Exploring the future of UK retirement savings

ACA Members' Gatwick Conference

- Crawford Taylor
- Amanda Switzer

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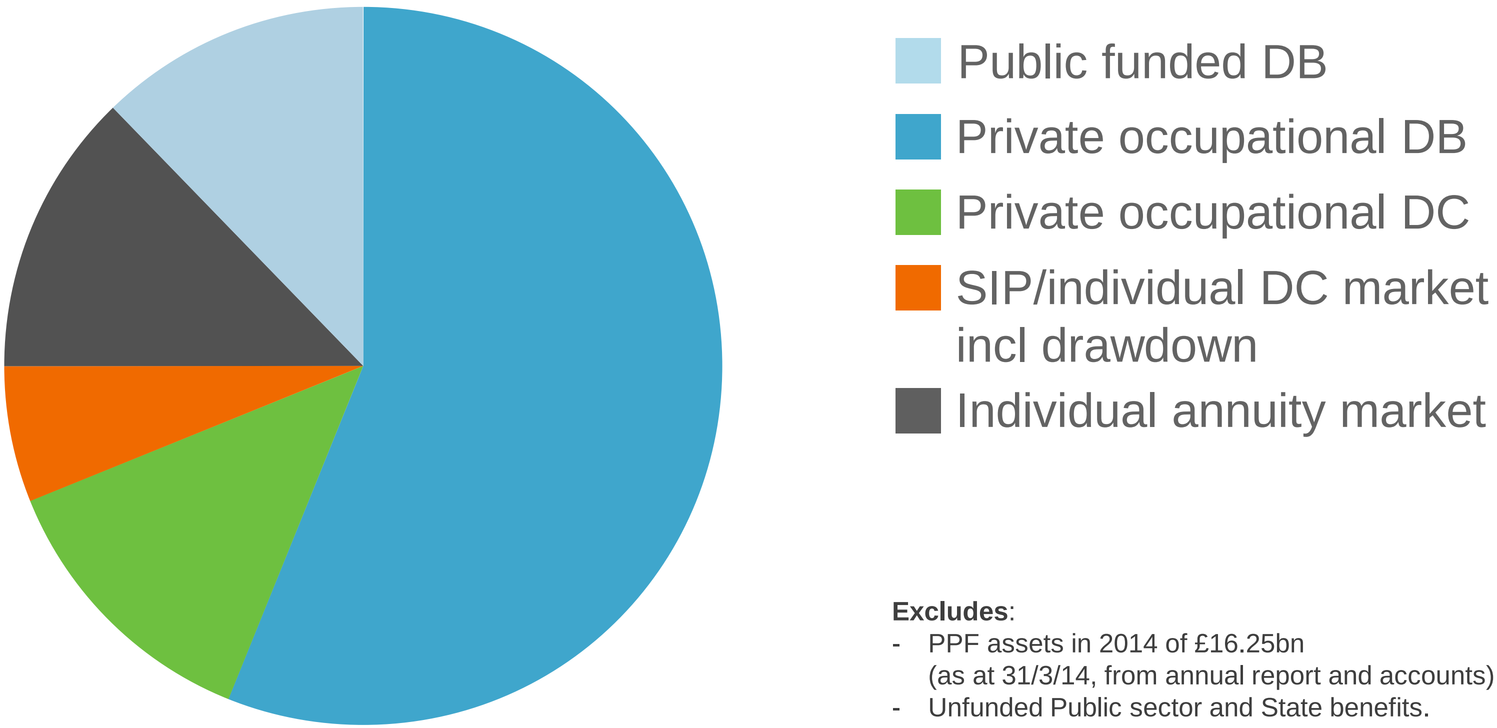
The current pensions landscape

Market value of pension fund assets (£1.9 trillion)

