The Actuarial Profession
making financial sense of the future

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Demand for DC Products

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Agenda

- Background
- DC contribution levels
- Investment fund options
- Annuity options
- Member communications and advice

Background

- The UK pension fund market represents approximately £850 billion of assets under management
- The majority of occupational fund assets are in defined benefit (DB) arrangements
- As employers close their DB schemes, defined contribution (DC) arrangements are replacing them

Background

- DB schemes being closed due to greater awareness of risks of running DB arrangements
- Pension Protection Fund and much other new legislation applies to DB but not DC arrangements
- DC arrangements often have substantially lower contribution levels than the DB arrangements they replace

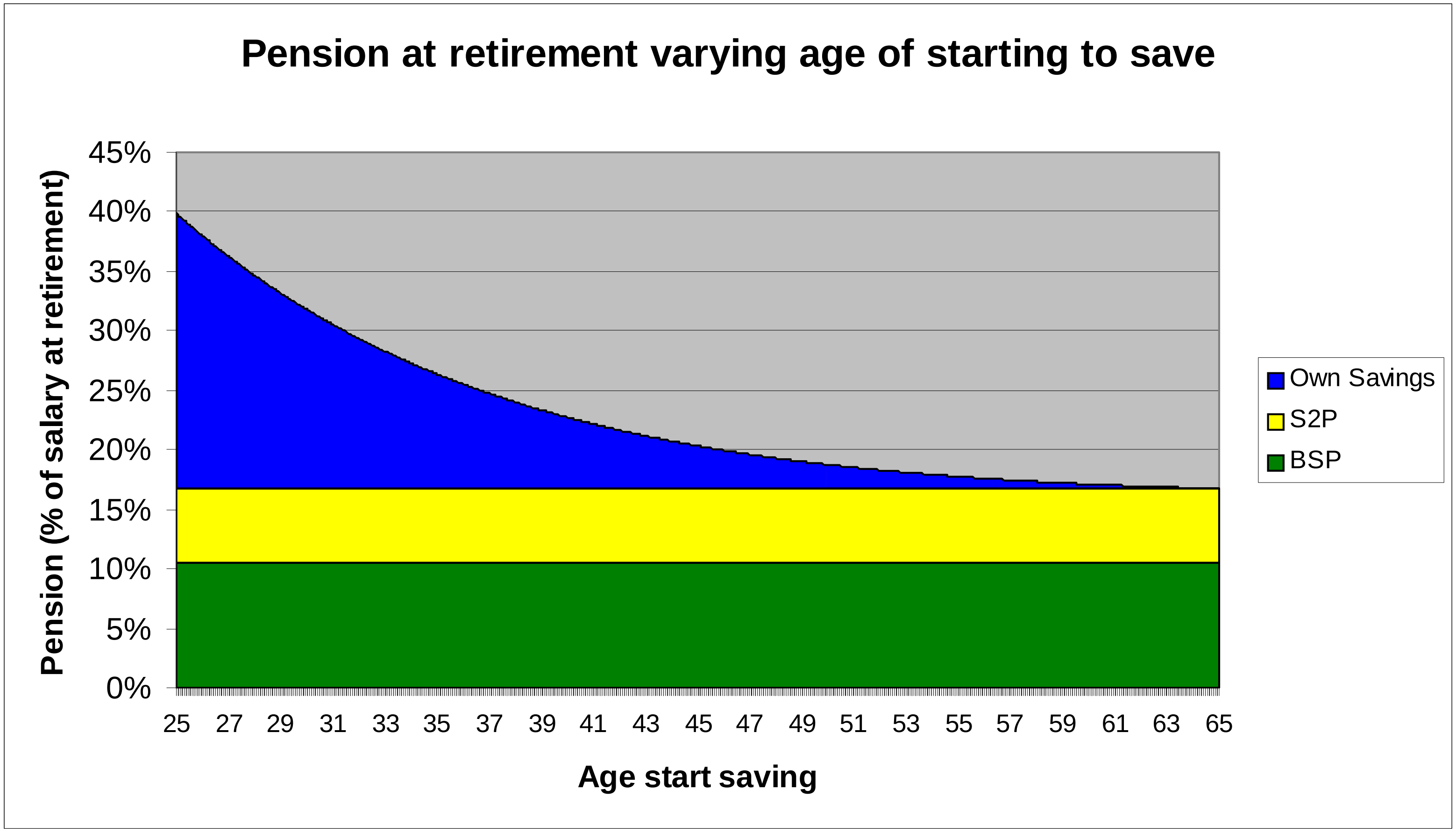
New tax regime

- More flexibility in level of contributions
- More flexibility in timing of drawing benefits
- Need to draw income in retirement
- Individual Savings Accounts (ISAs) strong competitor to DC schemes

