The Actuarial Profession
making financial sense of the future

FIERM Conference 2011

Investment Products for Retirement Savings

Agenda

- Introduction
- Where we are now?
- What do others do - the overseas experience
- What do people want? Is this the same as what they need?
- What do we think should happen?
- What do we think will happen?

Introduction

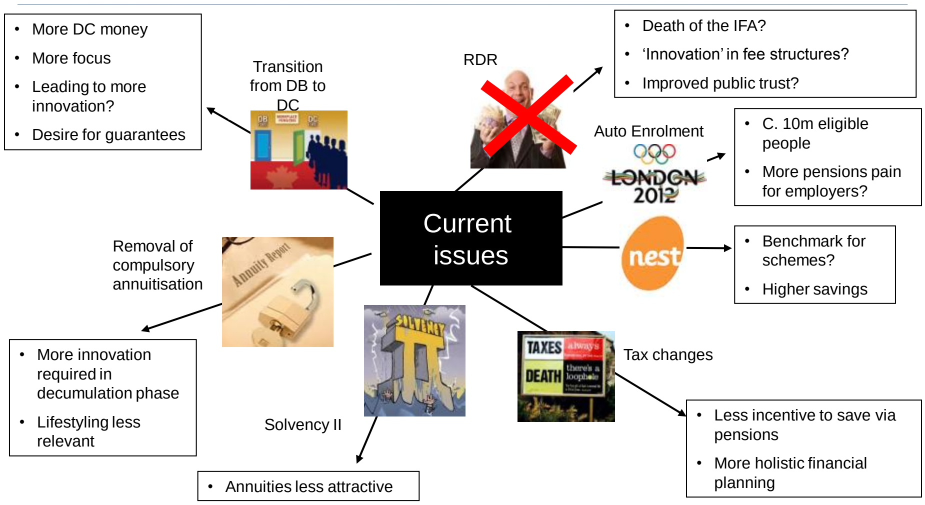
- Working party established in Summer 2010
- Broad remit: “Investment products for retirement savings”
- Members included individuals from fund management, investment consultancy, insurance and investment banking

Jenny Holt	Andrew Lill
Andrew Slater	Kevin Telfer
Gareth Jones	Scott Eason
Tessa Page	Hugh Cutler
Keith Feldman	

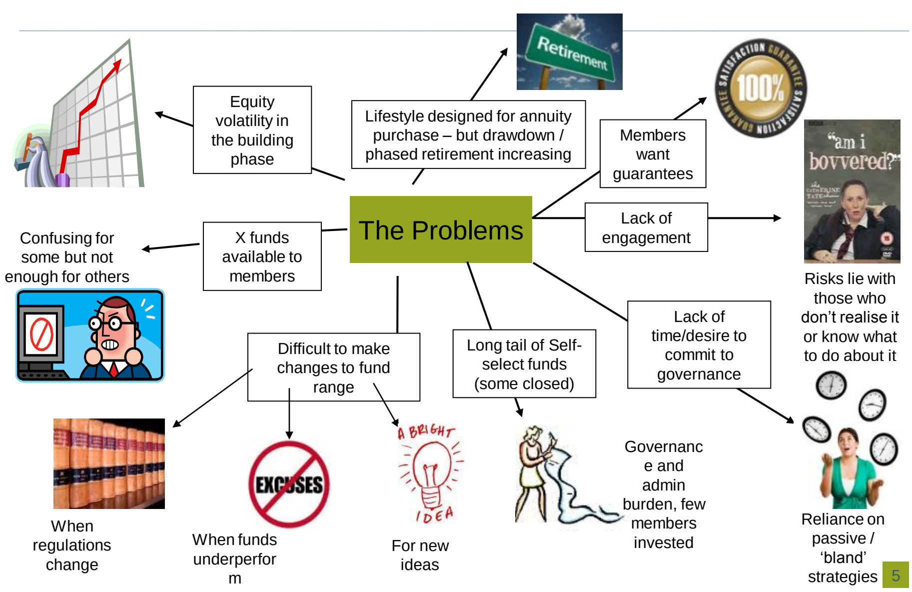
- Opinions expressed are those of the members of the working party and do not necessarily reflect the views of their employers

Where are we now?

The coming shake-out in DC



Typical DC investment 'problems'



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What do others do?

