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# Why DC desperately needs actuaries

A presentation from the 'sleepwalking into retirement' working party

Jim Hennington – Distribution Technology  
John Taylor - NEST

10 June 2013



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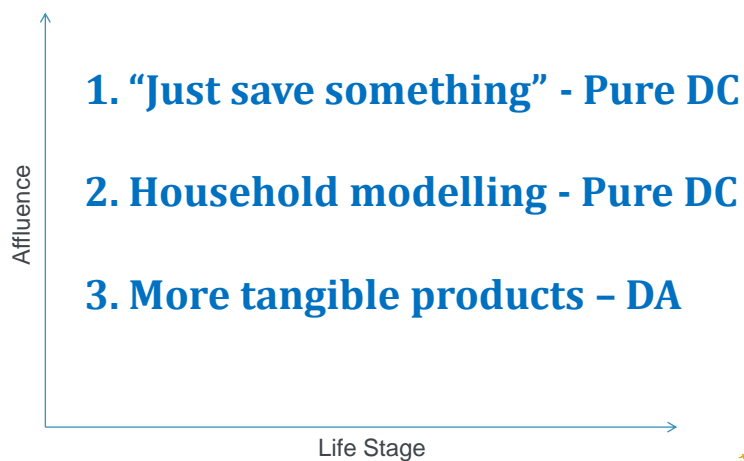
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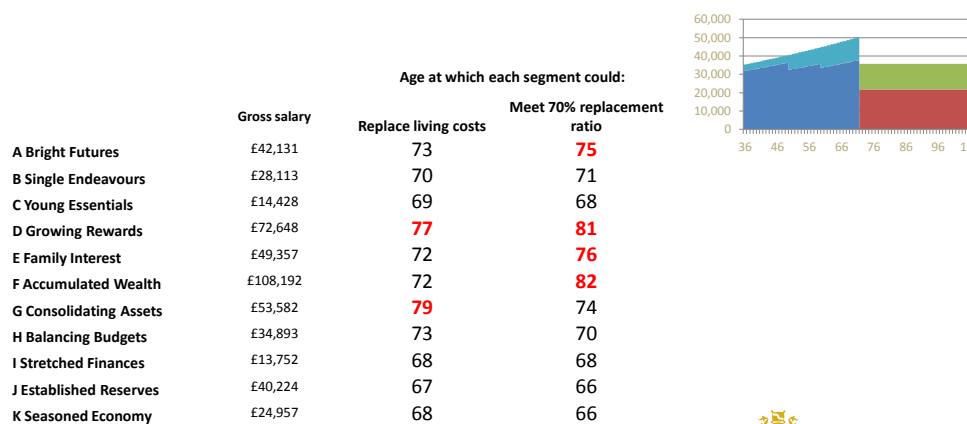
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## The average rarely tells the whole story.....

Groups (household figures)	Percentage of UK households	Current age	State Pension Age	Gross salary	Salary after tax
A Bright Futures	5.4	32	68	£42,131	£31,181
B Single Endeavours	8.0	34	68	£28,113	£21,649
C Young Essentials	3.8	31	68	£14,428	£12,343
D Growing Rewards	5.9	38	67	£72,648	£48,914
E Family Interest	4.7	36	67	£49,357	£35,405
F Accumulated Wealth	4.0	50	66	£108,192	£67,892
G Consolidating Assets	7.5	46	66	£53,582	£37,856
H Balancing Budgets	13.1	44	66	£34,893	£26,259
I Stretched Finances	7.4	42	67	£13,752	£11,883
J Established Reserves	9.1	56	66	£40,224	£29,884
K Seasoned Economy	5.8	56	66	£24,957	£19,503

