



Opportunities in the retirement income market

Feb 2007

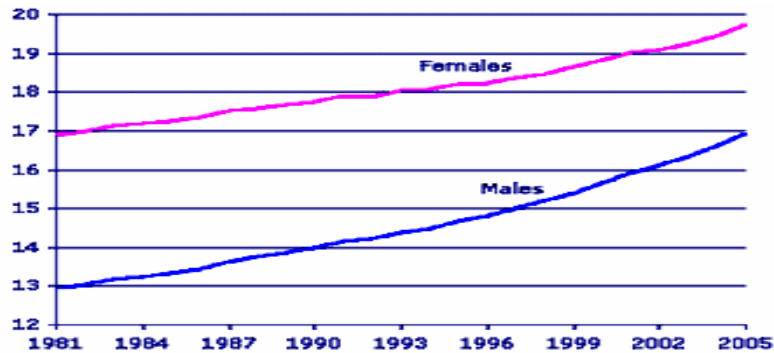
Lawrence Somerset
Growth through Innovation

Innovation is sorely needed to help address the retirement funding gap

- **Big 'gap' identified by Turner**
 - Baby-boomer demographics, and age cohort effect
 - Retreat of paternalism – by both Corporates and State
 - Large disparities between social groups
- **Some initiatives have been undertaken but no signs of real change**
 - State withdrawing from pensions, but ...private sector not taking up the slack
 - Stakeholder pensions developed, but not successful
 - 'Sandler' products recommended but largely ignored
 - 'A' Day welcomed but likely to be a reshuffling and benefit to affluent
 - Now work on compulsory pensions scheme - NPSS, but with problems
 - Advice regime accommodating new forms – Thoreson Review
- **Several impediments at the consumer level**
 - 'Irrational' behaviour
 - Still a hangover of concern about equity risk
 - Poor view of annuities
 - Low level of trust
 - Housing equity positioned as a substitute
 - Low income trap - No incentive to save because of likelihood of losing state benefits
- **Where will the challenges be tractable for innovators?**
 - Find low cost solutions
 - Build trust
 - Improved flexibility, Risk management and Asset accumulation
 - Novel accumulation vehicles
 - Equity release
 - Worksite marketing
 - Novel annuity vehicles

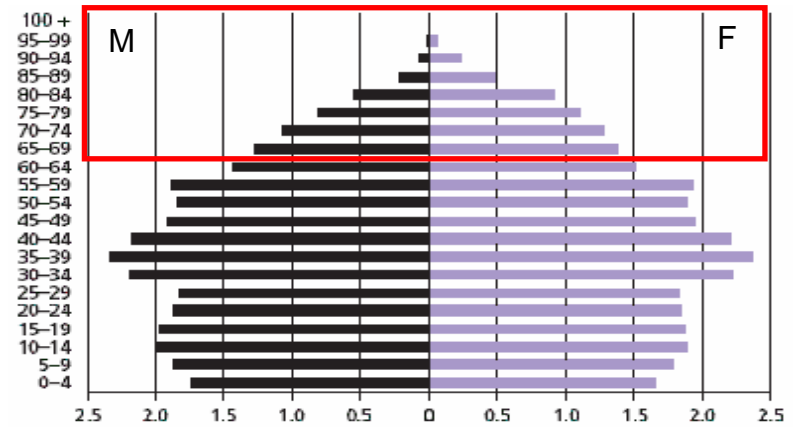
The 65+ population is set to double in the next 40 years, increasing dependency ratios