The Netherlands

- Industry / sector wide funds common
- Quasi-mandatory: 80% of occupational plan members covered by mandatory sector-wide plans
- Most occupational schemes still DB, though shifting from final salary to career-average
  - In 2000, 59% of active members had a final salary scheme vs. just 1% in 2008
  - In 2000, 31% of members had a career-average scheme vs. 87% in 2008
  - Shift from DB to DC negligible (1% to 5% from 2000 to 2008) as **both** employers and (union-backed) employees must agree to changes
  - Hybrid plans also used - collective plans with fixed contribution rates (for min. 5 years) and pension based on salary & time in the plan
    - If funding proves insufficient, benefits are reduced
- Funds managed in line with Prudent Person Principle: assets held to meet liabilities should be appropriate to those liabilities

Denmark

- Tax-financed basic pension and ATP provides first pillar
- ATP is a public pension fund set up in 1964 and is compulsory (although contributions are low – a fixed amount < 1% of average earnings)
- ATP Investment risk tolerance is 'No more than 1% risk of not passing the minimum surplus requirement on a 3 month horizon'
- In order to achieve this, contributions split into guaranteed / bonus parts (80% / 20%)
  - Guaranteed part: life annuity guaranteed at prevailing market rate, hedged in full via swaps
  - Bonus part: provides investment buffer for active asset management
- ATP a brand in itself - opened UK office in 2010 to offer admin, governance and investment services
- 80% of the workforce also contributes to a "voluntary" second-pillar occupation scheme
  - Compulsory industry-wide funds common
  - >90% DC, with majority invested with insurance companies
- Regulations allow up to 50% in equity
  - In practice, only 20% on average in equity
- Minimum return guarantees imposed on pension fund investments

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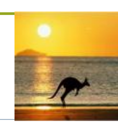
Australia



- Predominantly based on a mandatory second pillar - funded individual pension accounts provided by superannuation ('super') funds
- Wide range of providers marketing themselves as brands, including industry funds
- 80% of pension plans are DC
- Most super funds use a trust structure with trustees responsible for investment strategy
- Relatively high equity exposure (c. 70%) though use of less liquid assets (e.g., infrastructure) is also more common due to access to scale
- Some flexibility in withdrawing funds including ability to take all as lump sum
- Australians have more money invested in managed funds per capita than any other economy

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US

- 401(k) plans popular
  - c. 60% of US households nearing retirement age have 401(k)s
- However, WSJ reported in 2011 that the median 60-62yo with a 401(k) account has less than 25% of the amount needed to maintain standard of living in retirement
- Employees able to choose investment strategy, though default generally provided
  - Target-date now the most widely selected default (c. two-thirds of all schemes)
  - Balanced/managed fund use has fallen; ‘stable value’ funds have virtually disappeared
- Recent SEC investigation into target date funds expressed concern over how long they stayed in risky assets
- Annuities far less common
  - 22% of plans sponsors in 2009 offered an annuity as a distribution option
- Early access to retirement savings possible but not widely used
  - In 2009, 2.6% of savers accessed their accounts and 1.3% took hardship withdrawals

Sources: Cerulli quantitative update, Watson Wyatt Defined Contribution Plan Trends Report, Investment Company Institute (ICI)

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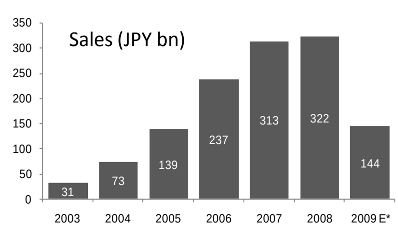
Variable Annuities

- Variable annuities developed in US as an alternative decumulation product to a fixed annuity
- However, in Japan, sales of individual GMAB dominate as a pension product (see below)
- European market has been slow but we are seeing considerable increase in companies wishing to launch guaranteed savings products



Source: Hoken Mainichi Shimbun

- Credit crunch has shown that the guarantee costs being charged were insufficient
  - Number of companies made losses and some exited market
  - Despite this, guarantee charges are often still perceived as too high
  - Challenge is to innovate to reduce guarantee costs to acceptable level

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What can we learn from others?

