A Life & Pensions Industry Newsletter. March 2013

TechLife

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Government takes the First Step with Pension Reform // Ralph Tucker - UK Sales Director - Exaxe

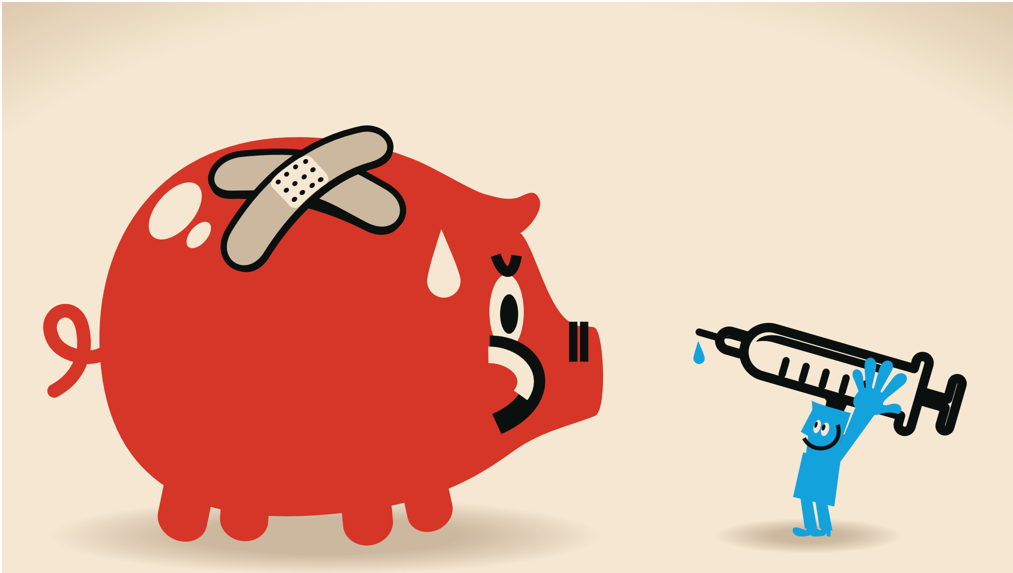
The government's white paper on pension reform is a big step on the road to a simpler, fairer and more comprehensible system. The ending of contracting out and the amalgamation of the second state pension into a basic state pension, which eliminates most of the need for pension credits, will give people a simpler and fairer basis on which to plan their pension. In particular, credits given to those who drop out of the work force, to raise children or to be carers for the elderly, is a great step and will allow many, mostly women, accumulate the 35 years contributions needed to give them a full state pension.

A lot of the attention has focused on the anomalies in the proposal instead of focusing on the reform's effects on the majority of the population but it isn't possible for the system to be changed in a way that benefits everybody while at the same time having a sustainable cost base. The government deserves credit for coming up with a system that eliminates many of the traps inherent in the current system and making it easier for those who are saving small amounts to see the value of such savings.

This is particularly beneficial to those low-earners currently being auto-enrolled into pension schemes. The fact that they will benefit from the schemes because their savings will not be offset by reductions in pension credit will make it much easier to encourage them not to opt out of their new pension schemes. For employers it also removes a concern that lower-earners would have a case if they claimed that the employer sponsored pension schemes they had opted into had caused them a loss because their pension credits were reduced.

This pension reform bill is a big step forward and the pressure to make changes to deal with some of those who lose out should be resisted. Those who may lose out in the changeover should be compensated by parallel measures rather than by complicating the basic pension system. We've seen that complex systems will backfire because hardly anyone understands how they work and so they act as a disincentive to engaging with the system.

However, this reform does not solve all foreseeable problems in the pensions area. In particular, it is still expected that a significant portion of the population, possibly as high as 40%, will opt-out of the auto-enrolled pensions. To avoid the government being pressured into giving in and providing extra benefits, which would get us back into the same complicated pension landscape which we have been trying to escape, we need to move to a compulsory pension system where anybody who works contributes to a scheme.



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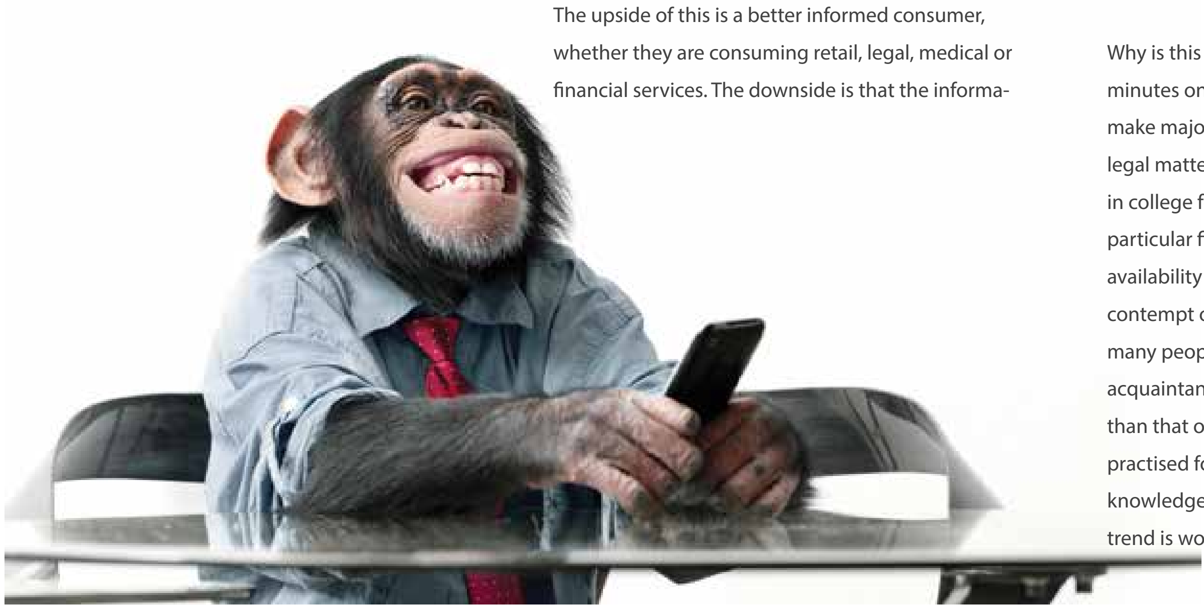
Compulsion is the next logical step and it will ensure that everyone not only has the basic pension from the state but will have it topped up by an amount of pension savings that have accrued across their working life. This is a much surer way to bring pensioners above the absolute poverty line while keeping the taxpayers' contribution to a fixed amount that is calculable and therefore can be provisioned by the Treasury. This pension reform proposal is a good first step; but there is more to do if we are to have a system which ensures that everyone can have a dignified retirement based on their own savings, supported by a strong basic pension.

