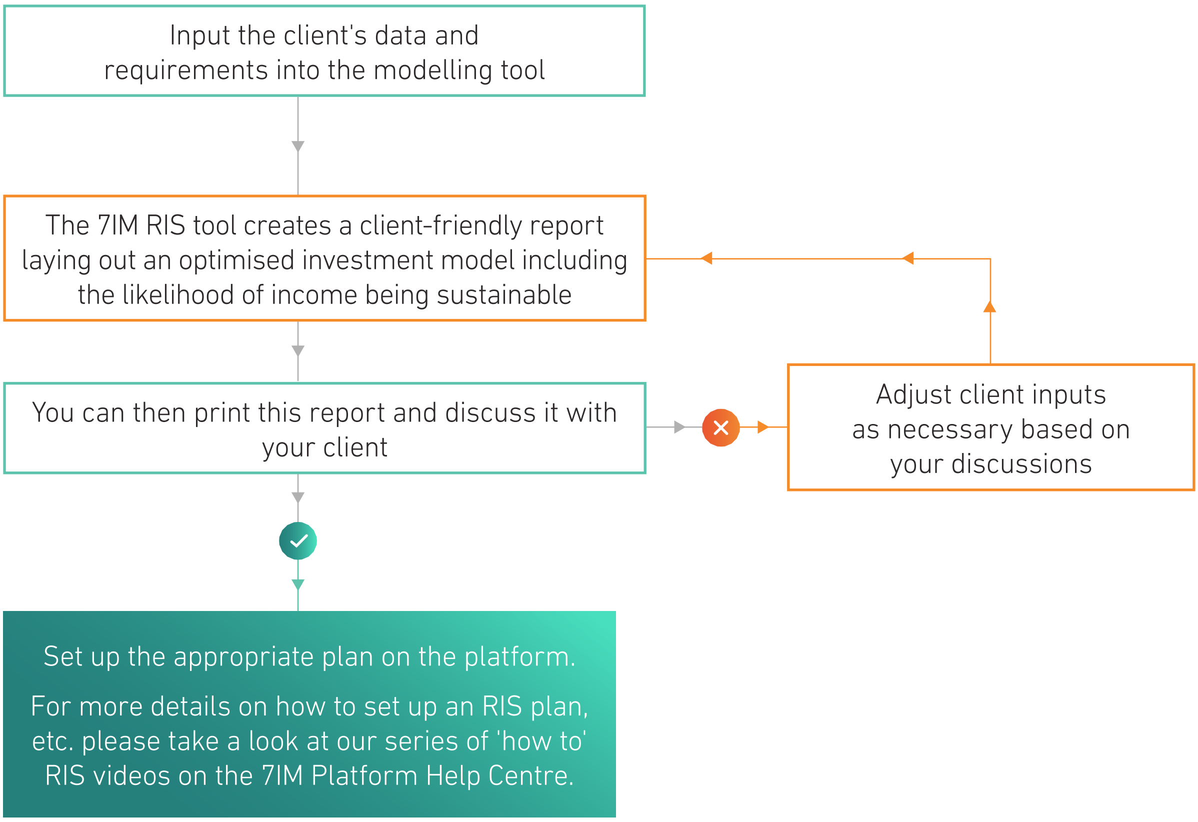
The starting point is to use the 7IM RIS portal to capture the necessary client data to model a personalised forecast for the likelihood of a good client outcome.

