DC Investment & the true cost of volatility

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Challenges

- Member engagement
- Contribution rate / compulsion
- Governance structure
- Cost / value for money
- Investment strategy / Default / Lifestyle
- Post-retirement: Longevity & standard of living

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3 contentious investment considerations

1. Accumulation:

   Cost vs Value when investing for the long term

2. Default fund objective:

   Why do most pension funds help buy cars & vacations…
   …at the expense of better pensions?

3. Risk capacity:

   Thru-retirement investing – are Silver-Surfers really risk averse?

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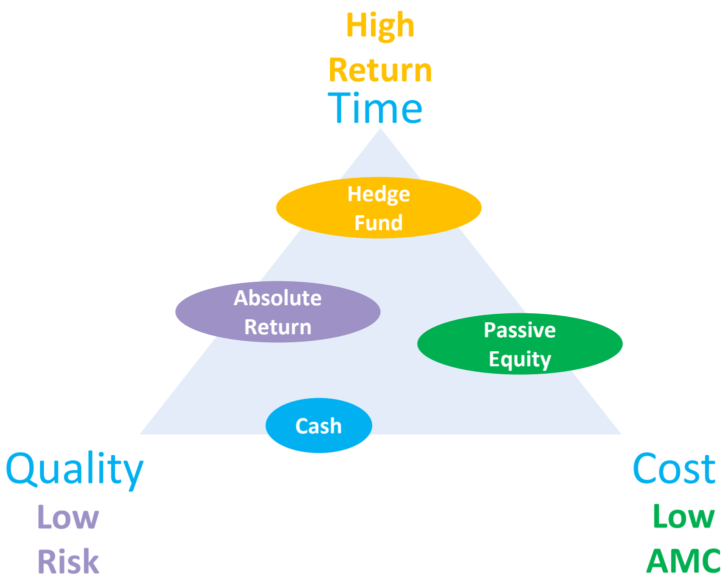
Changing the mind-set can markedly improve the outcome

Early stage accumulation & value for money



- Default for young DC savers:
  - Have plenty of time
  - Limited financial capital to put to work / at risk
  - Can control cost easily

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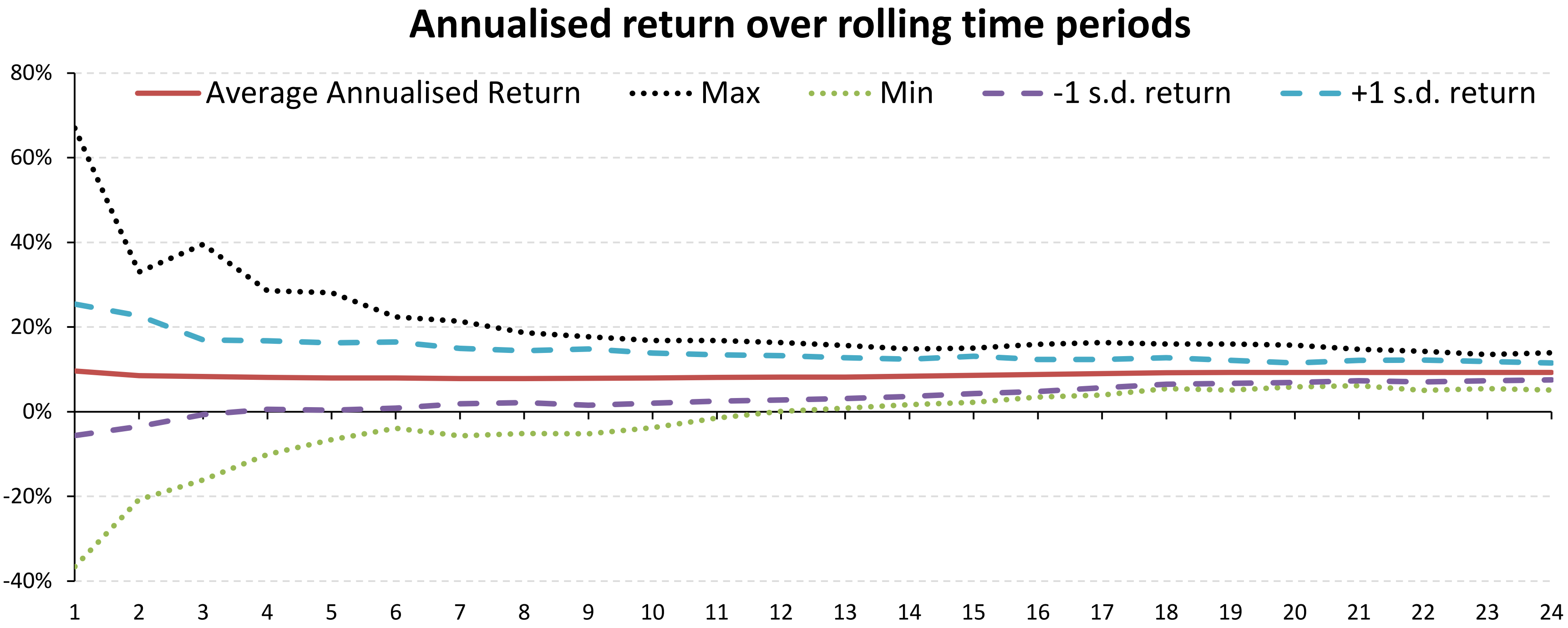
Hard to prioritise quality in default investment design