UK life expectancy at age 65

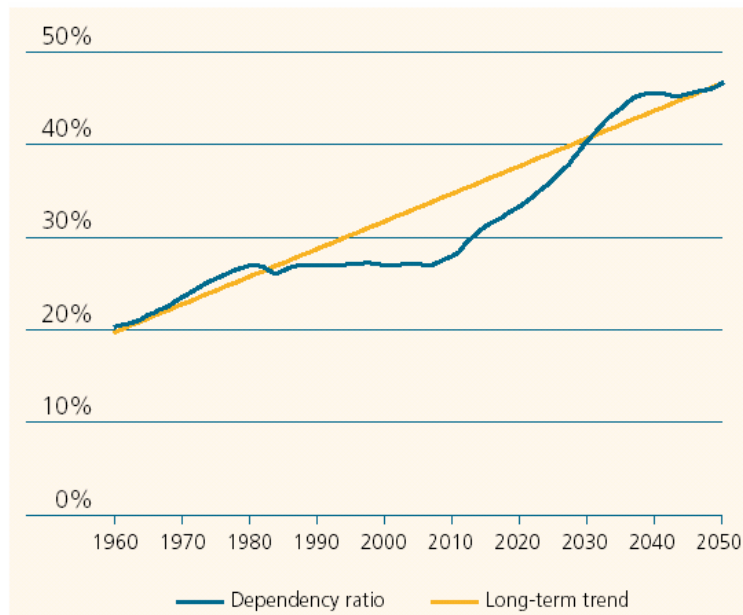


Baby Boomers coming through

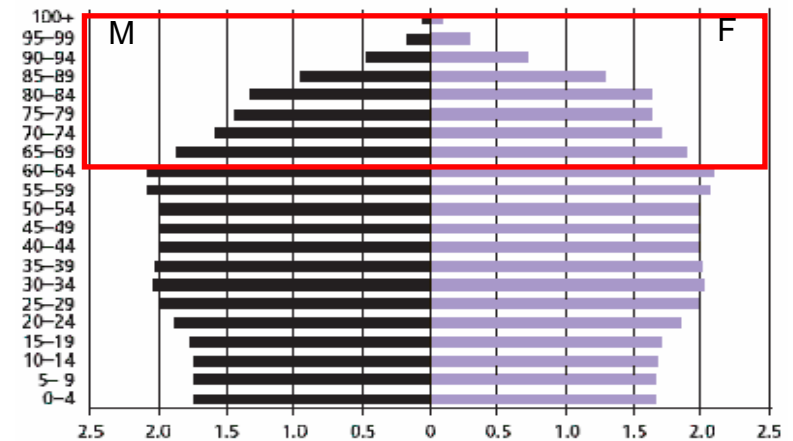
2003



Rising UK Dependency ratio

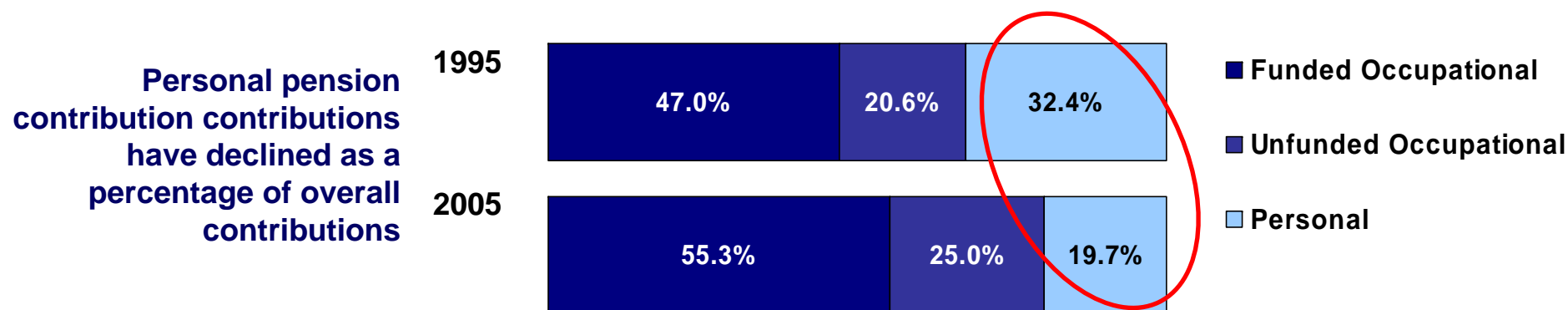


2050



Turner identified a funding crisis and expected the private sector to step in to make good the state shortfall