- Collective schemes
  - Economies of scale - lower costs
  - Stronger governance?
  - But – less accountability and competition
- Investment strategies
  - Greater focus on risk reduction
  - Clearer objectives
- Compulsion appears to work
- Need to encourage an aspiration to have a well-managed pensions plan
- Guarantees liked by individuals but expensive to provide
- More power for employees when discussing benefit changes would be expected to lead to higher benefits (generally)
- Early access does not appear to be abused

What do people want?

Key organisation's views

	ABI	CBI	Money Advice Service
Responsibility for retirement provision	• On state to avoid poverty but ultimately the individual	• Employers now less paternal due to mobile workforce • Firms should provide education & encourage / provide contributions but onus is on individuals	• Individuals – but they need, and should be given, information and (importantly) advice
Annuities	• Pushed for rule changes • Looking at how OMOs should work for customers and ensuring people know what they are buying	• In favour unless significant funds for IDD • Feel there has been little innovation, so new flexibility is good.. but little impact on most people	• Need for OMOs is now better communicated but not necessarily understood / easy to do by consumers
Guarantees	• Idea widely liked, but costs prohibitive	• Against - 'normal' funds are fine if individuals take advantage of contributions • Concern that guarantees lead to more regs - slippery slope like DB	• Not against but as they add to product complexity, can make life harder for consumers.
Collective schemes	• Concerned – over-focus on cost savings and not the other features • Schemes transfer wealth between generations and so run on trust • Similarities with with-profits!	• Attractive, as they could lessen burden on employers • But no-one is convinced yet, lots of talk but little actual business.	• Not discussed

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Key organisation's views continued

	ABI	CBI	MAS
Default	• Can't assume all defaulters are not engaged , it can be the right option • Lifestyling is fine in general, though not perfect • Newer funds targeting RPI+x% or cash+y% will still diverge hugely over shorter periods & this may not be understood	• Concern that most end up in default (which may be too low risk) due to poor education • Employers should target a high % not in default funds • Large firms could provide free advice but tricky for SMEs	• Simplicity and comparability of product choice is key.
NEST	• Support auto-enrolment but Government not doing enough to communicate it • Don't necessarily see NEST as a competitor to insurers	• Support auto-enrolment & minimum contribution levels • But < 50% of employees take up full contributions & employers won't raise them when they aren't valued • CBI members above the minimum levels will stay there… • … but if certification is too complex, will level down to minimum to cut red tape	• Support auto-enrolment • NEST is an important part for consumers
Other issues	• Concerned about small pot commutation – need a slick transfer system and recognition that having money in one place has a value	• Support more flexibility, including possible early access, hybrid pension / ISA / flex schemes	• Research shows staff benefit from financial education in the workplace – evidenced by a lowering in employee stress levels
Key message	**Should think about good outcomes, not perfect outcomes**	**Government should stay away from pensions investment products as far as possible!**	**Individuals need information, advice and products that are simple and easy to compare**

What do individuals want? Is this what they need?

I want…	Is this what individuals need?	Possible product solution
Steady returns, no capital losses	Not necessarily - risk important to prevent cost being prohibitive	Ratchet guarantees
To use money for other things	In some cases, ‘other things’ may well be preferable (e.g., debt repayment)	Schemes allowing early access, Save More Tomorrow schemes
Simplicity	Yes, but may limit product development	Objective / outcome-based funds where detail of strategy not ‘seen’ by members
A guarantee	Minimum performance levels are often required but guarantees must be cost-effective versus alternatives like CPPI and lifestyling	Innovative guaranteed products
A brand name provider	Not necessarily - are brand names always ‘safe’? May also limit competition	
Decisions made for me	Probably [for a large proportion of population]	Default funds including dynamic asset allocation
No fees / low fees, particularly for advice	Focus should be on paying a ‘reasonable’ level for the service provided	RDR will help
Advice not just information	Yes, but where from and at what cost?	

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What do we think should happen?

1. Pensions no longer ‘in a box’ – integration with other financial products
2. Risk sharing / pooling
   - Collective schemes
   - Hybrid DB / DC where employer accepts some risk
3. Default funds that meet needs / wants without high individual governance
4. Return of some element of guarantees in products
5. Flexibility to adapt – unencumbered by regulations / tax regime as far as possible
6. Role for actuaries?
   - Replace / monitor / advise the IFA?
   - Assist in risk projections for individuals
   - Advice to employers on new structures / risk sharing solutions

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What do we think will happen?