## Segment Results – whole nation (8%)

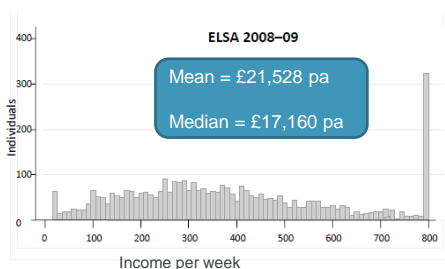


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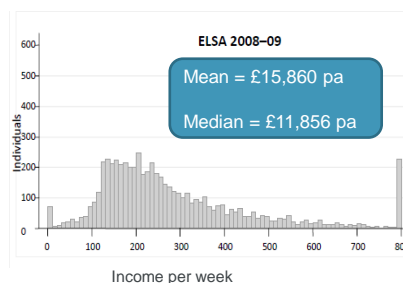
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### Individuals aged between 50 and state pension age (post tax income)



### Individuals aged above state pension age (post tax income)



[www.ifs.org.uk/elsa/report10/ch3.pdf](http://www.ifs.org.uk/elsa/report10/ch3.pdf)



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## Households need to achieve an adequate standard of living with confidence



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**MANAGED DC**

[Nederlands](#)
[English](#)
18 March 2011
Welcome MDC Tester
[Log out](#)

[Your Plan](#)
[Edit Plan](#)
[Help Center](#)

### Personalize Your Plan

Watch a video on personalizing your plan

Move the sliders to change your settings. The meter at right shows the effect the changes will have on the likelihood that you'll reach your Desired Income target.

**Desired Income**  
€ 2 000 per month  
[Learn more](#)

€ 2 000

**Minimum Income**  
€ 1 500 per month  
[Learn more](#)

€ 1 500

**Voluntary Contributions**  
€ 0 per month  
[Learn more](#)

€ 0

**Retirement Age**  
65 years  
[Learn more](#)

65

**86%**

Likelihood of achieving your desired income  
[Learn more](#)

**SAVE THESE SETTINGS**

You will have an opportunity to review these settings before submitting them.

[Reset to original settings](#)

Additional planning considerations

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## Re-building trust



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## Pension reform & defined ambition



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## Pensions Reform

- In scope: 11m employees, 1m employers
- All employers must offer, and contribute to, an eligible scheme
- Employers staging from October 2012
- Auto-enrolment
- Opting-out
- Phasing in of contributions up to 8% of band earnings
- NEST
- (State pension reform)



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## Pensions Reform 2. So far, so good.....



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## Pensions Reform 2. So far, so good.....

**Pensions auto-enrolment 'revolution' in danger of embarrassment with HALF of workers set to opt out**



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## Pensions Reform 2. So far, so good.....

**Pensions auto-enrolment 'revolution' in danger of embarrassment with HALF of workers set to opt out**

**BUT**

**Low opt-out rates reported by McDonald's (<3%)**

**John Lewis reports 3.2% initial opt-out rate**

**Asda: 8% auto-enrolment opt-out rate achieved**



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## Pensions Reform 2. So far, so good.....

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**BUT**

Low opt-out rates reported by McDonald's (<3%)

John Lewis reports 3.2% initial opt-out rate

Asda: 8% auto-enrolment opt-out rate achieved

**AND**

**NEST hits 100,000 member landmark**



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## Adequacy

### Transforming Consumer Information

**Principle 1:** Information should relate to a consumer's financial goals

**Principle 2:** The delivery of Consumer Information should facilitate consumer engagement:



### Behavioural Economics

**Save More Tomorrow**

### Legislation

**Increase Contribution Levels**



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## DC outcomes depend on birth date

In one year every decade, those turning 65 **will** experience the 10<sup>th</sup> percentile of market outcomes. One year every two decades **will** experience the 5<sup>th</sup> percentile outcome. What does this look like?