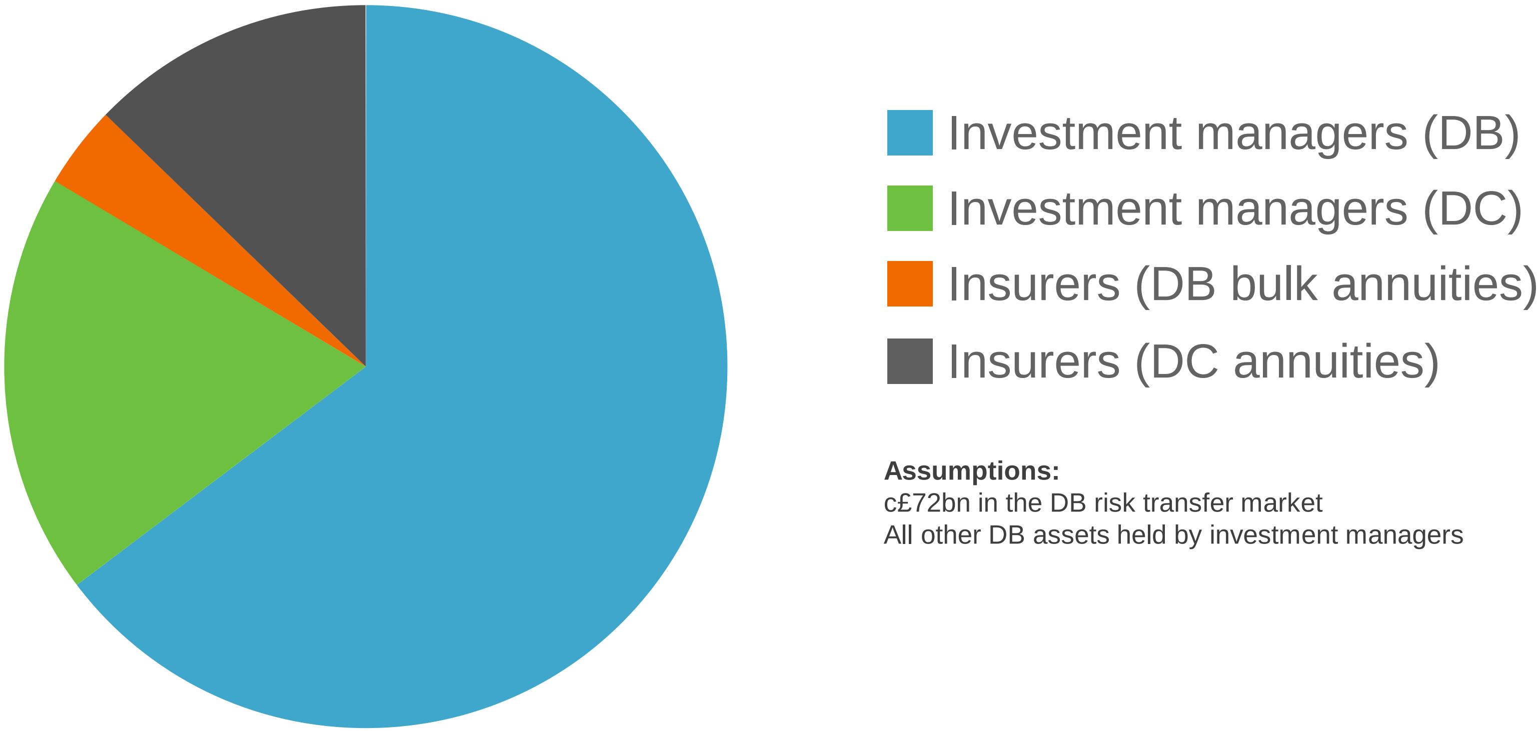


Excludes:
- PPF assets in 2014 of £16.25bn (as at 31/3/14, from annual report and accounts)
- Unfunded Public sector and State benefits.

DB assets are currently about 2/3rds of total market value

The current pensions landscape

Who holds pension fund assets



Assumptions:
c£72bn in the DB risk transfer market
All other DB assets held by investment managers

Investment managers invest c80% but…
changes are a coming…

Purpose of this session

- Consider the forces that are driving change
- To explore how the pensions landscape might evolve
- Understand the key challenges we face in this unchartered pensions territory

So what forces are driving change?

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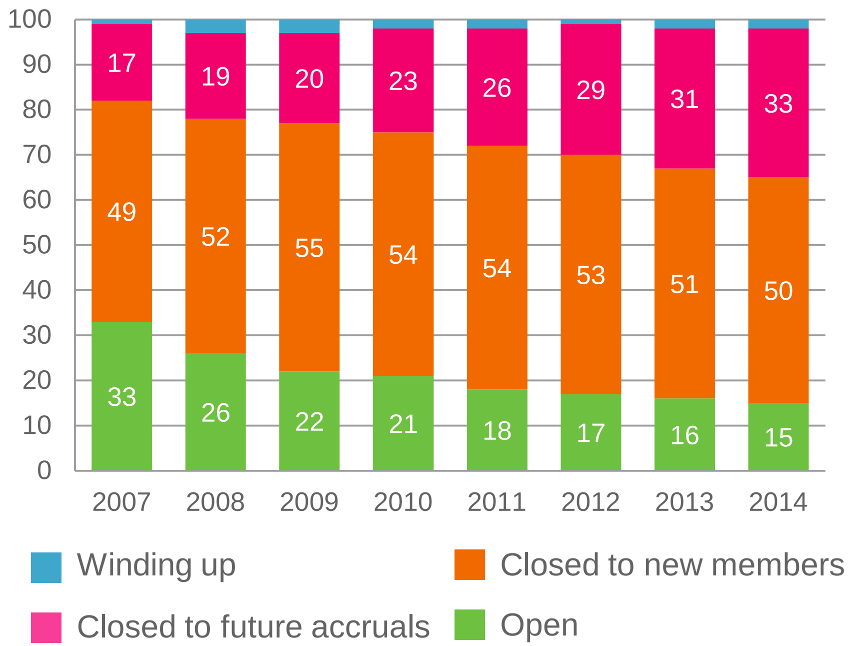
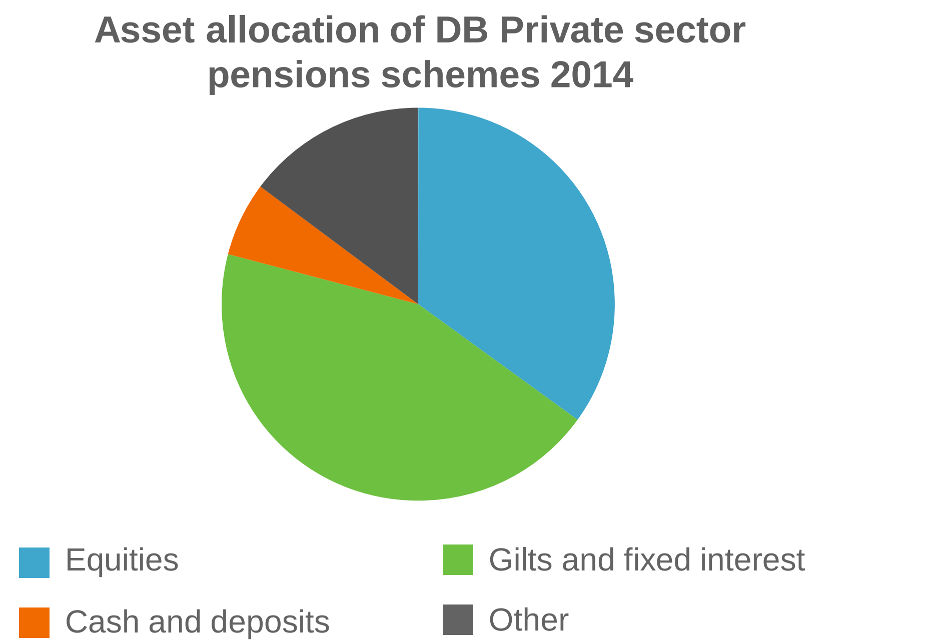
1. Closure of DB and impact of risk transfer
2. Auto-enrolment and the rise of DC
3. 2014 Budget and retirement flexibilities

How are each of these contributing to change?

1.Closure of DB and impact of risk transfer





- Schemes accruing benefits has fallen from 82% to 65%
- 33% of schemes have closed to accrual
- Active memberships have fallen by 50% since 2006 to 1.8m
- Budget 2014 introduced more flexibility

- Bond holdings grown from 28% in 2006 to 44%
- Fall in share of equities from 61% in 2006 to 35%
- Growth of alternative classes incl. hedge funds, derivatives, property, commodities, infrastructure etc
- Expectations for future…more bonds, more other including buy-ins/outs?