Accumulation: Does Volatility Matter?



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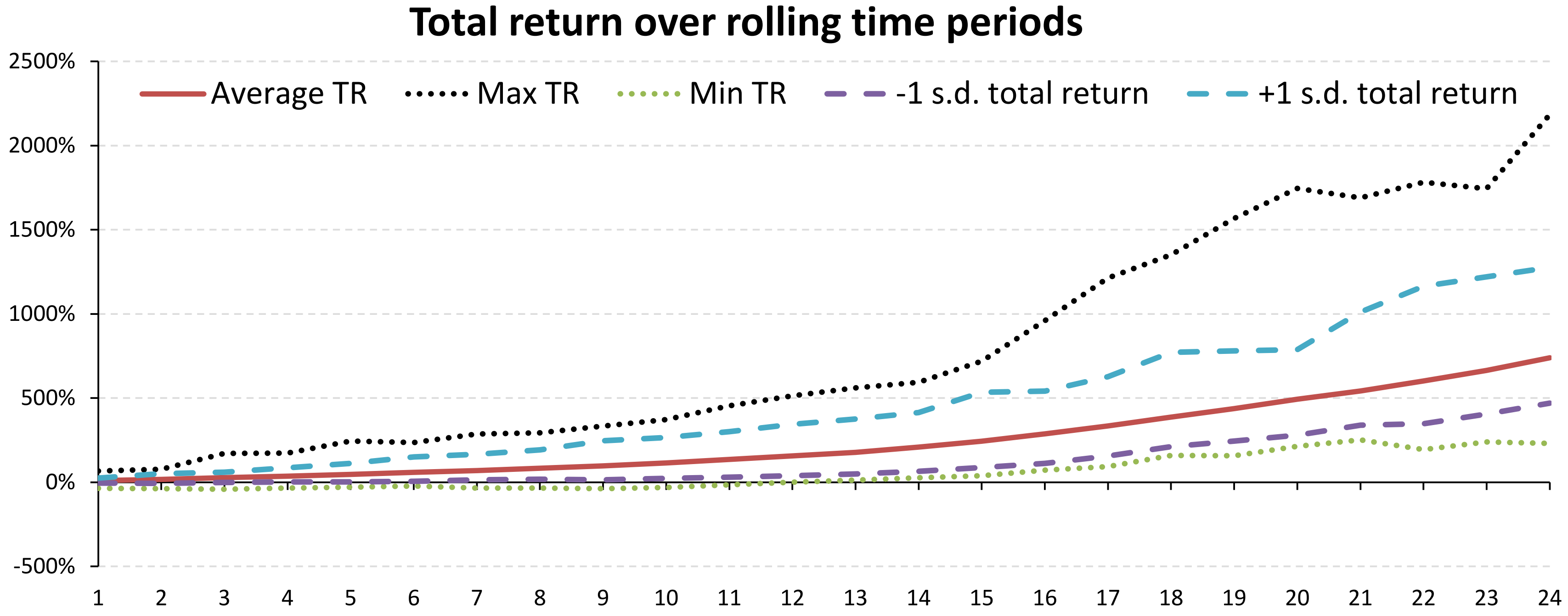
Longer time periods appear to make returns more consistent