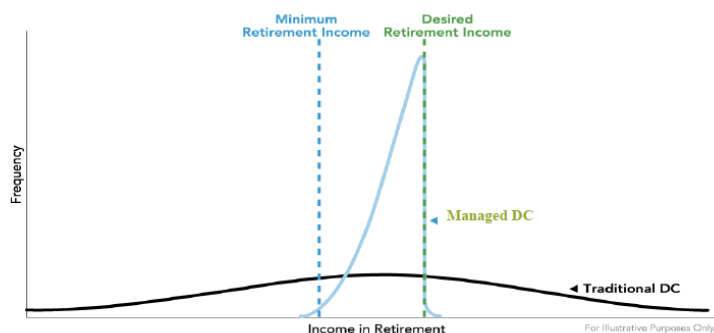


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## Narrowing the Distribution of Possible Outcomes



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## Is this really appropriate?

Term	5 <sup>th</sup> percentile of forecast returns - net of inflation (annualised average real return for each period, gross of fees)		
	Gilts	Equity	Equity Lifestyling
5 years	-3.5% pa	-10.2% pa	-2.9% pa
10 years	-1.2% pa	-5.2% pa	-1.8% pa
15 years	-0.3% pa	-3.0% pa	-1.5% pa
20 years	0.3% pa	-1.7% pa	-0.9% pa

These are taken from the asset model driving Dynamic Planner – financial planning software for financial advisers produced by Distribution Technology.

- The DC industry focusses on the *expected* return.
- But would you buy a car that only worked half the time?



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### Principles for development of Defined Ambition pensions

#### Reinvigoration objective

Enable industry innovation and development of new products including those which will give people more certainty about their pensions and encourage more risk-sharing.

- **Consumer focused** – a DA scheme should address consumer needs (members and employers).
- **Sustainability** – a DA scheme should be affordable to stakeholders (employers/pension providers/members) over the long term.
- **Intergenerationally fair** – a DA scheme should not be biased to pensioners, but also take on board needs of future pensioners.
- **Risk-sharing** – a DA pension scheme should incorporate genuine risk-sharing between stakeholders.
- **Proportionate regulation** – the regulatory structure needs to be permissive to enable innovation in risk-sharing, while protecting member interests.
- **Transparency** – any DA solution would need to be transparent and have high governance standards.

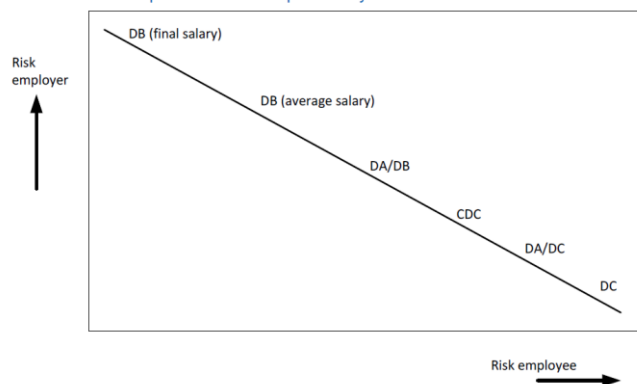


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Differences in risk profiles of various pension systems

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## Defined ambition options

From a DC starting point	From a DB starting point
DC in with profits funds	Career Average Revalued Earnings
Deferred annuities	Cash balance schemes
Managed DC	Flexible retirement age
DC with insured capital guarantees	Risk management tools: buy-outs, buy-ins, longevity swaps and re-insurance
DC with mutualised capital guarantees	Core DB + bonus
Split retirement into term annuity plus (mutualised) later life annuity	CETV on leaving employer
Collective DC	Fluctuating pensions
Employer smoothing fund	
Risk sharing between multiple employers	

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# The key DC risk components

To maintain your standard of living in retirement requires:	While employed	At Retirement	In Retirement
Setting income target	✗	-	-
Making contribution and investment decisions:	✓	-	-
Investment risk tools/ products	✓	✓	✓
Longevity risk tools/ products	✓	✓	✓
Inflation risk tools / products	✓	✓	✓
Career salary profile modelling	✓	-	-
Life cycle modelling	✗ / ✓	-	-

- ✓ Solutions need actuaries
- ✗ Non actuarial



## Summary

**“Appropriate” contribution and investment decisions require:**

- a) A target standard of living;**
- b) Some life-cycle modelling; and**
- c) Risk management tools**



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