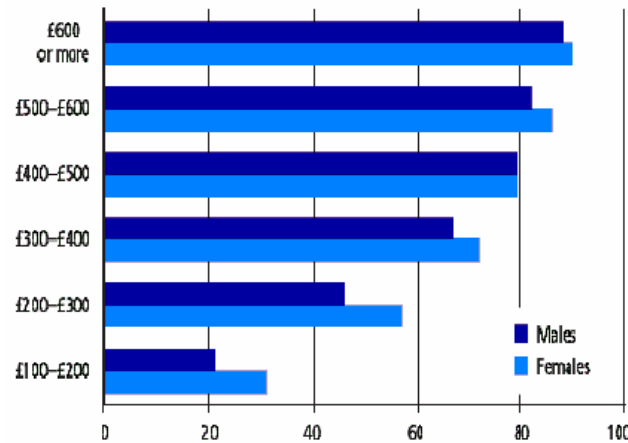
- The Turner report in 2004 estimated the UK pension gap to be **£57bn, just to maintain the pervious level of state pension**, with between 8 and 13 million people not saving enough to fund an 'adequate' retirement.
- The solution was thought to be a combination of
 - Raised taxes
 - Later retirement age
 - Increased savings
- However whilst the state had been decreasing support for some time, in order to control its expenditure, the private system had not developed sufficiently to offset the state's retreating role, and had in fact been in decline.
- Without significant innovation it seems there will be no shift in the balance of provision from state to private sources



The 'gap' is not even – some groups are especially disadvantaged

Those on low incomes are saving the least:

Percentage of employees with second-tier pension provision by weekly earnings



71% of small firm employees have no second tier provision:

250+ employees



50-249 employees



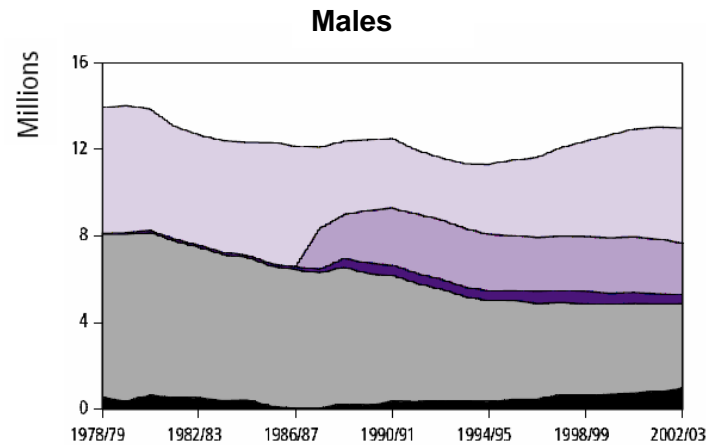
1-49 employees



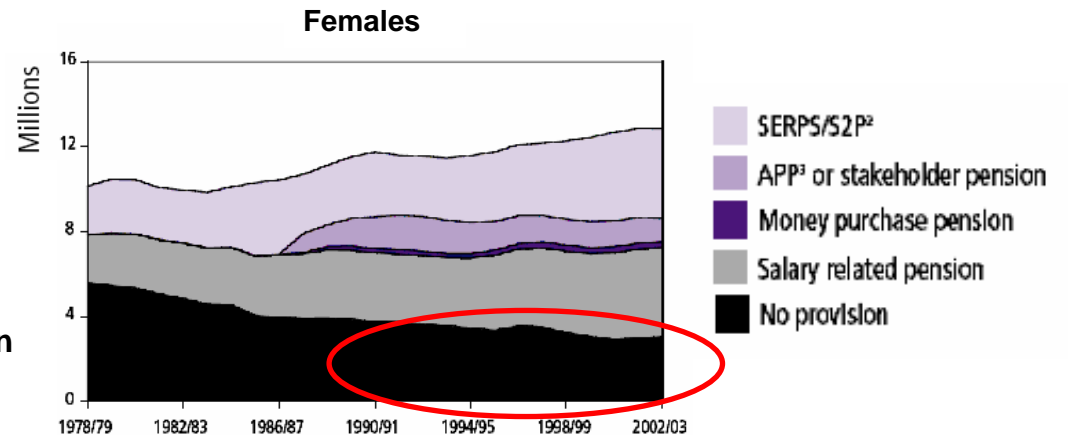
Participation in employer sponsored schemes by firm size

■ Salary-related ■ Money purchase ■ Other ■ GPP ■ None

Women are lagging behind men:



Male and female employees by type of second-tier pension provision

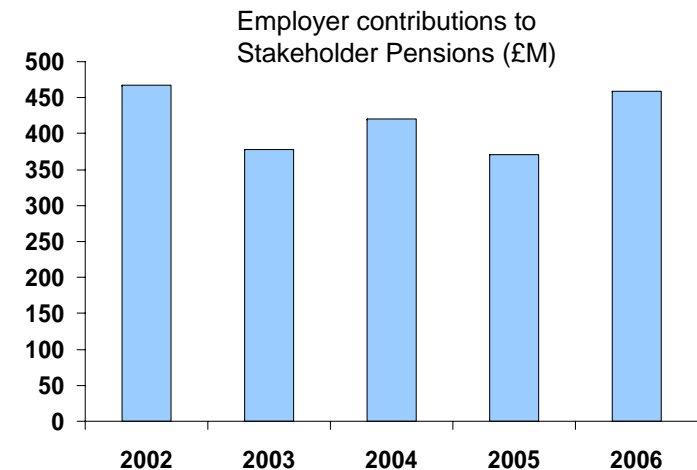


Responses: Stakeholder Pensions and “Sandler” products

Stakeholders introduced **2001**, to provide **low cost schemes with capped fees**

Sandler products introduced **2004** to provide **simpler savings products needing less advice**

- Over 300,000 new stakeholder pension schemes were introduced to the market but the vast majority of these schemes have no members – membership was not compulsory and employers were not required to pay into the schemes.
- Proved unattractive to Providers – break even point not until between 12 – 15 years into the plan. Many argued customers would be better off with ‘a wider range of high-quality stock-picking funds than trying to skimp on the charges and making do with poorly performing investments’
- The industry was suspicious of Sandler products, which they felt, because of the low level of advice with which they would be offered, would leave them open to charges of mis-selling.
- Sales of both were disappointing: e.g. 2004/5 £2.4bn of contributions made into stakeholder pensions - not significantly more than to ISAs (ISA contributions 05/06: £1.8bn) but improved following 2005 increase of the fee cap from 1% to 1.5% of total fund value



Take up has been too low to make a significant impact

Responses: SIPPs and A-day

- **Aim:** To encourage more saving by **lifting upper limits on deposits**
- **Increased business?**
 - 56% of advisers believe the changes associated with A-day (April 2006) have increased business
 - However it is unclear whether this is genuine new business or merely consolidation of existing funds
 - the market is currently worth £35-40bn
 - total insured individual pensions market £250-300bn
- **Consolidation of the industry?**
 - Regulatory pressure has moved market share and advantage to mainstream providers with more resources and used to operating in a regulated environment making the SIPP market increasingly challenging for smaller providers and market consolidation likely.
- **Possible miss-selling?**
 - Some IFAs warn SIPPs could be the subject of the next mis-selling scandal - claiming investors have bought into them sometimes in spite of advice that they are not the right vehicle.

Some increase in business but mostly consolidation of funds

Higher charges mean SIPPs are only suitable for larger funds

Responses: Thoreson report and the GFA service

- Interim report published Oct 2007
- Feasibility study / Customer pilots underway for a **Generic Financial Advice Service**
 - Available to all
 - Impartial / not linked to product
 - Signposting to commercial providers of advice and financial services solutions
- Guidance would include: jargon busting, managing debts and budgeting, savings and mortgages, planning for retirement, understanding taxes and state benefit entitlements.
- 19M people have been identified as those who would benefit the most and 7.5 M as the most vulnerable to the consequences of poor financial decision making.

Jury still out

Responses: National Pension Saving Scheme

- Announced Dec 2006, due to be launched 2012
- Automatically arranged for those without adequate pension arrangements
 - Employers will have to make compulsory contributions of 3% of an employee's salary.
 - Employees contribute 4%, the government 1%
- This government-run scheme could have a major and damaging effect on life and pensions industry revenues, some have estimated a loss of up to 30%
- An alternative industry-run scheme proposed by the ABI was found to be more trustworthy than the
- Will also have a major impact on employers. An estimated one in five small businesses will have to cut jobs or reduce wages if it is introduced
- Many believe the scheme will result in the levelling down of company pension schemes as companies seek to reduce their contributions in line with the Government's (lower) changes.

May not be the best option for the consumer / could reduce overall contributions

Any new development will need to address several behavioural and perceptual barriers to the success of voluntary saving for retirement

1. 'Irrational' behaviour around savings

- People underestimate life expectancy and use....
- An effective discount rate estimated to be c50%

2. 'Low income trap'

- Little incentive to save for those on low incomes because of the likelihood of losing state benefits.
- Can a voluntary market for pensions work for low income, low premium customers?