Sources: Standard Life Investments, Thomson Reuters DataStream, S&P500 Index total return from 1965 to 2014

Market Volatility and Outcome Uncertainty



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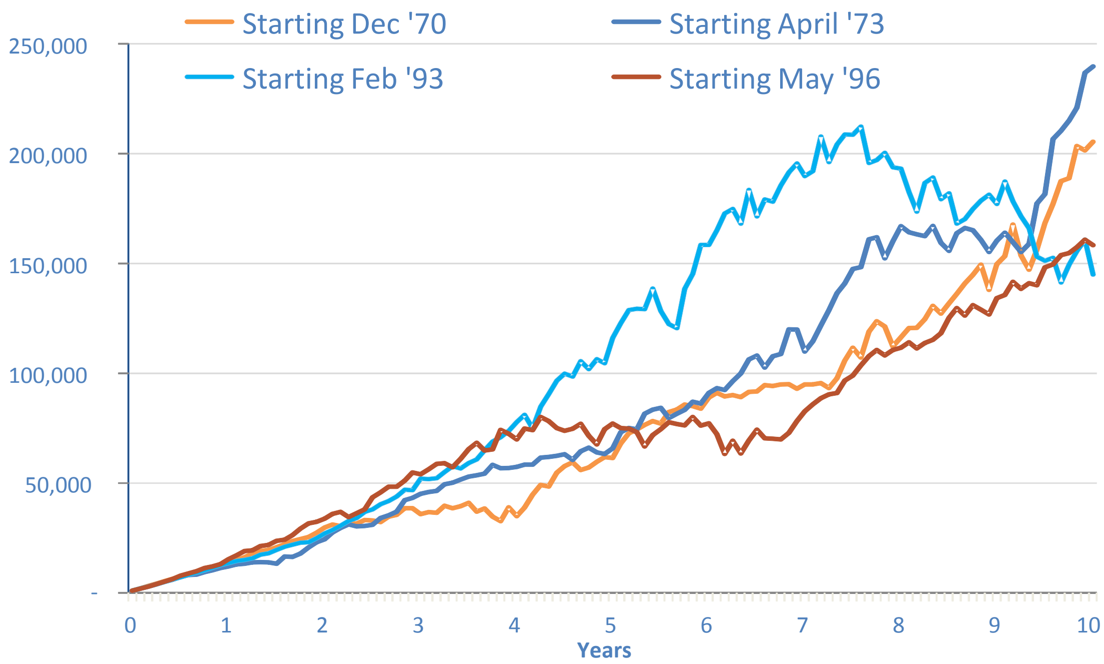
In fact the outcome for investors becomes more varied

Sources: Standard Life Investments, Thomson Reuters DataStream, S&P500 Index total return from 1965 to 2014

Inconsistency matters for regular savers too



- 1000 a month
- saved over 10 years
- 8.4% annualised equity market return in all cases
- 95,000 range in the final outcome