The key client inputs are:

- Risk profile
- Total portfolio amount (amount to be modelled on)
- How long you want it modelled for (the term)
- The gross income requirement
- If there is any income escalation – CPI, RPI or 0-5% (our CPI and RPI figures are taken from long-term forecasts)
- If you want the income amount to vary (select variable income)
- Other income that you want the modelling to take into account
- The underlying wrappers and where the withdrawals will be coming from
- Any of your initial and/or ongoing charges

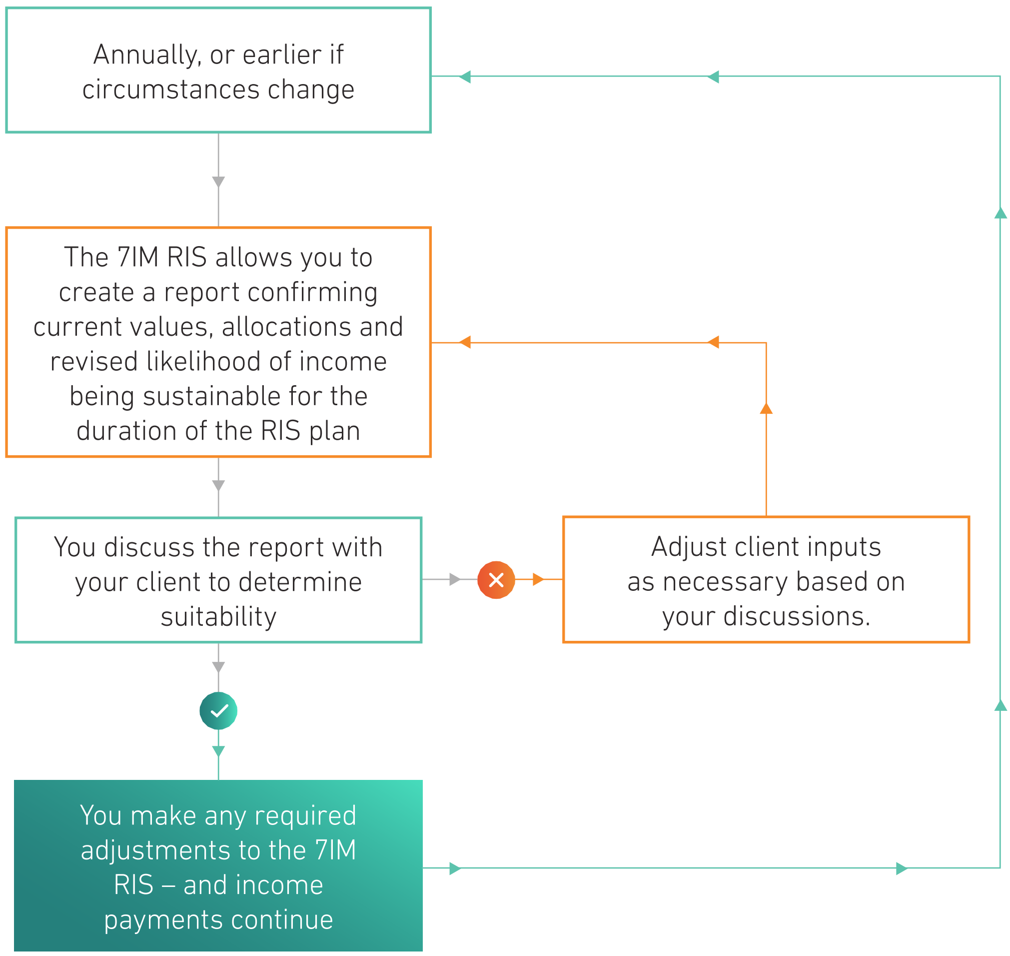
What is the process?

At outset



A robust, repeatable process
Continued

At review



A detailed understanding

The methodology behind forecasting a good client outcome

The 7IM RIS takes the client inputs then overlays them with additional and more complex inputs and assumptions to create a model that provides a level of probability regarding the likelihood of the client having excess capital at the end of the plan.

The process takes the client's gross income requirement (including any selected escalation) to create an array of future expected cash flows. These cash flows are then overlaid with guideline investment growth rates relating directly to 7IM's capital market assumptions. These forward-looking guidelines are the latest available long-run return views, with an adjustment made for additional costs, such as fund charges, platform fees, and advice charges. Each year these guideline returns are refreshed and, as part of the service, the plan is re-evaluated against the updated data.

