MetLife UK – Fixed Interest Update

Frequently Asked Questions (FAQs)

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What is a fixed income asset class?

Fixed income broadly refers to types of assets that are known as gilts, treasuries, or bonds which pay investors fixed interest or coupon payments until their maturity date. At maturity, investors are repaid the face amount.

Governments and Companies are the most common types of fixed-income issuers. Unlike equities, the payments made from a fixed-income security are known in advance.

For the purpose of this FAQ all fixed income assets will be referred to as 'bonds'.

How is fixed income used?

Issuing bonds is a way in which governments and companies can borrow money. Interest is paid on the borrowing and a promise made to repay the debt at a certain point in the future.

Governments may use the debt to provide public services whilst companies may use the money raised to fund large corporate projects.

Why is the price of a bond so affected by interest rates?

Interest rate movements can have a significant impact on bond prices and therefore on the unit prices of funds that invest in them. As interest rates rise, bond prices fall, and if interest rates fall, bond prices will rise.

If you lend a company £10,000 for 10 years at a 4% interest rate, you will receive £400 a year for 10 years, and your money back. So, you will get £4,000 in interest plus your original £10,000 loan, making a total of £14,000.

However, if interest rates rise to 6%, you are only getting £4,000 in interest over the 10 years, while the market says £6,000 is the going rate. This means the value of the bond will fall, as the value of the outstanding payments are worth less in the new market environment

But if interest rates fall to 2%, you are now getting £4,000 while the market says £2,000 is the going rate. This will mean the value of your bond will increase.

Are there other risks apart from interest rate movements?

A potentially bigger risk is the chance of a default by the issuer. Bonds issued by governments, particularly those with strong economies, are deemed to be much safer from default and hence the interest paid is lower. The risk associated with bonds issued by companies will depend on the financial strength of that company, but in general bonds issued by companies are considered to be riskier than government ones, so interest rates are normally higher to reflect this. Bonds that are believed to have a lower risk of default are known as "Investment Grade" or "High Grade" bonds.

An investment manager for a fund that invests in bonds, will use their skill and judgement to earn the best rate of interest without exceeding the risk tolerance of the fund (although some funds may look to invest in higher risk bonds to obtain higher returns). An investment fund will typically invest in a significant number of differing companies so that if a company does go into administration, the impact on the overall fund is mitigated through diversification of holdings.

What is the term of a bond and why is it important?

A longer term or duration of a bond implies a higher interest rate risk and a higher chance of default. In general, the longer the duration of a bond, the more sensitive it is to interest rate changes. For example, a bond that is due to mature in the next few months is less sensitive to interest rate movements as there will be only a small number of interest payments to be made before the investor gets their money back. For a bond with a maturity date 20 years in the future, if interest rates are rising, that customer will be receiving interest payments at a lower rate than is prevailing in the market, for a longer period than shorter-term bonds, and the value of the bond will fall proportionately more than shorter bonds. There are likely to be many interest rate changes before the bond matures, which makes the bond very sensitive to interest rate movements.

Additionally, bonds with longer durations are classed as "riskier" as there is a greater chance that the bond issuer may default over longer periods of time.

Can you tell me more about the levels of fixed interest in my MetLife portfolio?

The asset split will depend on the type of fund selected, and details of the fixed interest allocations are shown below along with links to the underlying factsheets. Our fund list provides more information on our open funds, including individual asset breakdowns and charges.

MetLife Managed Wealth Portfolios

The portfolios aim to control volatility over a 60-day rolling cycle by moving from equity to cash during periods of high volatility, and to provide a total return. The funds aim to hold a fixed exposure to fixed interest, as shown below.

Fund Option	Equity exposure[1]	Fixed Interest exposure
Foundation (5% volatility)	0 - 40%	60%
Min (6% volatility)	0 - 50%	50%
Mid (8% volatility)	0 - 60%	40%
Max (10% volatility)	0 - 70%	30%

[1] *Equity exposure will move to cash to control volatility*

Each fund's fixed interest exposure is invested on a 50/50% basis in two underlying funds managed by Blackrock. These are shown below with links to the Blackrock fund factsheets.

- iShares UK Gilts All Stocks Index Fund (UK) Class X ACCU GBP
- BCIF Corporate Bond 1 – 10 Year X Acc Funds.

MetLife Index Portfolios

The Index Portfolios invest in a range of external funds that are managed by Blackrock, and MetLife rebalance the portfolios each month to ensure they continue to meet their fixed allocations. The table below shows the four Index Portfolios that have exposure to fixed interest.