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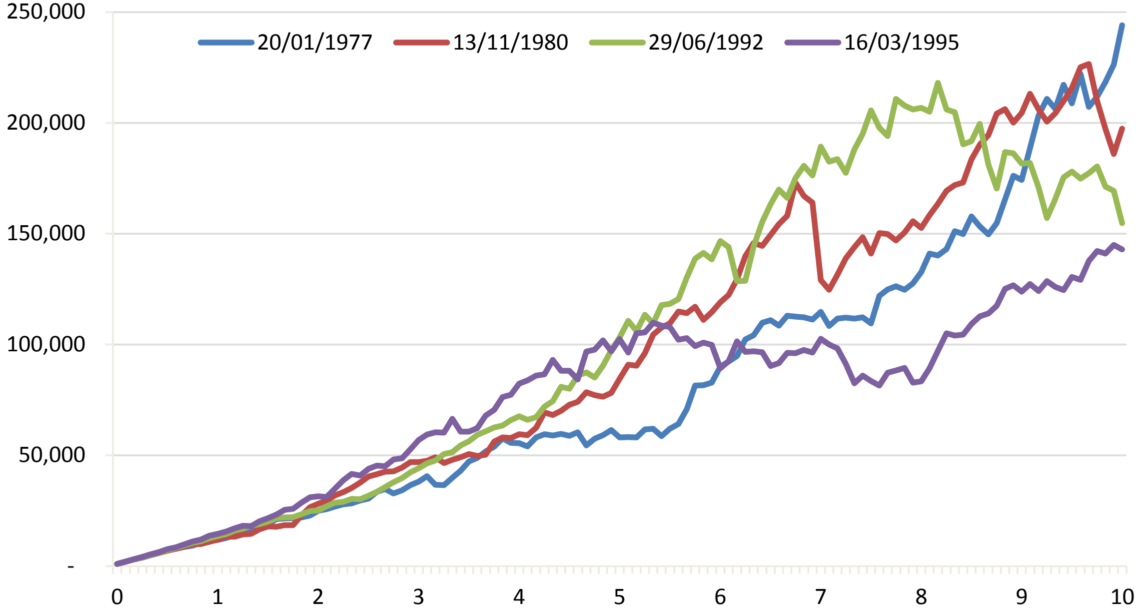
Investment inconsistency problematic for savers too

Source: Standard Life Investments, Bloomberg SPX Index (Total Return)

…just in case you thought inflation was the difference…



- 1000 a month
- saved over 10 years
- 8.4% annualised **real** equity market return in all cases
- 101,000 range in the real final outcome
- Inconsistency derives from the sequence of **when** return is delivered

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Inconsistency can REALLY wreck livelihoods

Source: Standard Life Investments, Bloomberg SPX Index (Total Return, Inflation Adjusted)

Budgeting for uncertainty

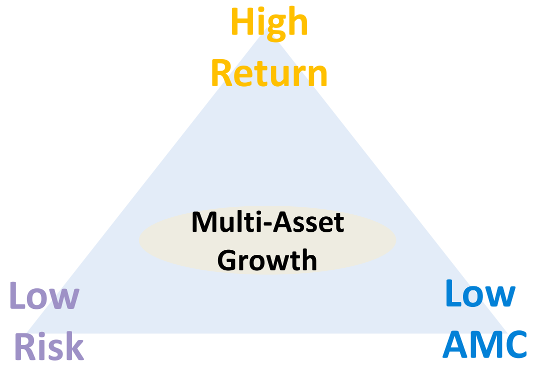
- How much do I need to save to achieve my savings objective over e.g. 40 years?
  - 8.5% average annualised return
  - 16% annualised volatility

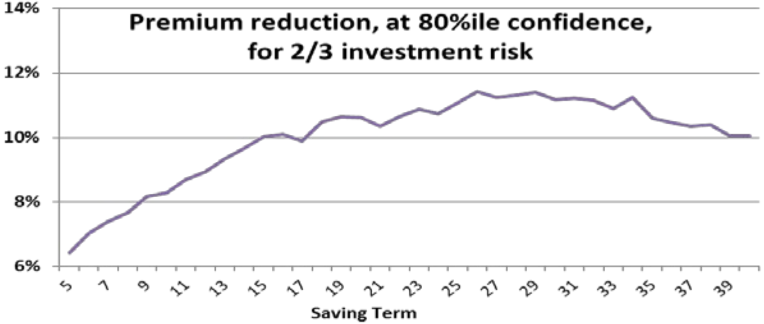
- 100 a month (inflating 3.5% p.a.) generates **565,105** …on average
- To have **80% probability** of hitting this target I actually need to save **167.55** per month (inflating at 3.5%, 20bps AMC)
- **What if the annualised volatility were only 2/3rds of 16%?**

  …& the AMC is 2.5x higher (50bps not 20bps)…

  - 150.72 a month would be sufficient
  - **16.83 a month "saved", or 10% of the premium**

- A meaningful impact for young savers with low propensity to save and multiple demands on limited income.