A common weakness of cash flow plans is that they operate on a deterministic basis and frequently fail to take adequate account of the risk that investment returns will naturally deviate from the forecasted average growth rates. The 7IM RIS addresses this by using information based on the historical experience of 7IM clients since 2003.

This moves our cash flow plan from a straight-line approach to one based on thousands of simulations, which incorporate the potentially damaging effects of pound cost ravaging and sequence risk.

By using a statistical process known as Monte Carlo Simulation, we chop the historical returns into blocks of six-week returns and reorder them several thousand times to generate myriad paths over time (an extract of this is shown in Diagram 1). This gives each scenario a wide spread of possible returns, including samples far worse than those actually experienced: for instance, a simulation might be unlucky enough to end up with a sequence of blocks entirely made up of the nadirs of 2008 and 2011. For each set of inputs thousands of scenarios are run.

The percentage of test scenarios that run out of money before the end of the retirement plan gives you and your clients an indication of how robust a plan may be in the face of the uncertainty around future investment returns. 7IM recognises that this level of detail, although key to providing a robust plan, is not easy for clients to interpret so we simplify the output for clients from a Monte Carlo Simulation (Diagram 1) to reflect the likelihood of there being excess capital at the end of a plan. A summary of this process is shown in Diagrams 1 to 3.

A detailed understanding
Continued

Based on the output, 7IM provides the results and determines the likelihood of excess capital being available at the end of the plan (Diagram 3).

The output is robust and assumes that no action is taken over the whole course of the plan. In reality, rather than being a chance of success versus failure, a more realistic (and encouraging) term is to describe deviations from the expected as the 'chance of adjustment' versus the 'chance of excess'.

Where a plan begins to veer off course, this would be identified at the annual review process, at which point adjustments can be made to expectations for near-term goals to avoid a failure of the plan at some later date. Simply put, the plan is dynamic and maintains its flexibility to adapt to a client's changing needs and circumstances.

To help clients understand the results, we show this as a simple-to-understand gauge, shown in Diagram 3.

Diagram 1 – Monte Carlo Simulation

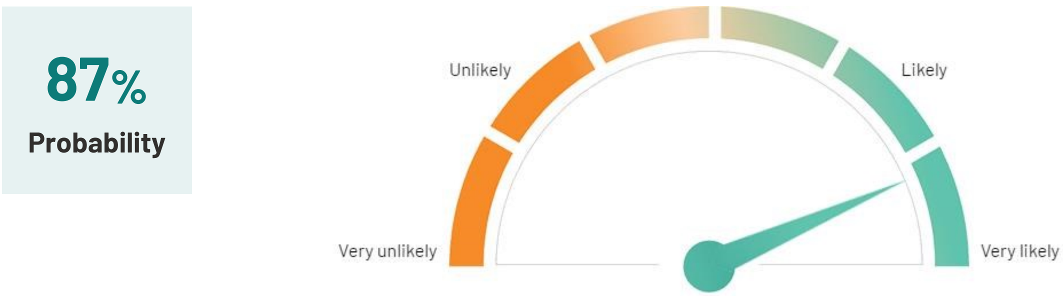
Source: 7IM. This chart shows a range of simulated investment outcomes, starting at age 65 with an initial investment bucket of £100,000. Simulations overlay forward-looking guideline returns for a given risk profile with the risk historically experienced by that profile (proxied using 7IM OEIC fund returns since inception). A 4% withdrawal rate is applied to each path to generate the final investment outcome. The simulation process re-orders historical blocks of volatility to generate returns that are much better/worse than historically realised returns. Past performance is not a guide to future returns.

