



Retirement Conference

An Investment Manager's View of the
UK Retirement Market

19 October 2010

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Agenda

- DB to DC
- Default options
- NEST
- Products to help with uncertainty risk
- Tax simplification

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The trend to DC is continuous

- Active membership in DB schemes expected to decrease a further 40% by 2050¹
- Active membership in DC schemes which is currently around 5million could grow to 15 million by 2020 and 17 million by 2050¹
- We have to stop giving and allowing the message that 'DB is good and DC is bad'.
 - The most significant issue is that contribution rates by both employers and employees are significantly lower in DB plans
- We are already a long way down the pure DC route so collective DC is unlikely to start now

Source:
¹ PPI

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DC Default

- Around 80% of members actively or passively 'elect' for default option
- Traditional default has been UK or Global equity passive product with a majority (but not all) including a lifestyling option
- On average this isn't a bad option... But who is average?

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Is Pauline average...!?



“I may be at the age when most grannies are taking it easy, but not me.

I’m not ready to hang up my running shoes just yet.”

Pauline Newsholme, 69, runner of 69 marathons

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DC Default Options

- Market developing for alternative default options :
 - Target date funds
 - Diversified growth funds
 - Absolute return/ Inflation +/- Cash + products
 - Multi Asset funds
 - Diversified alternatives
- Australian pension schemes already offering a range of alternative products but they have a much higher level of financial education and professional support (e.g. access to financial advisors)
- US: Target date funds growing market share fast – already >20% of all contributions

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Our industry is currently focused on the accumulation phase...

- There are plenty of pre-retirement savings products in the market
- Marketing spend is over focused on the accumulation phase
- Other industries, like consumer goods, have recognised the opportunity and launched products and solutions targeting the retirement group
- Pension gap is a widely recognized issue across Europe
- A less recognized issue is what to do with retirement assets, once the gap has been closed, and how to maintain the desired lifestyle

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Decumulation Products

- Growth of income drawdown may increase drive for investment products with 'certainty of outcome'
- Greater focus on income products that can also offer capital preservation / growth
- More flexibility around annuity type products – insurance company partnerships likely to increase
- At its simplest income products
 - Fixed Income – but rates are low...
 - Equity Income
 - UK has been a good source but issues such as BP highlight the risk
 - Global Equity Income produces a more diversified option
 - Emerging market equities which historically had low dividend yields now becoming core payers
 - Multi Asset Income
 - Infrastructure

Certainty of income comes at a cost

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DC – After the Accumulation Phase

- The current default is set for the growth phase with lifestyling generally moving you towards an annuity purchase
- If annuities are not required or not optimal then we should be looking at income producing products
- We need to get people thinking about their pension as to what income it will generate in retirement rather than the 'size of the pot'
- We need some certainty for pension savers : 'DB for DC'. The market needs to develop products which give some certainty over minimum income levels but give growth flexibility. Possibly this is the next phase of deferred annuity type products... although there is a still risk here, just of a different type.

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Product Developments

- Various surveys have found that what people want is certainty with potential upside...
 - A transparent 'with profits'?
- 'DB like DC'
 - Banking products – risk of cash locking
 - Volatility tolerance products
 - Protection of minimum income with growth flexibility
- Capital guarantees are expensive and require a very significant amount of capital
- Capital protection is less expensive but still carries a risk of uncertainty

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- A new low cost national pension savings scheme was proposed in the Pensions Act 2008 – National Employment Savings Trust (NEST)
- The act also brought in auto enrolment and set a minimum employers contribution
- Auto enrolment could result in a further 5 – 9 million people saving in private pensions (mostly low to moderate earners)
- NEST will be a significant cost to set up and run but if successful could help fundamentally change our savings culture
- The government has restated its commitment to auto enrolment but has not yet re committed on NEST