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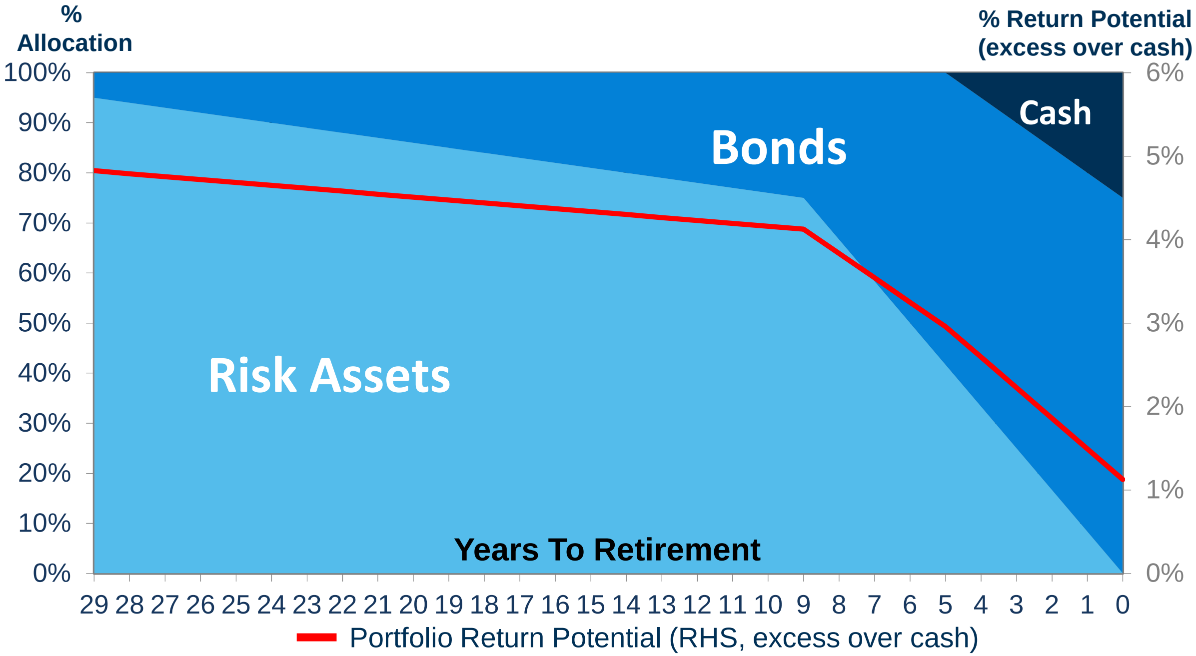
Return potential and risk-control matter for all savers

Glide-path depends on Retirement Plan



- Classic DC glide-path prepares for annuitisation
- ARF / drawdown members would need to re-risk post retirement
- New glide-path is needed