Diagram 2 – **Example withdrawal rates**

Number of Years

Withdrawal Rate	10	15	20	25	30	35	40
7.0%	99%	72%	25%	7%	2%	1%	1%
6.5%	>99%	83%	39%	13%	5%	1%	1%
6.0%	>99%	91%	52%	21%	10%	5%	3%
5.5%	>99%	96%	69%	36%	18%	10%	5%
5.0%	>99%	98%	81%	50%	30%	18%	10%
4.5%	>99%	>99%	94%	73%	49%	31%	19%
4.0%	>99%	>99%	97%	85%	66%	50%	36%
3.5%	>99%	>99%	99%	93%	81%	66%	52%
3.0%	>99%	>99%	>99%	98%	93%	84%	74%
2.5%	>99%	>99%	>99%	>99%	98%	95%	90%
2.0%	>99%	>99%	>99%	>99%	>99%	99%	98%

Diagram 3 – **7IM's Excess Capital Likelihood Calculator**



The structure

7IM believes a bucketing approach, if appropriately constructed and executed, offers a robust answer to the questions asked of a retirement income strategy:

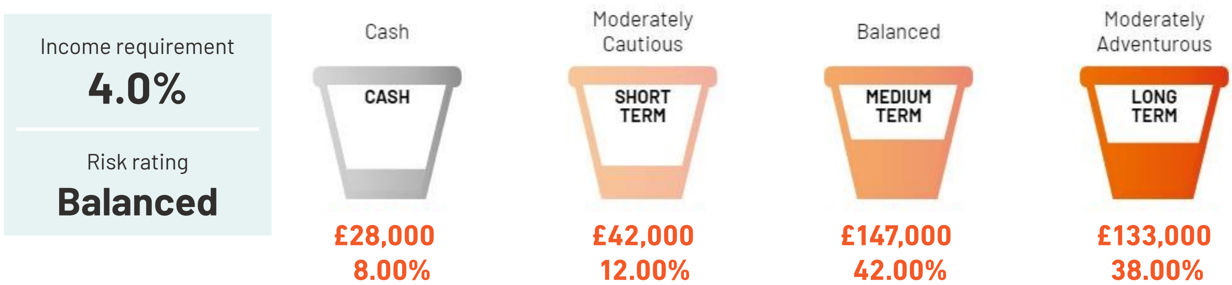
- It reflects our belief that, in retirement, the focus should be on total return rather than pure income-seeking strategies. These strategies which narrow the available investment universe to those that provide a 'natural income' and in doing so, restrict asset allocation.
- It doesn't require the introduction of additional liquidity risk or complexity (i.e. structured products).
- It assists in the management of sequence risk/ pound cost ravaging. In a bucketing approach, the ability to hold a cash buffer reduces the likelihood of needing to crystallise losses in periods of weaker market performance.
- Specific buckets help clients to visualise how their capital is being held and this understanding can help with their engagement and willingness to stick with the process.

For all its benefits, running a comprehensive bucketing strategy which mixes numerous risk profiled buckets into one portfolio across various tax wrappers presents a significant challenge, not least in terms of administration. However, at 7IM we have developed an approach where a client's investment portfolio can be treated as a single entity by you, with an asset mix that remains appropriate to the level of risk the client is able and willing to take.

Simply put, for each risk profile and income level we have calculated a benchmark set of weights for cash, low, medium and higher risk investments. These are calculated in a way that combine to form a portfolio that matches directly with an individual's risk profile and in so doing helps to minimise the drag that might otherwise be caused by holding cash.

Let's take an example of a client with a balanced risk profile who wishes to draw 4.0% income.

We provide the information to allow you to allocate the capital into the various buckets, as illustrated in the example below:



The cash bucket

Having too much cash can cause a drag on long-term portfolio performance, but too little may be insufficient to help manage sequence risk. Getting this balance right is crucial.

The purpose of the cash bucket is threefold:

1

To cover 12 months of planned income between reviews and provide a cash buffer.

2

To help reduce the impact of sequence risk.

A client who withdraws income from their retirement portfolio during or just after a market downturn may permanently deplete the value of their account. When unit prices are low, a client needs to sell more units to provide the same level of income as would have been the case in a buoyant market, and consequentially less money remains to grow as the market recovers.

3

To help counter the behavioural biases (such as mental accounting*) that many clients exhibit.

Allowing for this behaviour can help investors feel more comfortable with their investment strategy.

The 7IM RIS maintains a cash buffer which can be used to provide the income during these periods of market downturn, therefore delaying the need to sell down.

