Distribution Technology

Powering profitable advice

# Factsheet.

# Web based tools.

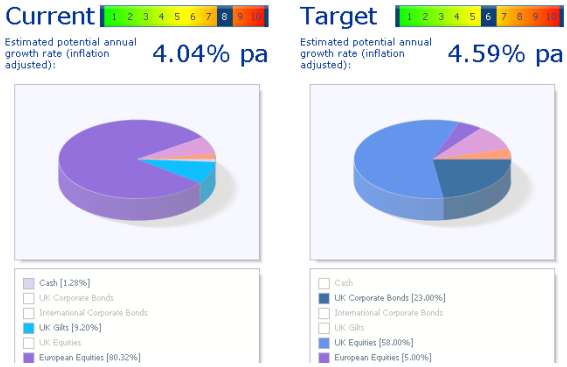
## About the tools supplier

### Distribution Technology

Distribution Technology (DT) is an enterprise solutions and software company providing financial planning and sales technology for regulated sales. Over 14,000 advisers use our tools through insurers, portals, platforms, wraps and advisory firms. We currently serve over 25 major clients including AIG, AXA, Citibank, Cofunds, F&C, Friends Provident, and Lloyds TSB. DT is a private independent company now in its 5th year. It employs 60 people with offices in London and Reading.

Risk profiling, asset allocation and investment modelling capability sits at the heart of our business. This is provided by our Quantitative Analysis Team lead by a former consulting actuary and our Financial Planning Team lead by a former head of research at a national IFA. As a company, DT is exclusively focused on the needs of advised distribution, and our tools and the underlying asset model have been developed to focus on the needs of advisers and their clients.

**For more information on the use of web based tools, please refer to the DT guide – *Safe and effective use of tools.***




### Tool construction

All of the components of DT's toolset are built in house, including the underlying asset model and risk profiling tool. The underlying research backing the psychometric risk profiling was commissioned from The Psychometric Centre at the Cass Business School, part of City University London. Outsourcing is limited to research related to risk profiling and qualitative fund ratings.

### Academic reviews

Dr Douglas Wright of the Faculty of Actuarial Science and Statistics at the Cass Business School conducted a comprehensive review of the asset allocation and forecasting model based on the current version of DT's asset model. This report was published in November 2004. Dr Wright commented in his paper, "The … model for asset returns used by (DT) gives a simple and understandable model which provides a risk management tool that can be readily incorporated into the investment decision-making process". DT is committed to seek further academic review in the event of any future material change to the underlying basis of the model. The model is regularly reviewed by provider clients as part of their due diligence process, with the last review having taken place in March 2007.

## The risk profiling tool

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| **General description** | This risk profiling tool is designed to use proven techniques to provide a guide to how a client 'feels' about risk. The outputs are designed to inform a discussion with the client regarding risk, rather than operate as a substitute for such a discussion. This risk profiling tool has been calibrated based upon research conducted by **GfK NOP** based upon a sample of 1,023 UK adults representative of the UK population. The risk levels have also been calibrated to match the asset allocations within the companion asset allocation tool.<br><br>The **18 question questionnaire** contained within this tool has been deemed to provide a sufficiently high level of confidence (the extent to which the answers a client gives are likely to be an accurate reflection of their risk tolerance) to be deemed valid in a **psychometric** sense. The **24 question questionnaire** contains extra questions which can provide the user with more feedback. Whilst the **5 question questionnaire** contained within this tool offers an insight into how clients 'feel' about risk, due to the small number of questions answered, this questionnaire cannot be described as a complete psychometric assessment. |
| **Modifications** | **None** – the questions and associated calibrations with risk levels have not been altered from the standard supplied by DT. |

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| **Questions** | The risk profiling tool has been supplied with a choice of a **five**, **eighteen** or **twenty-four** question questionnaire. |
| **Risk profiles** | The risk profiling tool contains **10 risk profiles**, grouped into **5 risk descriptions** – **Safety first, Cautious**, **Balanced**, **Motivated** and **Acquisitive**. Each risk profile is calibrated to a specified asset allocation within the companion asset allocation tool. |

## The asset allocation tool

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| **General description** | This asset allocation tool is designed to show an efficient asset allocation based upon the client's level of risk. It can also be used to analyse the efficiency of the client's current portfolio against a set of efficient asset allocations calculated within the tool.<br><br>The asset allocation tool is based upon the principles of **Modern Portfolio Theory (MPT)** proposed by Markowitz (1952), which seeks to find the optimal portfolio for a given level of risk. MPT provides a simple and effective tool for the construction of optimal portfolios from a range of possible assets. The optimisation is based upon **12 different asset classes** which are detailed below. A combination of historical prices and data and internal research by DT is used to feed the tool. The key economic assumptions include Inflation, which is configurable but whose default median value is set at 2.5%; and earnings inflation which is also configurable with a default value of 4%.<br><br>In order to arrive at the specific optimised portfolio a set of rules or constraints are applied to the outputs of the process. These rules are decided upon independently by DT, and an example rule would be "an asset class should make up no less than 2% of an asset allocation", which is designed to prevent very small allocations in some asset classes. |
| **Economic assumptions** | The key assumptions within the tool are:<br><br>● The expected real return for each asset class<br>● The volatility of each asset class<br>● Inter-asset return correlations<br>● Expected inflation<br>● Salary inflation<br>● The distribution of asset returns<br><br>Linear asset returns are assumed to follow a lognormal distribution with constant volatility. Parameter assumptions are calculated using historical index data and market data at the review data. A representative index is chosen for each asset class and the historical values of that index are used to calculate the volatility of that asset class and the correlations of the returns on the asset class to returns on other classes. Index history is also used to calculate the realised risk premium for the asset class against conventional gilts. The results of this analysis together with market information about the yield curve and an analysis of past real returns are used to derive the expected real return on each asset class. The median assumption for inflation is set at 2.5%. This is in line with the target set for the Bank of England and recent inflation experience. The median assumption for salary inflation is 4%. These figures are configurable but all our clients currently use the default settings. |
| **Modifications** | **None** – the asset allocations and economic assumptions have not been altered from the standard supplied by DT. |
| **Model asset allocation** | The tool contains **ten model asset allocations**, each of which is aligned with a specific risk tool profile within the companion risk profiling tool.<br><br>The **time horizon** in the model is designed for **medium to long term projections** as it is intended to analyse a client's finances over a lifetime including any financial goals that may be set.<br><br>The tool allows users to input **multiple goals** with a range of payment dates, or goals with multiple cash flows. Individual cash flows are **lifestyled** over a period of 5 years (i.e. 60 months) such that 1/60th of the goal cash flow amount is transferred to safe assets in each month in the 5 year period running up to the cash flow date.<br><br>The asset classes supported are – **UK equities**, **European equities (excluding UK)**, **North American equities**, **Japanese equities**, **Asia Pacific equities (excluding Japan)**, **Emerging markets equities**, **UK Gilts**, **UK Index Linked Gilts**, **UK Corporate Bonds**, **International Corporate Bonds**, **Cash** and **Property**. |
| **Assumption reviews** | The asset allocations and underlying assumptions within this tool are reviewed on a **quarterly basis**. In practice, changes are normally very small, due to the fact that the tool is based on up to several decades of data. |