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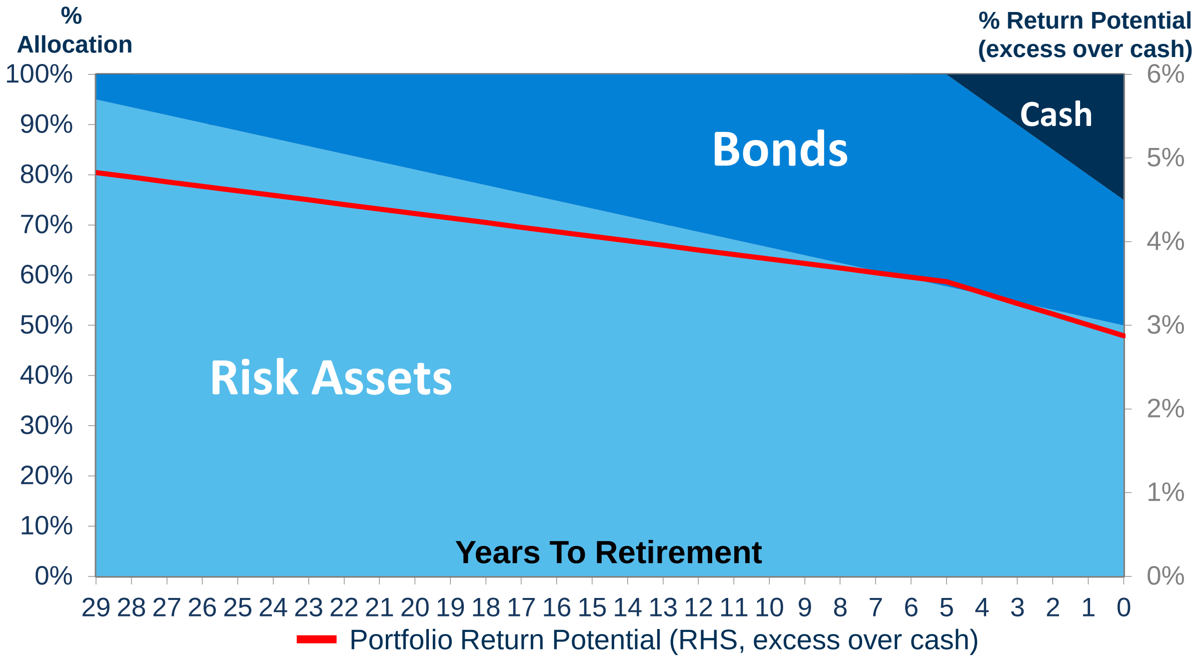
Source: Standard Life Investments

Glide-path depends on Retirement Plan



- Australian model is a balance
- Return potential is improved ...when it matters
- ~4.2% higher average pot
- Many UK defaults have been redesigned to reflect the most likely retirement plan
- Swim-lanes / engaged members
- Why Tax Free Cash?

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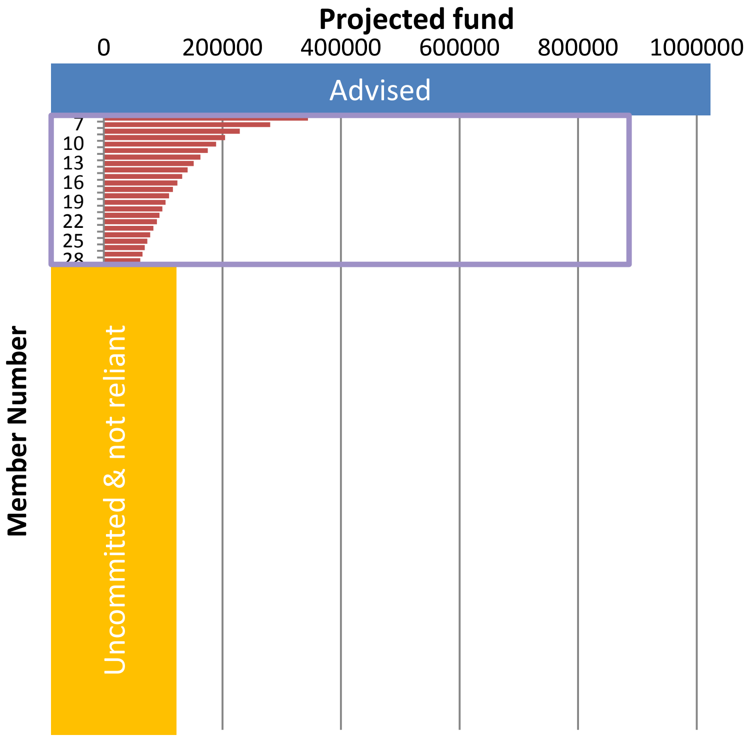
For whom should the default fund be designed?