* Mental accounting is our tendency to mentally sort our funds into separate "accounts," which affects the way we think about our spending. Mental accounting leads us to see money as less fungible than it is, and makes us susceptible to biases such as the sunk cost fallacy (the phenomenon whereby a person is reluctant to abandon a strategy or course of action because they have invested heavily in it, even when it is clear that abandonment would be more beneficial).

The structure
Continued

The dilemma

To determine the size of an appropriate cash buffer, the 7IM RIS uses historic data relating to the actual performance of the various 7IM risk profiles which go back as far as 2003. To validate our findings, we also tested additional sources of returns starting in the 1980s, which supported these results.

The goal of the cash buffer is not to defend with 100% certainty against all market falls but rather to provide some flexibility to make small adjustments over time in relation to market downturns. Holding 'large' cash balances may provide more of a buffer, however they create additional difficulties when managing the risk of a portfolio in line with an investor's risk profile.

The following table shows the number of months it has taken for 7IM Multi-Asset portfolios to recover from declines after historical peaks in performance (i.e. the duration a portfolio is underwater versus previous investment highs). The underwater period for each observation is calculated by looking at the historical high achieved by a portfolio and counting how many periods that was in the past.

Referring to the table, we can see that 83% of the time, a Balanced portfolio has recovered from a fall in value within 12 months. Framed differently, clients could have expected to still be below previous highs after 12 months for 17% of the time.

If this was the case, we can look out a further 12 months (up to 24 months in total) to see the probability that a fund would still be below its previous high. As we can see, a Balanced portfolio has recovered from an underwater period after 24 months 96.5% of the time. A client invested in this portfolio could have expected to be underwater after 24 months only 3.5% of the time.

One year's income and a cash buffer covers potential downturns in all but the most extreme of circumstances. It also provides a greater degree of certainty for clients deemed to have a lower risk appetite. A year of income and a cash buffer covers a high probability (>95%) of eventualities, is more defensive for lower risk profiles and creates a manageable drag on the rest of the portfolio.

Percentile	Risk Profile A	Risk Profile B	Risk Profile C
99%	27	29	32
98%	25	27	30
97%	23	25	28
96%	21	23	26
95%	19	21	24
94%	18	19	22
93%	17	18	20
92%	16	18	19
91%	15	17	18
90%	14	16	18
89%	13	16	17
88%	13	15	16
87%	**12**	14	16
86%	12	14	15
85%	12	13	14
84%	11	13	14
83%	**11**	**12**	13
82%	10	12	13
81%	**10**	**12**	**12**
80%	10	11	12

This example table shows the percentiles for underwater periods, in months, for different risk profiles run*. The underwater period for each observation is calculated by looking at the historical high achieved by a portfolio and counting how many periods that was in the past. The distribution of these calculations across all periods is summarised below.

* The examples are based on 7IM Multi Manager C share class funds since inception.

Past performance is not a guide to future returns.

The structure
Continued

Short-term buckets

Beyond holding a year's income and cash buffer, an additional three years' worth of income will be invested in the short-term bucket. This bucket is linked and relative to the client's risk appetite. The 7IM RIS takes the approach of using a risk profile lower than the client's overall risk profile. This combination of the near-term and cash buckets covers a five-year investment horizon as a default, a time horizon that could be considered short term in our opinion.

Medium and long-term buckets

It is essential that overall the portfolio matches the client's risk profile. Therefore, the medium and long-term buckets must offset the lower risk of cash and near-term buckets.

For each client we calculate the percentage needed in the medium and long-term buckets, to keep that client within their overall risk profile.

Implementation across tax wrappers

When using multiple tax wrappers, the 7IM RIS gives you the flexibility to deplete the funds in the order that best meets your client's financial planning objectives.