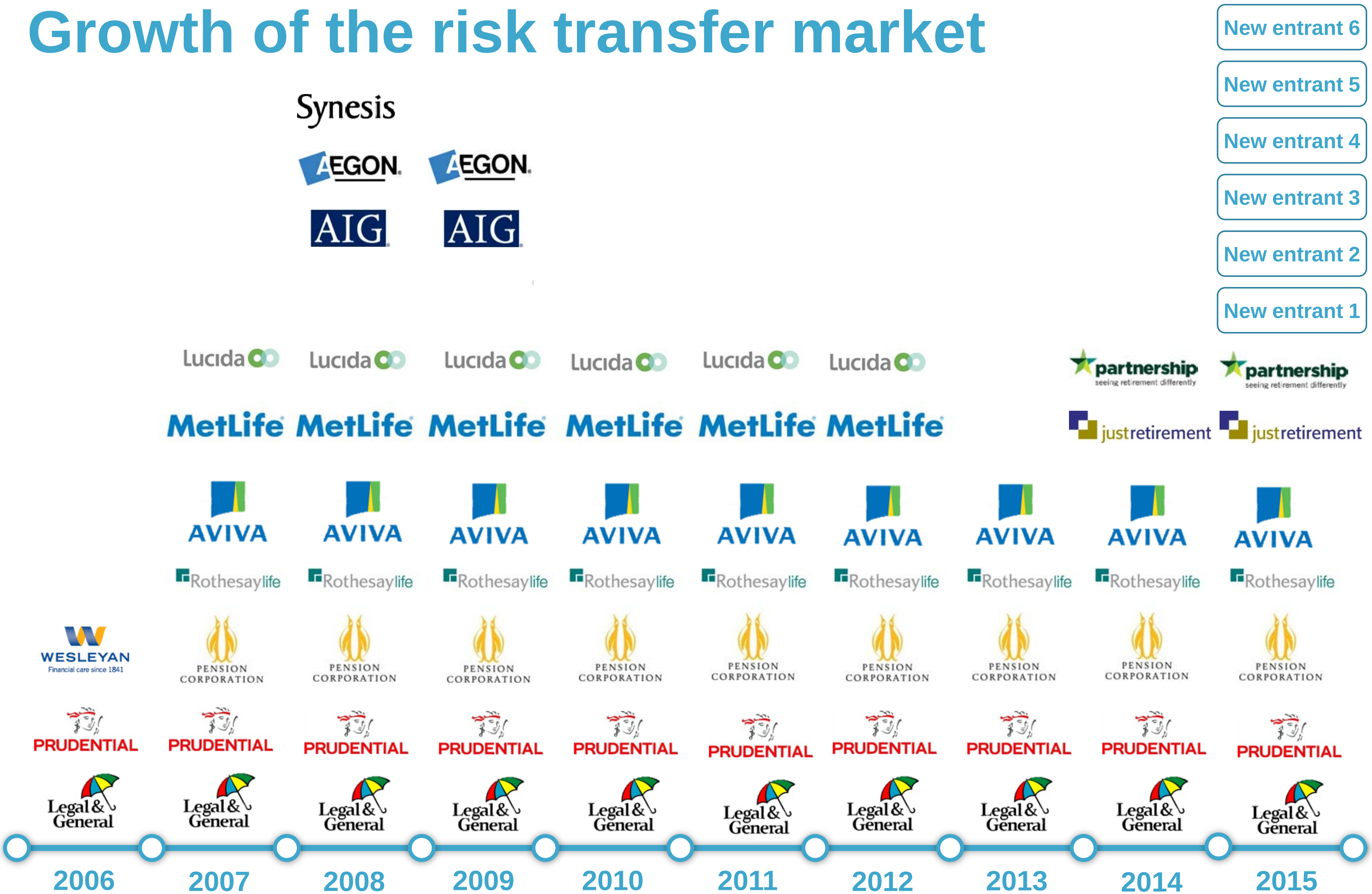
Source: The Pensions Regulator

Evolution of DB scheme assets

- Expect continued demise of DB
- Post April 2015 expect increase in transfers out
  - if say 30% immediate take-up of over 55s DB assets could reduce by c£90bn (c8% of DB assets).
    - will have funding, investment and cashflow implications
- Expect value of private sector DB assets to remain fairly flat over next 10 years
- Expect de-risking to continue from equities to bonds with more focus on matching strategies (LDI and illiquid cashflow matching)
- Expect increase in insurance products such as buy-in policies and longevity swaps – BUT capacity constraints