Source: Standard Life Investments

Whose needs are paramount?



- 80% of assets held by top 25% of members
- Those with largest pots / projected pensions tend to be most engaged and least likely to rely on the default
  - ➢ Top 5 get independent advice
  - ➢ 42% of assets
  - ➢ DC default investment is irrelevant
- The long tail lack engagement & cannot reasonably expect to be reliant on this pension for their retirement
  - ➢ Cash could be an appropriate investment
  - ➢ ...only 20% of plan assets
- The "squeezed middle"
  - ➢ unwilling to pay for advice & lack investment knowledge
  - ➢ ...but form ~40% plan assets
  - ➢ ...are reliant on this pension for a substantial part of their lifestyle in retirement
  - ➢ ...so unlikely to "squander" Tax Free Cash

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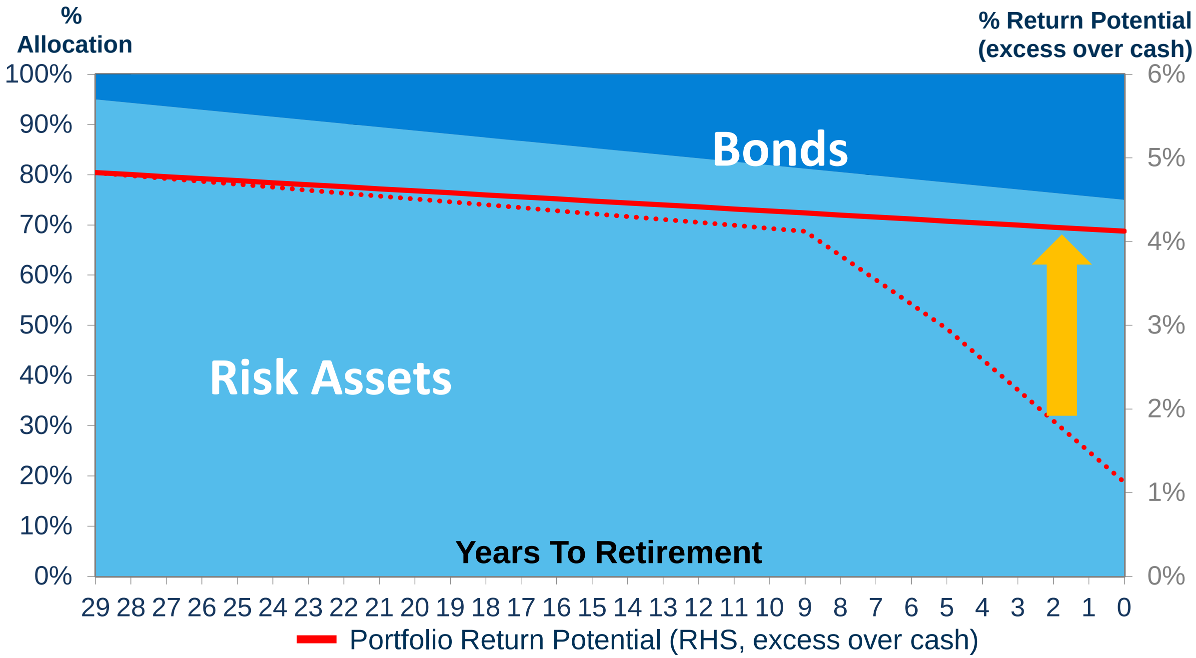
Lifestyle / Default: designed for the many or for the committed needy?