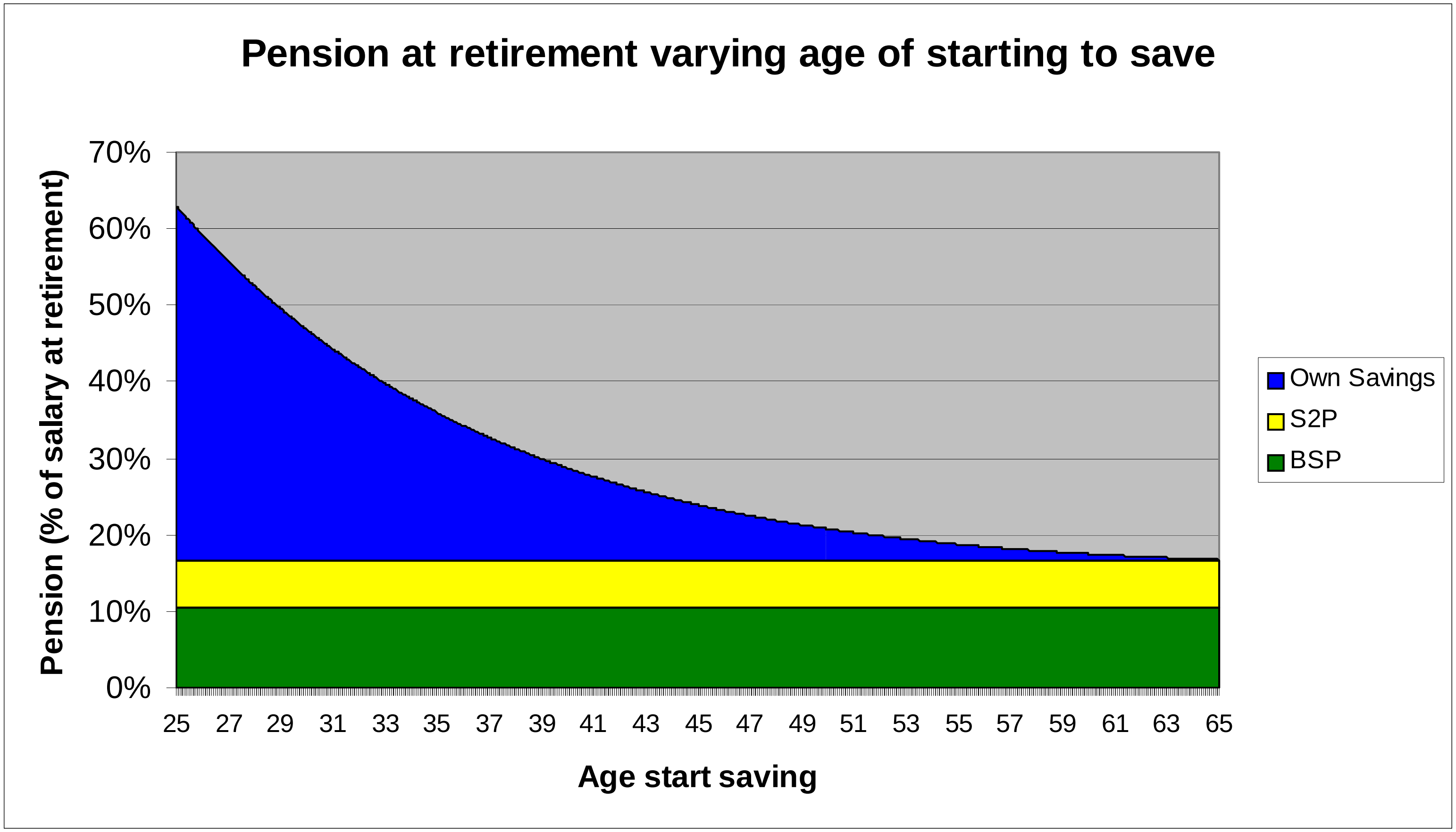
DC contribution levels

- Relatively stable average employer DC contribution rates since 1997, averaging around 6% of pay
- However, average employer contribution rates to DB schemes over same period have risen sharply – rates in excess of 20% of pay are common
- Some recent evidence that rates of contributions to DC schemes are increasing – probably reflects fact that new DC schemes are being introduced with higher contribution rates than existing schemes