3. Positive perception of housing equity

- Significant growth in housing equity so it now rivals financial assets
- Thought by many to be a substitute for a financial pension
- Equity release products, and alternative to downsizing, got off to a poor start and have not yet recovered

4. Perception of poor value/high cost of provision and low level of trust in firms and in equities

- Providers' charges can absorb 20-30% of an individual's pension saving, even though they have fallen to a level where provision to lower income groups is unprofitable.
- Trust in financial institutions is low – even for short-term savings
- Trust in equities still suffers from 2002 crash

5. Concern over annuities

- Current rules seen as inflexible
- Current products seen as inadequate

6. Perceived ambivalence of Government

- Taxing of pension funds vs
- Encouragement of spending through personal credit

7. Complexity of the UK pension system

- Currently there are Possible product forms available for the average investor
- Many need advice which has become increasingly inaccessible and expensive

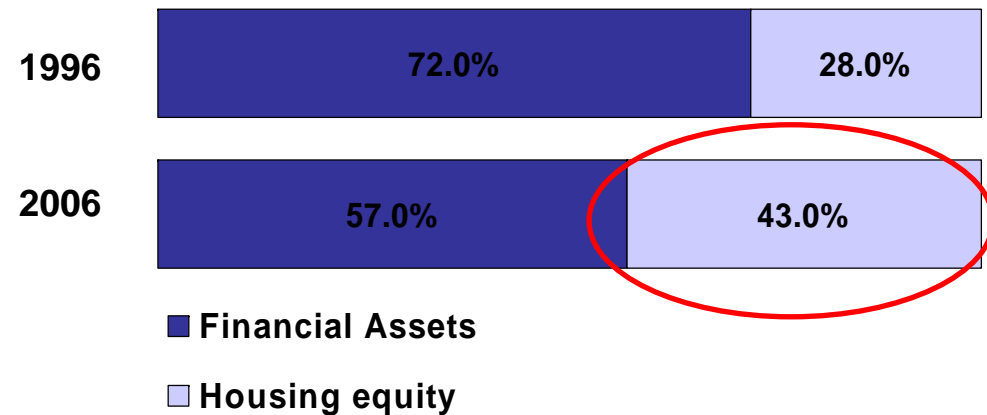
The customer response, to rely on housing equity, may not be sufficient

A 216 per cent increase in the value of the UK's housing assets has contributed to an overall 127 per cent increase in household wealth over the past ten years

On the face of it the use of net housing wealth appears attractive but are not a complete solution because:

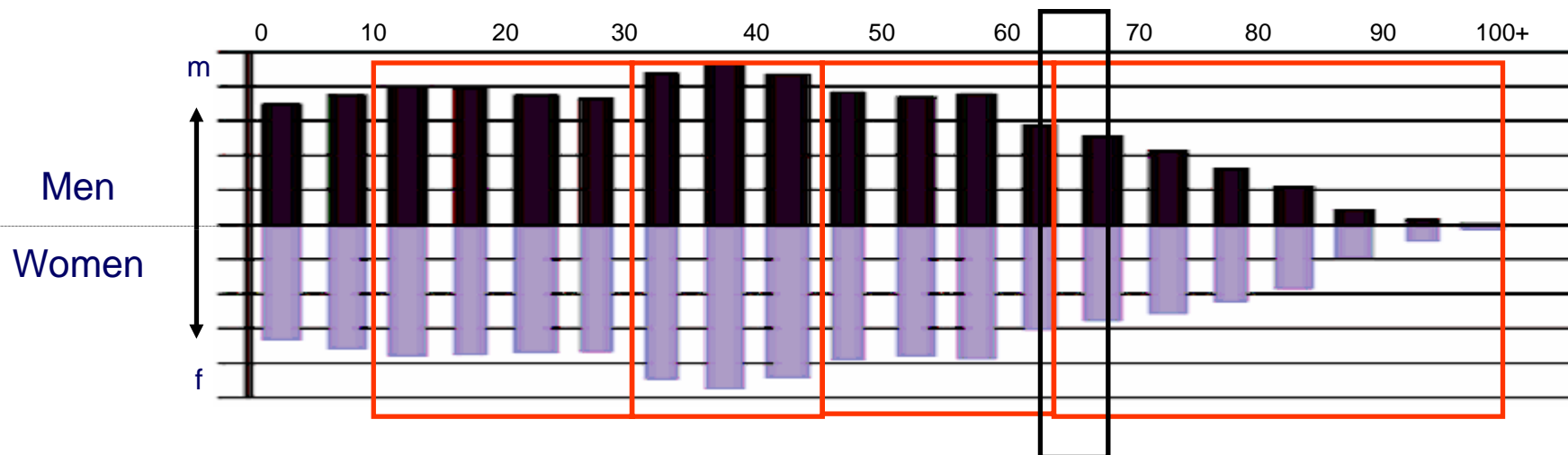
- There are often other claims on housing assets especially of long-term care
- Home ownership distribution does not correlate with that of those most in need
- The baby boomers will want to downsize at the same time