Naturally, the client's priorities may change over time; for example, in a given year, their personal tax situation may make it preferable to switch the emphasis from a tax-free income to taxable income source. You can adapt the withdrawal method to suit your client's evolving goals. In each scenario the various cash and investment buckets are structured across these tax wrappers with the medium/long-term buckets held in the accounts that have the longest time horizon and the cash and near-term buckets in those that will be immediately paying out income.

This is illustrated in the below table:

7IM SIPP	Portfolio ID	Investments	100% Account %	£150,000 Account value (£)
Cash	D	Cash	10.7	16,000
Short term	J	7IM Moderately Cautious Fund	11.7	17,478
Medium term	K	7IM AAP Balanced Fund	40.8	61,174
Long term	N	7IM Moderately Adventurous Fund	36.9	55,348

Individual Investment Account	Portfolio ID	Investments	100% Account %	£100,000 Account value (£)
Cash	D	Cash	6	6,000
Short term	J	7IM Moderately Cautious Fund	12.3	12,261
Medium term	K	7IM AAP Balanced Fund	42.9	42,913
Long term	N	7IM AAP Moderately Adventurous Fund	38.8	38,826

ISA	Portfolio ID	Investments	100% Account %	£100,000 Account value (£)
Cash	SHD	Cash	6	6,000
Short term	IJD	7IM Moderately Cautious Fund	12.3	12,261
Medium term	IKD	7IM AAP Balanced Fund	42.9	42,913
Long term	IND	7IM AAP Moderately Adventurous Fund	38.8	38,826

Reviewing the portfolio

The way the 7IM RIS has been built means it relies on you to carry out a review on an annual basis.

Using the RIS tools, you can produce an Annual Review Report and take any action needed to bring the portfolio back in line with the plan. The annual review process will usually involve topping up cash from the relevant buckets to take individual bucket weights back to target allocations, but as detailed below this might not always be the case.

At the point of a standard realignment the process would observe whether the total return of the portfolio is positive or negative since the start of the year.

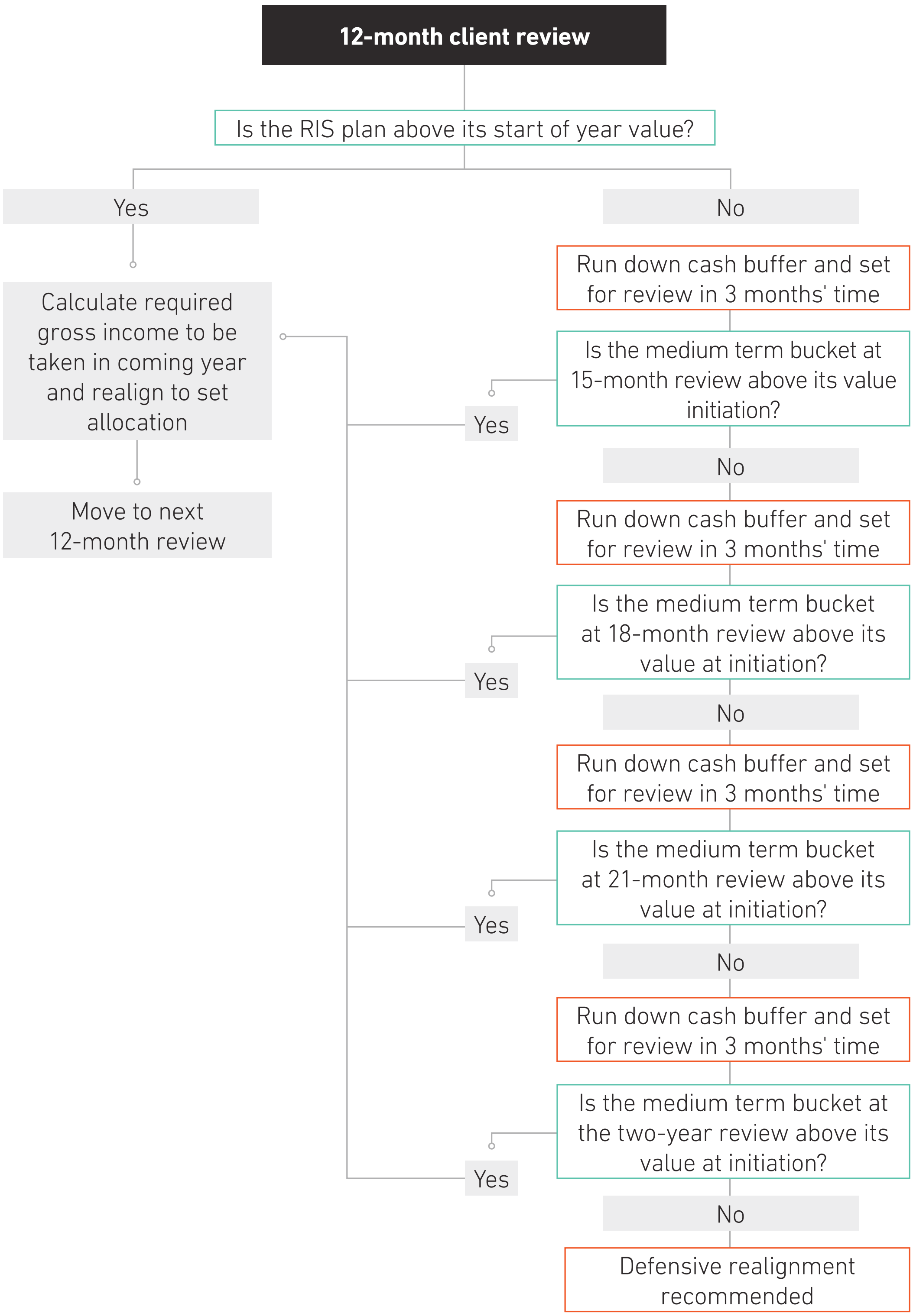
If the portfolio returns are positive – In the case of positive total returns over the period (for calculation purposes, we use the value of the medium-term bucket minus any cashflows), the process will determine the weights to be applied to the cash, short, medium and long term buckets using the core RIS portfolios.