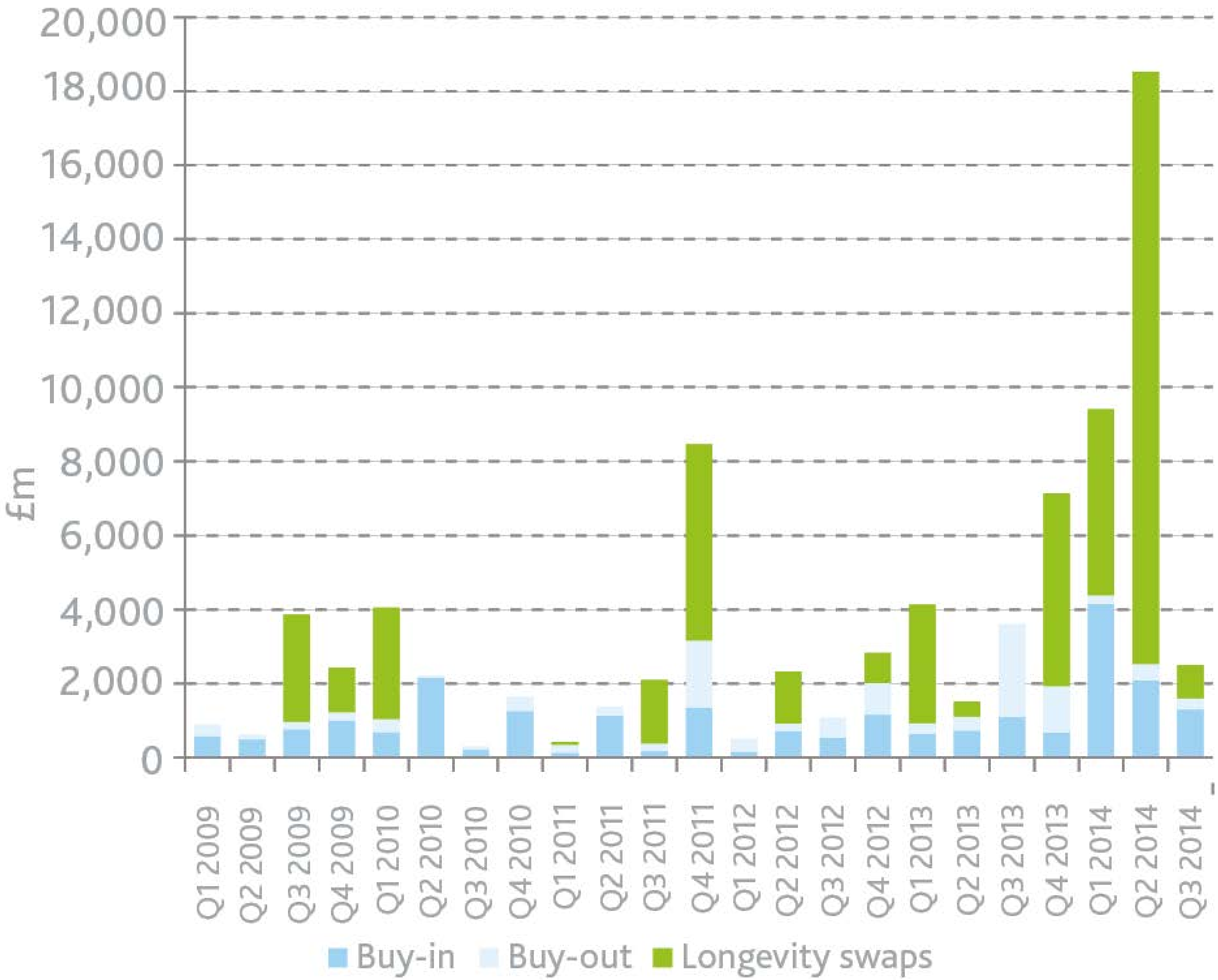
Are these reasonable expectations?
Is risk transfer the solution for everyone?

Growth of the risk transfer market



HYMANS ROBERTSON

Risk transfer transactions since 2009



Source: Hymans Robertson quarterly risk transfer report

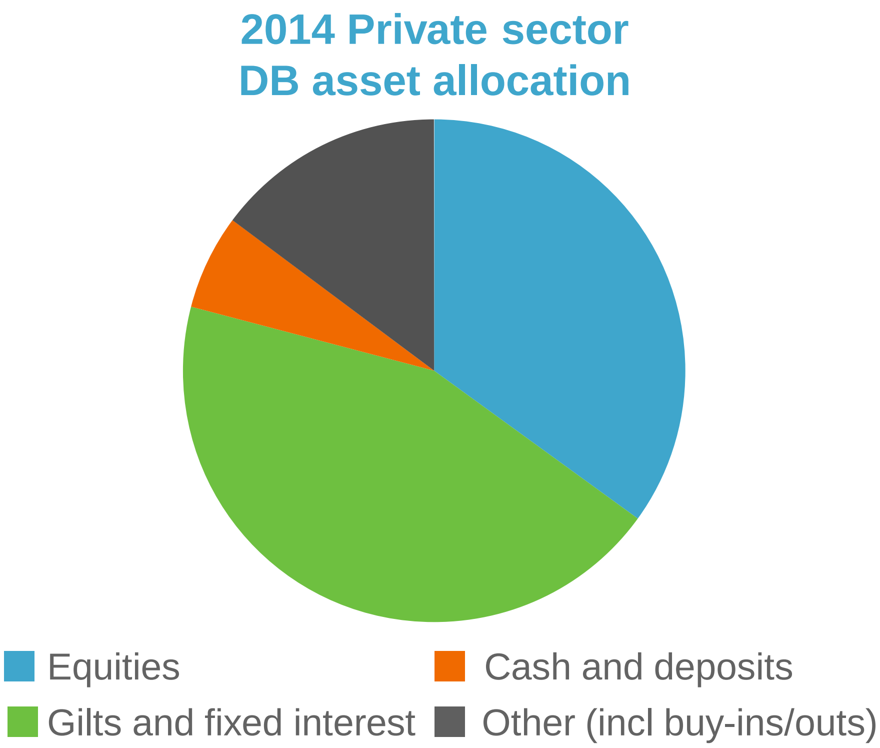
Evolution of bulk annuity market

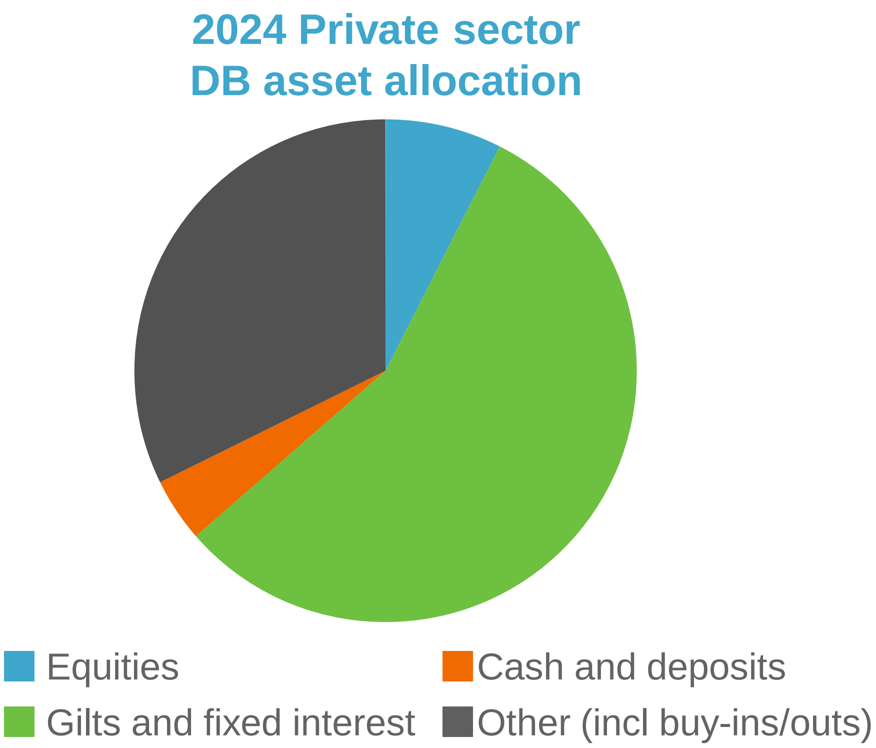
- In 2013 bulk annuity market was £7.4bn (buy outs and buy-ins) vs individual annuity market of £12bn
- In Q2 of 2014 there was around 40% fall in individual annuities
- Predict bulk annuity market to be £20-30bn p.a. by 2024 (vs £1.1tn Private DB assets today)