Housing Equity now accounts for 43% of UK household net wealth



Baby boomers and Gens X and Y have a different attitudes which have not yet been accommodated

Generational cohorts (2003)

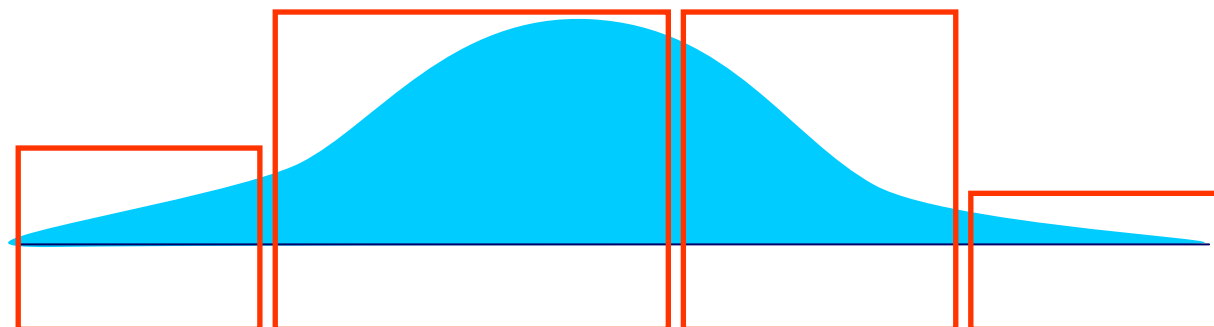


Attitudes	Gen Y	Gen X	Baby Boomers	Pre-War
	Selfish Money driven	Privileged Enterprising Less accepting of established modes	Individualistic Soc. Mobile Self Made Demanding	Used to Hardship Used to Frugality

←
Increasing feeling of entitlement to a good standard of life

Different responses will be required across the wealth spectrum to reflect needs, motivations and economics

Distribution of Ability to Fund Retirement



Disadvantaged	Mass Market	Mass Affluent	Affluent & Upscale
<£1k	<£50k	£50 - £500k	£500k +

Retirement Income Issues

Benefits Trap	Housing Equity	Housing Equity	Tax Management
Lack of Funds	Limited Funds	Motivation	Advice
Right course?	Motivation	Trust	Protection
No EB	Trust	Advice	Estate Management
	Patchy EB	Vehicles	
		Estate management	

On the 28th, we will discuss some of the following questions:

1. How should markets and customers best be defined and mobilised to highlight opportunities for innovation?

Eg, across the wealth spectrum

- For upscale clients with funds but requiring tax efficiency and access?
- For mass affluent who have alternatives to financial assets?
- For the disadvantaged with few funds and conflicts over means testing?

And for Baby Boomers in particular

• What opportunities will there be for new products and services to improve propositions in:

- asset accumulation;
- equity management;
- asset 'decumulation' and income management;
- risk management and asset allocation;
- Platforms/WRAP
- personal protection;
- Income provision;
- estate management?

1. What channels will be required, eg worksite marketing, and what form of advice, guidance or selling will be appropriate?

2. Is there an opportunity to disrupt the traditional market, in particular, where should the initiative be taken by firms rather than waiting for Government/FSA action?

3. Will a profitable future for suppliers depend on re-engineering the business to support aggressive pricing

4. What strategic opportunities are there for incumbents and new entrants?



John Lawrence, Director

TEL 020 78132197 07971 559 564

jlawrence@l-s-l.com

www.l-s-l.com



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