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NEST

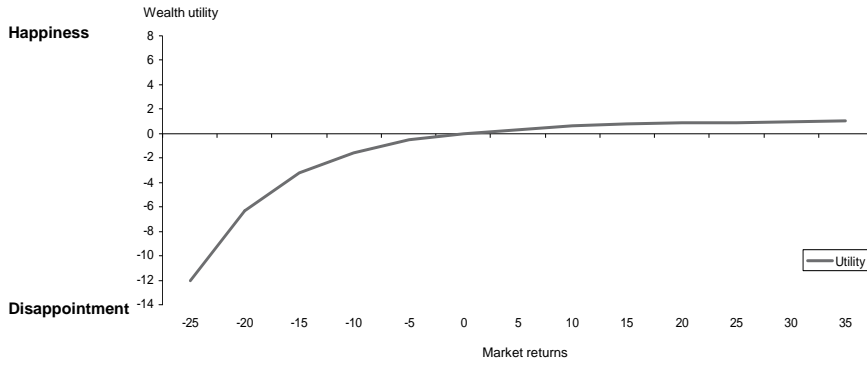
- The default option for NEST which will likely form the vast majority of the assets will likely be a 'low cost equity tracker'
- Is this the ideal product for this type of saver?
- Do they want full exposure to the equity markets?
- What will the perception be if the equity markets crash during the early years of NEST
- Our view is that 'cheap' product is not always suitable and not necessarily 'good value'

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Savers' tolerance of risk is asymmetric

Asymmetric utility



... the pain of absolute loss is greater than the pleasure of absolute gain

There is a difference between price and value



Price of BA single flight to New York today booking on BA.com 8 October

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Simplification

- ISA's are very successful... In part because they are simple to understand
 - 42% of pensioner households have at least one ISA
- Suggestion to bring pensions savings and ISA limits together
 - Certainly helps with simplification
 - But requires caution on access to pensions savings pot
- Merge SIPP and ISA to create a similar product to the US Investment Retirement Account (IRA)
- Allow pension product purchased using ISA funds to be tax free
- People need to know what they are going to get from the state pension and what they are going to get from workplace and other pensions... Again this needs to be what income they will receive not the size of their pot
- We believe that 'Simple' does not necessarily equal 'Cheap'

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Why pay more ?

- Asset Allocation
- Alpha
- Guarantee/Protection

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A nation of savers – not investors

- There is a well documented gap between the perception and reality of what income people will receive on retirement. On average we estimate that people are saving only 5% of their income into a pension
- Even where we are saving we are highly risk averse
 - Since 2001 cash ISAs have significantly outsold stocks and shares ISAs
 - An FSA survey found that 43% of people claimed they wanted to take no risk with their savings
- Unless a high level of income is directed to deposits most investors will need some exposure to growth assets if they are to have any hope of building sufficient funds for retirement

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Longevity

- People are living longer: the average life expectancy has increased by 10% over the last 30 years
- Population of over 65 years old will almost double in the next 50 years
- Increasing realisation that state pension is insufficient: the European commission estimates that the pension benefit ratio will decline by 25% in the coming decades
- Today the 50+ segment captures 58% of total personal financial assets in Europe
- Annuities do protect against longevity. For the UK pensions sector, every month added to life expectancy increases liabilities by £2.5bn
- But it's perhaps a concern that 87% of annuitants purchase level annuities leaving them exposed to their need for increased income for healthcare etc as they get older and most significantly exposed to future inflation

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We believe that people will have to save more

- They are going to be retired longer
- DB is going to continue to diminish
- Employer contributions to DC are generally lower than they have been to DC
- The state pension will not suffice for the majority of people
- They need to consider both the early years of retirement when they are likely to be active and the later years when they need to be consider healthcare costs.

Tax incentives which are simple to understand and use are essential to encourage people to save more.

But how else do we persuade people to save for their retirement?

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Previous Government campaigns have worked



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...and have been very direct



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Do we need to be clearer about the effect of not saving enough?

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Do we need to be clearer about the effect of not saving enough?



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J.P. Morgan Asset Management

Contact:

Roger Thompson, Head of UK Business

☎ +44 (0) 20 7742 5059

✉ roger.thompson@jpmorgan.com

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