Current capacity suggests could take over 20 years to absorb
Expect combination of capacity growth and more ‘DIY’ approaches

Potential evolution of DB scheme assets

What do you think the asset allocation might look like in 2024?





Assumptions made:
2.5% p.a. de-risked out of equities, 1% going to 'other', say DGF, and 1.5% going to gilts for first 5 years, all to gilts thereafter
1% p.a. out of gilts into buy-in/buy-out market for 5 years and 2% p.a. thereafter

Risk transfer market may expand to c15-20% by 2024
And growth asset holdings might fall to c25%

2. Auto enrolment and the rise of DC

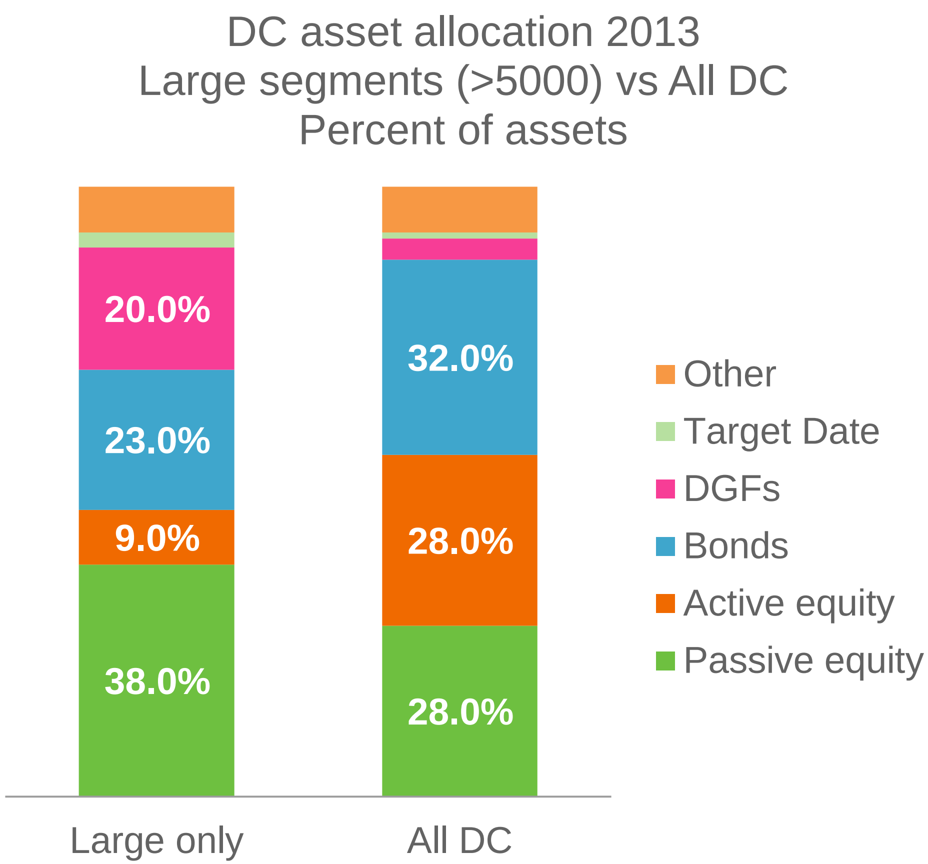
- Expect significant growth due to auto-enrolment and increased contributions due to increased awareness and education

£ bn	2014	2024
Value of DC assets	370	1,300

- DC market value might triple in 10 years but **future very uncertain**
- That would narrow the gap between DB and DC assets under management
- c 2/3rd of DC assets are in workplace arrangements and expect that might continue

Many factors will impact the potential evolution of DC market

Potential evolution of DC asset allocation



- Large schemes are likely to have:
  - more passive;
  - less active;
  - more diversified growth funds

  than the wider DC market
- Expect gradual change as a result of maturing DC membership profile
- Post Budget may expect fewer bonds, less active management, more DGFs (but more competitively priced due to default fund charge cap).

Expect changes to allocation when reviewing whether still fit for purpose

The market tells us DC isn't working

Employers need more help

63% Think employees aren't saving enough money to ensure adequate income in retirement

89% Would like to ensure staff are able to retire when they want to

66% Believe almost half of their workforce will be unable to retire at State pension age

Members need more help

67% Of DC pension savers are worried about not having an adequate retirement income