If the portfolio returns are negative – In the case of negative total returns over the period the process would make no change to the investment allocation and would instead fund further income from the cash bucket. A review will be scheduled for three months' time.

This process will be repeated until either the portfolio goes back above water or the cash buffer is depleted.

At the point in which the cash buffer has been depleted and the portfolio remains underwater, a defensive realignment will be recommended. Here we generate 12 months' worth of income, but, importantly, this is done in a way that minimises the crystallisation of losses and ensures that the bucket structure remains consistent with the client's risk profile.

The diagram on the next page summarises how this works.


12-month client review
Is the RIS plan above its start of year value?
Yes
No
Calculate required gross income to be taken in coming year and realign to set allocation
Move to next 12-month review
Run down cash buffer and set for review in 3 months' time
Is the medium term bucket at 15-month review above its value initiation?
Yes
No
Run down cash buffer and set for review in 3 months' time
Is the medium term bucket at 18-month review above its value at initiation?
Yes
No
Run down cash buffer and set for review in 3 months' time
Is the medium term bucket at 21-month review above its value at initiation?
Yes
No
Run down cash buffer and set for review in 3 months' time
Is the medium term bucket at the two-year review above its value at initiation?
Yes
No
Defensive realignment recommended

Reviewing the portfolio
Continued

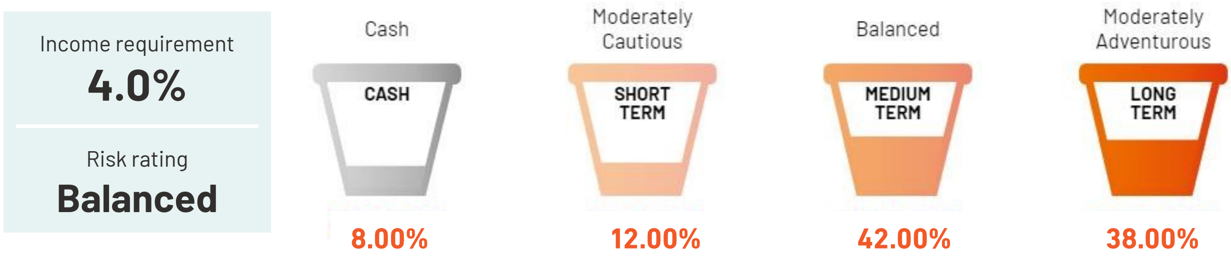
The below shows the difference between the standard bucketing structure and a defensive bucketing structure.