Fund Option	Equity exposure	Fixed Interest exposure
Defensive[2]	30%	70%
Conservative[2]	45%	55%
Cautious[2]	55%	45%
Balanced	85%	15%

[2] Investments made before Oct 2009 have a 5% higher equity and 5% lower fixed interest exposure.

The fixed interest exposure is invested on a 50/50 basis in two underlying MetLife mirror funds that are invested in external funds managed Blackrock. The funds are shown below with links to the underlying Blackrock fund factsheets.

- MetLife UK Fixed Interest Index Fund
- MetLife Corporate Bond 1-10 Year Fund

MetLife Managed Portfolios

The Managed Portfolios invest in a broad range of MetLife mirror funds that invest in funds managed by external fund managers. MetLife rebalance the portfolios each month to ensure they continue to meet their fixed allocations. The table below shows the four Managed Portfolios with their fixed interest exposure, and each fund listed provides a link the underlying external fund manager's factsheet.

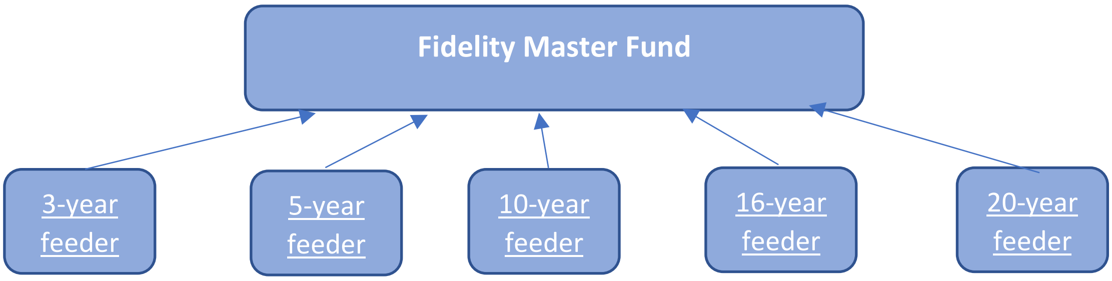
	Defensive Portfolio[3]	Conservative Portfolio[3]	Cautious Portfolio[3]	Balanced Portfolio
MetLife Artemis Strategic Bond	12%	9%	8%	3%
MetLife Fidelity MoneyBuilder Income	14%	10%	8%	0%
MetLife Invesco Perpetual Corporate Bond	16%	15%	14%	8%
MetLife Newton International Bond	7%	5%	5%	2%
MetLife Schroder Gilt and Fixed Interest	16%	12%	10%	2%
MetLife Schroder Monthly High Income	5%	4%	0%	0%
Total	**70%**	**55%**	**45%**	**15%**

[3] Investments made before Oct 2009 have a 5% lower fixed interest exposure. If individual fund allocations are required these are available on Page 14 of our Fund List.

MetLife Active Asset Allocation

The Secure Asset performs a critical role in our Active Asset Allocation process. Each customer's allocation to the Secure Asset is split between a range of MetLife Fidelity Corporate Bond Funds, each of which is a "feeder fund". Each MetLife fund is a mirror fund that invests directly in a fund managed by Fidelity.

These feeder funds are invested in a "master" fund which is also actively managed by Fidelity. Each feeder fund targets a specific interest rate duration and will hold a small proportion of the fund in derivatives to facilitate this. The "master / feeder" structure is shown below, including links to the MetLife Pension feeder fund factsheets.



The allocation between the Growth Asset (equities) and the Secure Asset (bonds) is broadly based on the distance between the investment value and the present value of the expected guaranteed payments and guarantee charges (guarantee value). This is reviewed daily.

If the distance between these two values reduce, e.g. because low yields have increased the value of guaranteed benefits, Active Asset Allocation will start to rebalance the customer investment. Initially a greater allocation will be moved to the 5-year feeder fund and then, if the distance reduces further, money will be moved into the remaining feeder funds.

Once the distance between the investment value and the guarantee value reaches near parity, the total investment is rebalanced to the Secure Asset. As an example, if a Secure Capital Option benefit is to mature in 5.5 years, the Secure Asset would be investing in the 3/5/10 year duration funds to give an "average" interest rate duration of 5.5 years. For a Secure Income Option customer, we assume that guaranteed payments are to be made over the customer's lifetime, therefore the Secure Asset may be investing in all 5 duration funds to match the expected payments to be made in the short and longer terms. Younger customers will see significant allocations to the longer 16/20 duration funds. These long duration funds would be most sensitive to longer-dated interest rate expectations and movements.

To see the current allocation to the Growth and Secure Asset please obtain a valuation Statement from our Financial Adviser secure extranet site https://metlife-eservices.com/adviser.