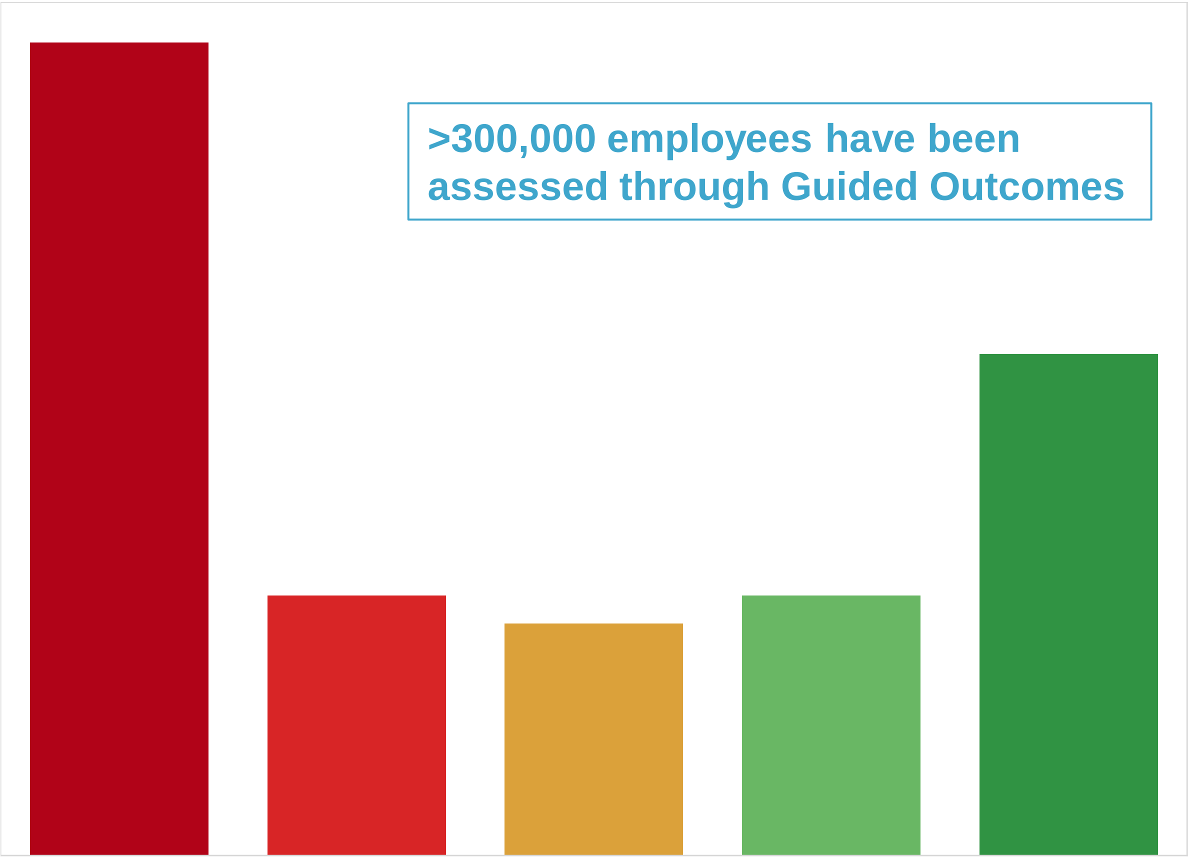
75% Said they wouldn't opt out of a scheme whereby someone else took care of their pension

23% Say they don't know how much of their monthly salary to save for an acceptable living standard in retirement

Need to set a target and regularly monitor progress – just like DB

Source: Hymans Robertson's report 'The looming pensions crisis' dated October 2013

So far results support perception



- High chance of hitting target
- Good chance of hitting target
- Moderate chance of hitting target
- Low chance of hitting target
- Very low chance of hitting target

Levers

1. Contributions
2. Investments
3. Retirement age

2/3rd of members will not retire on an 'adequate' level of income

Source: Hymans Robertson GO analysis

Magnitude of change required

Higher contribution rates required

- Average DC rates paid in 2013 – 9.1%*
- Example rate a 30 year old earning £30,000 would have to contribute to earn ‘adequate’ income in retirement – c18%

Increase retirement age – from 60 to SPA in this example

SAVINGS GAP CHALLENGE – In general a doubling of contribution rates required in conjunction with working for longer

3. 2014 Budget and retirement flexibilities

- In Q2 of 2014 there was around 40% fall in individual annuities
- Drawdown sales increased over same period but not by the difference implying deferrals until April or products evolve
- Potential future income solutions as alternative to annuities:

Hybrid Pensions

Buy to Let Pensions

Lifestyle Annuities

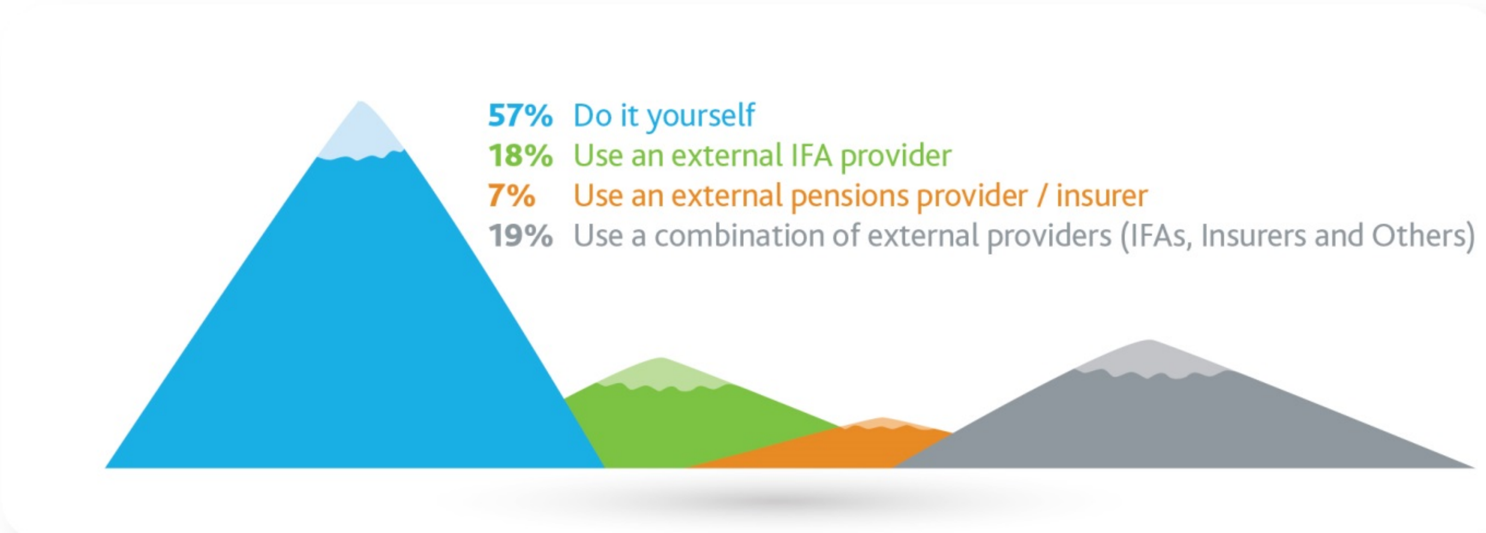
Extended Guarantee Annuities

Ring Fenced Pensions

Choices are complex and members will need guidance to make good decisions

Members need guidance but don't value it

How will you ensure that you make the right decisions?