Scenario:

Income amount = 4.0%

Risk profile = Balanced

Standard bucketing structure



Defensive bucketing structure

Client communication

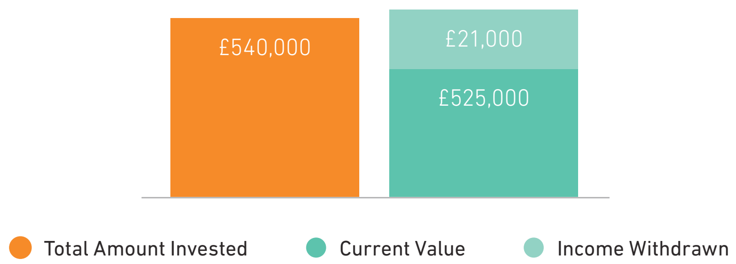
At 7IM we firmly believe that financial planning is most effective when the client is fully engaged in the process and this is never more important than in the drawdown phase of their lives.

Naturally, the depth of the relationship they have with you is core to this engagement. However, we believe that it can be significantly improved by giving clients a clear, concise picture, which answers their key concerns, in language they understand.

To this end, the ongoing reports that you can produce using the 7IM RIS to discuss with your client focus upon three key factors:

01

How the current portfolio value compares with the initial investment value on opening the 7IM RIS, including detail on how much income has been taken.

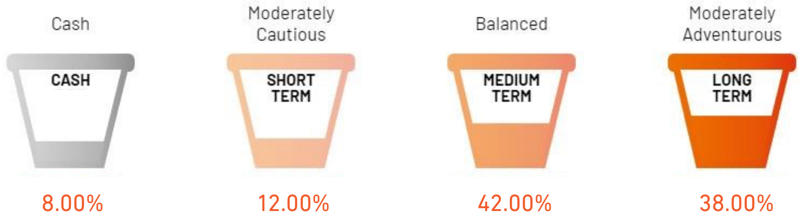


02

An updated likelihood of the income requirement being achieved for the duration of the RIS plan.

03

How the investments will be split across the different time horizons for the coming year.



About 7IM

The ‘7’ in 7IM refers to the seven original founders of the business. Back in 2002, they couldn’t find a firm they trusted to manage their families’ money properly – big banks seemed impersonal and greedy, while most boutiques lacked the necessary investment process and structure. They started the kind of organisation they’d like to invest with themselves.

Taking a steady approach

Their aim was to deliver steady returns over the long term, while keeping an eye on risk, using the best technology. They wanted everyone to have access to the kind of service and expertise that institutional investors would expect.

Nurturing a growing team and client base

Our team, our list of clients and our funds under management have grown steadily over the years and today our team of 480 talented people now look after over £19 billion for a range of clients (as at 31.09.2023).

Following our original philosophies

Despite our growth as an organisation, our principles remain the same. We still follow our founders’ plan to offer the kind of service we’d want ourselves. And we still aim to get the simple things right – like putting clients first, being true to our investment principles, managing risk effectively and being transparent about costs and charges.

2002	£19bn	480
7IM was established as an investment business in 2002.	Currently handling around £19 billion of our clients' money.	Drawing on the experience of over 480 employees.

Summary

Using the 7IM RIS you and your client will be able to make an informed decision about the income your client can take from their retirement portfolio and how any short-term decisions impact their long-term goals.

If you would like further information regarding our Retirement Income Service:

020 3823 8829

retirementincome@7im.co.uk

For professional advisers only, not to be distributed to retail clients.

10.23