DC contribution of 5% of pay



DC contribution of 10% of pay



Investment fund options offered

- More fund options are being offered

The number of different funds/options offered by the scheme			
Number of fund options	2002	2003	2004
1 to 3	60%	20%	14%
4 to 6	16%	32%	37%
7 to 10	10%	24%	27%
11 to 15	7%	12%	13%
Over 15	7%	12%	9%

Source: JP Morgan Fleming, Annual Defined Contribution Industry Survey 2003 & 2004

Range of fund options

Main reasons for extended range of fund options:

- To encourage individual responsibility
- Members are demanding more choice
- Allows members to choose from a greater range of risk and return alternatives
- The Myners review encourages choice

Investment fund options

Three funds can address major investment risks:

- An equity fund – inflation risk
- A bond fund – pension conversion risk
- A cash fund – capital risk

Extended range of fund options

Equity funds:

- UK equities
- US equities
- European equities
- Pacific Basin equities
- Emerging markets equities

Bond funds:

- Fixed interest UK government bonds
- Index-linked UK government bonds
- Fixed interest UK corporate bonds
- International bonds

Specialist fund options

Specialist fund options			
	Already offer	Yes, in the next 12 months	Yes, in the next 2 to 5 years
High risk/high return	26%	4%	12%
Multiple fund managers	17%	7%	24%
Guaranteed fund	17%	7%	8%
Property fund	9%	7%	22%
Absolute return fund	4%	3%	12%
Hedge fund	3%	3%	7%
Private equity fund	1%	1%	8%

Source: JP Morgan Fleming, Annual Defined Contribution Industry Survey 2003

Investment fund options available

The investment options available to members, the percentage of assets in each and how they are managed					
	Available Schemes	Total assets in each fund	Management of each fund		
			Active	Passive	Both
Lifestyle	65%	29%	38%	44%	18%
Mixed asset fund	54%	22%	61%	18%	21%
With profits	36%	19%	64%	23%	14%
Global equities	60%	14%	30%	30%	40%
UK equities	76%	7%	38%	28%	34%
Overseas equities	56%	4%	42%	19%	39%
Gilts/Fixed interest	75%	3%	38%	40%	22%
Deposit accounts	64%	2%	44%	43%	13%
Ethical/SRI funds	36%	-	61%	18%	21%
Other	31%	-	-	-	-

Source: NAPF 2003 Annual Survey of Occupational Pension Schemes

Annuity options

- Traditional fixed/index-linked annuity
- With-profits annuity
- Unit linked annuities
- Flexible annuities
- Open annuities
- Property backed annuities

Member communications and advice

- Fewer than half of the working population believe they understand their pension well
- Two-thirds of the population have never attempted to determine how much they need to save for retirement
- People are expected to be competent to make investment decisions
- Main challenge ahead for DC schemes is improving member communications

Questions to be addressed

- Are advisers paid by commission going to give the right sort of advice?
- How do we ensure advice is available at a fair and attractive price?
- How do we raise the quality of advice we give to individual consumers?
- How do we get consumers to trust advice they are given?

Possible solution

- Sophisticated user friendly financial advice software
- New mobile companies
- Use of school IT facilities – for night school seminars on investment and interactive modelling
- Using the internet for statements and ongoing advice
- Flexible investment products that allow consumers to change priorities over time

Financial advice software

- Phase 1 – Input current financial details
- Phase 2 – Project “risk free” outcome
- Phase 3 – Model impact of taking risk
- Phase 4 – Optimise asset mix
- Phase 5 – Option to override asset mix

Summary

- Demand for DC products is set to grow strongly
- Likely to be significant developments in:
  - Member communications/advice
  - Fund options
  - Annuity options
- Higher contributions need to be paid to ensure adequate income in retirement