How much (if anything) would you be willing to pay for financial guidance?

78%
Will not pay for external advice

22%
Will pay, but only willing to spend an average of £37

£37

Source: Hymans Robertson survey

Longevity challenge

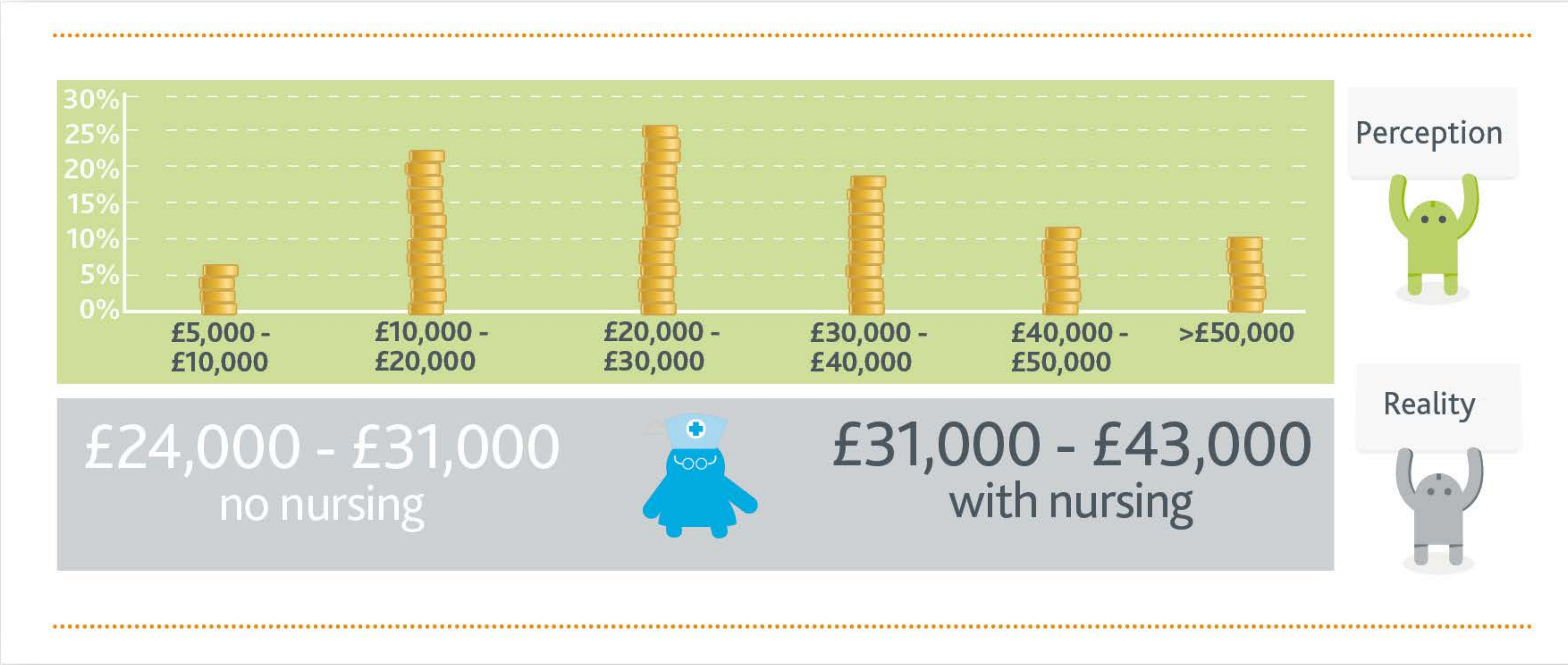
What age do you think you will live to?

How many years do you think you'll be in the 3 phases of health in retirement?

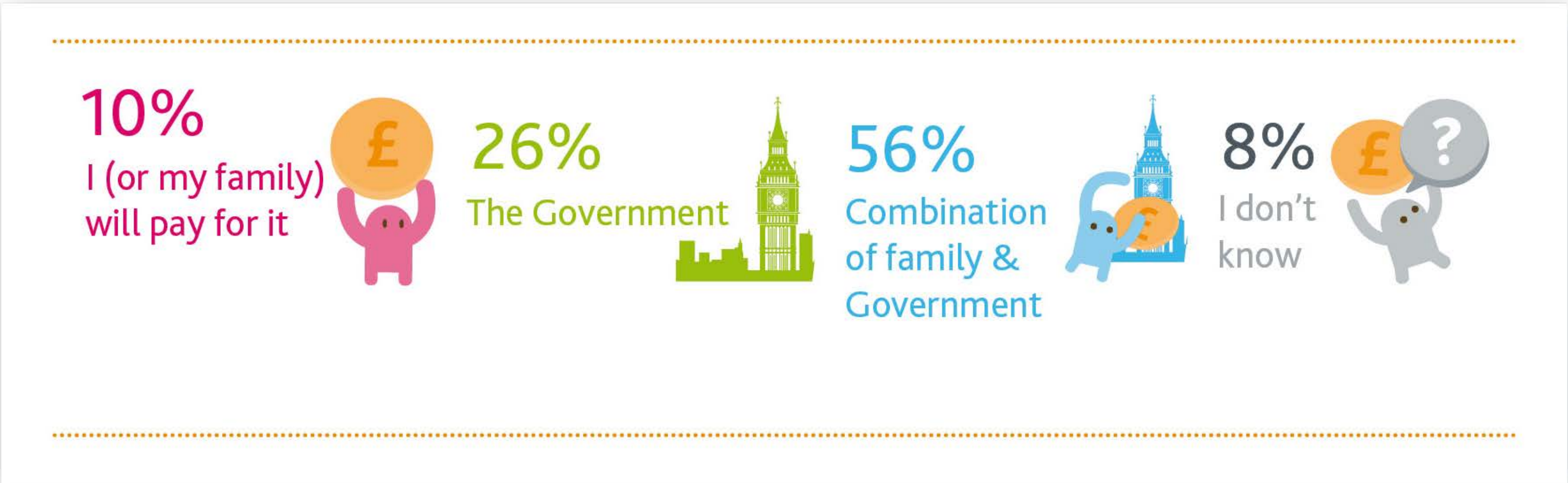
Perception will skew decision making and value assigned to longevity protection

How much do you think it would cost…

…to stay in a single room within a residential care-home, per year?