Tax-Free "Asset" approach



- ~16% higher average pot than traditional lifestyle
- ~11% higher that Aussie model
- Highly significant for ARF & drawdown
- …there is additional risk for those who encash & spend…

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Is a pension for life or for a new car / holiday…

Source: Standard Life Investments

Decumulation and the Silver Surfer

- Common investment advice appears to reduce investment risk markedly at retirement
  - Financial assets are at, or close to, their peak
  - Earnings potential is reduced (by age and by choice)
- Increased personal flexibility to
  - Defer expenditure
  - Change location
- Personal risk-taking also appears to rise
- …could be a unique opportunity to enhance long term income sustainability thorough remaining substantially invested…

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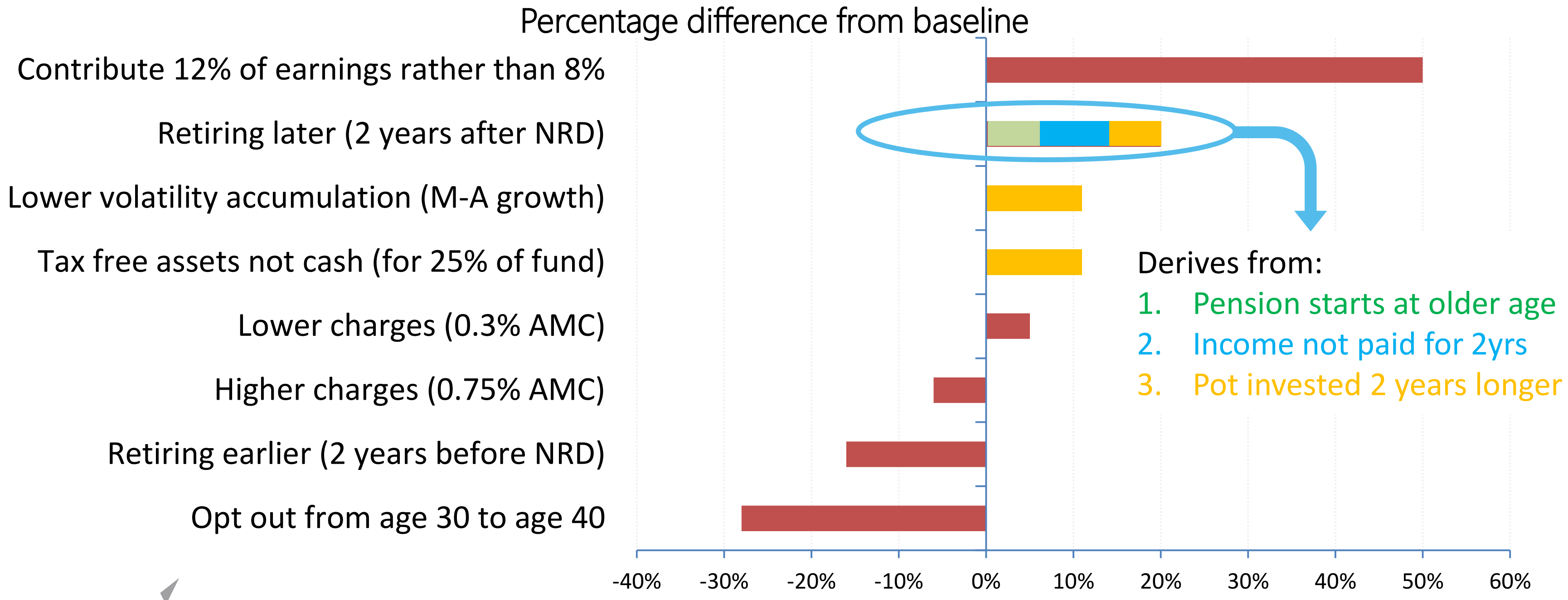
30+ yrs of retirement is a long time to spend "investment-idle"

Impact on Retirement Income

Impact on pension income for the median earning man on reaching NRD in 2059



Source: Pensions Policy Institute, Standard Life Investments

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3 ~~contentious~~ investment considerations

1. Accumulation:

   Quality pays for long term investing

2. Objective relevance:

   The squeezed-middle need a Tax Free "Asset" objective

3. Risk capacity:

   Silver-Surfers flexibility & propensity, can pay-off materially

➢ 3 simple actions for a 25% - 30% better outcome on average

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Changing the mind-set can markedly improve the outcome

The information shown relates to the past. Past performance is not a guide to the future. The value of an investment can go down as well as up.

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