If you were to require long term care in retirement, who do you think will pay for it?

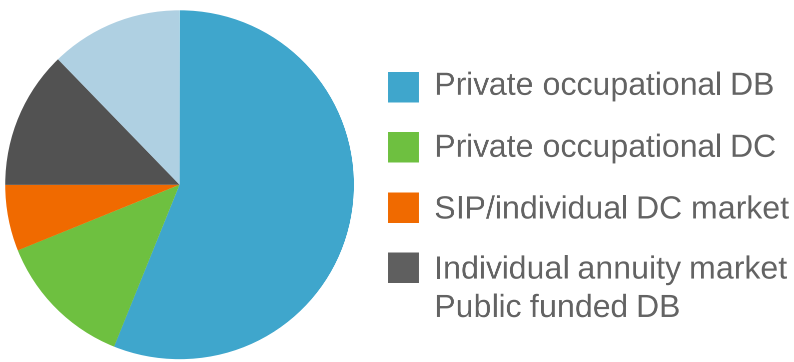


…reality is very complicated.

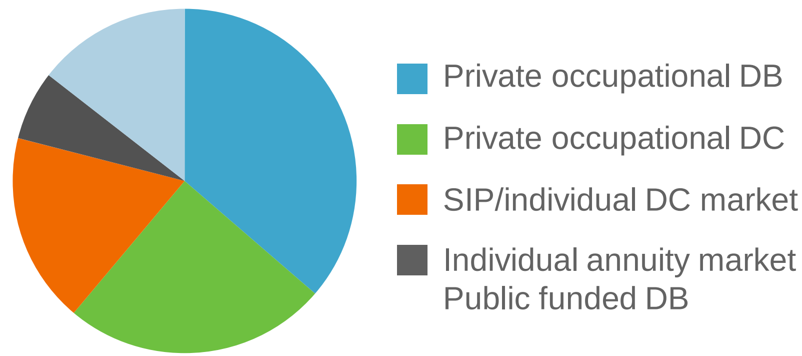
Members need to be taking guidance and advice to help make good decisions

Future pensions landscape?

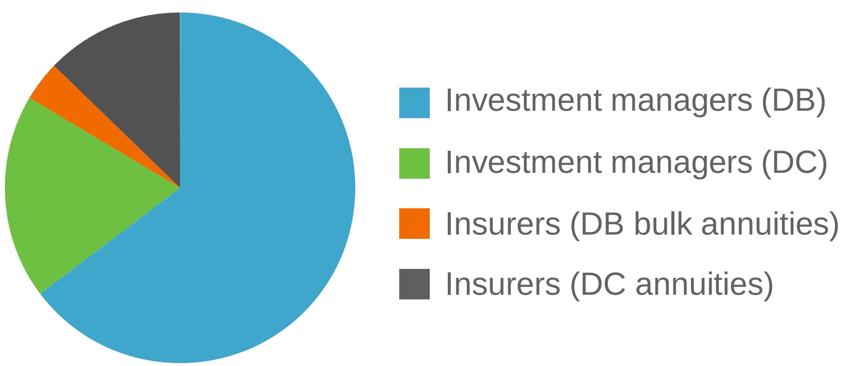
2014 Market value of pension fund assets



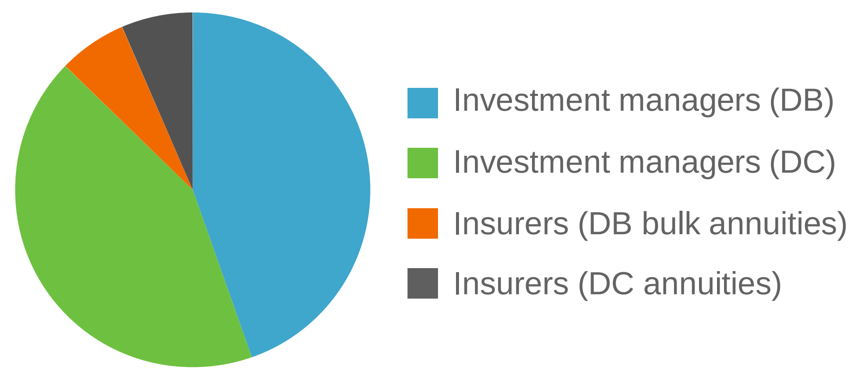
2024 Market value of pension fund assets



Who holds pension fund assets in 2014



Who holds pension fund assets in 2024



In conclusion, what might the future hold?

For DB:

- **Share of total pension assets** - could drop from c68% to c50%
- **More risk transferred** to insurers via buy-ins etc but capacity constraints expected
- **More 'DIY' approaches** with lower risk investment portfolios
- **Increased flexibility at retirement** with careful communication of risks

For DC:

- **Market value could triple** in next 10 years
- **Savings gap** – need for education - increased contributions and retirement age, tools for decision making
- **Spending patterns and increased flexibility** - need for education, and tools for decision making
- **Product innovation** and tools required

Only skimming the surface

Reliances and limitations

A number of different sources of information have been used in the analysis included in this presentation and neither the authors or Hymans Robertson take any responsibility for the accuracy of this.

In addition, the analysis is very broad brush for discussion and debate purposes only and should not be used for any decision making. Any views expressed are personal views of the presenters.