Investment Life & Pensions Moneyfacts: A New 'Trusted' Network // Tom Murray - Head of Product Strategy - Exaxe

This article was first published in the *Investment Life & Pensions Moneyfacts*, Issue 195. Tom Murray explores the rise of social media and considers why advisers and providers must find ways to be included within these trusted networks.

Society has changed. The advent of social media has slowly but dramatically changed the way people interact with the world and all business types, including the financial services sector, have to rethink their whole way of doing business in order to cope with the new landscape that has been formed.

In the early days, it was easy to dismiss social sites such as Facebook, MySpace and Bebo as playgrounds for teenagers but the speed with which they have been adopted by the adult population and become an integral part of their everyday life has been astonishing and the result is amazing. People's social networks now integrate others that they have met physically with those they have only met virtually, and the difference between the two is fading.



Trusting strangers

There are many areas of life affected by this change; one is the new tendency people have to trust total strangers, whom they believe they know very well even though the only contact with these individuals has been virtual. It is still too early to say what will be the final result of these sites on our concepts of friendship, identity and privacy, but it is certain that the consequences for human behaviour will be dramatic.

Of particular interest to those working in the financial services arena is the change in terms of where trust is placed by the individual. Up until recently, people who didn't work in legal, medical or financial services deferred to expertise from those who did. Today, the ubiquity of internet access means that these experts are constantly challenged by the consumer, whose arguments are based on information gleaned from scanning the Internet.

A better informed consumer

The upside of this is a better informed consumer, whether they are consuming retail, legal, medical or financial services. The downside is that the information can be suspect and there is a danger of incorrect information being believed by those who do not have the expertise to separate the wheat of true research and wisdom from the chaff of prejudice, wishful thinking and vested interests. The availability of so much uncontrolled information and opinion leads to an anomaly where the consumer believes themselves to be better informed and in a position to challenge expert opinion. However they may actually be in a worse position as instead of no information, they have wrong information and could already have their minds closed to the views of the expert even before interaction with him or her has started.

Fool's paradise

It is clear that the danger of such approaches are significant. The consumer is living in a fool's paradise of believing that they understand the medical or financial issue when all they have is a smattering of facts and opinions without the ability to understand and process them.

Why is this so? What makes people believe that 20 minutes on Google makes them expert enough to make major decisions on medical grounds or on legal matters than someone who has spent years in college followed by a lifetime of working in the particular field? There is a danger that the availability of information is now breeding a contempt of intelligence and wisdom such that many people prefer to believe their own or their acquaintances' diagnoses and remedies rather than that of the people who have studied and practised for years in the field and have the knowledge and training to analyse the facts. This trend is worrying for those in the financial services sector, who are likely to be pilloried by individuals who have bought the wrong product based on unofficial advice from those who are not qualified to offer such advice.

All companies need to be very careful of this sudden change in how people are approaching decision making. The consumer decision-making process was always affected by word of mouth but social networks allow this process to spread like wildfire across huge audiences in a very short space of time. The result is that effect of one individual's bad experience with a company can be multiplied exponentially; on the bright side, the same is true for good experiences.

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Brand damage

So far so good, but what if the information supplier is incorrect or has had a bad experience that incorrectly ascribed to the product and / or service? The damage that can be done to a company's brand and reputation could be severe, if not catastrophic, and retractions or apologies will not necessarily get the publicity that the original complaint received.

So what does this mean for businesses? Firstly, it is imperative that we do not ignore the whole social media phenomenon. By this, I don't mean that we should lash up a Facebook page replete with old advertising and start throwing out 140 character advertisements on Twitter. I mean we need to consider how this whole new approach to trusted circles of friends family, essentially trusted networks, is changing society and to define the place of their company within the new virtual social landscape that has come into being.

For the insurance sector, much research has been done in terms of who people go to for their financial advice. A consumer behaviour survey carried out by the Association of British Insurers (ABI) in 2011 showed that the most used and most trusted source of advice for financial matters was friends and family. This has probably always been the case for we trust friends and family to give us apathetic advice that is focused on our best interests.

The trouble is whereas prior to social networking sites, our immediate circle of friends and family with whom we would discuss issues as personal as our financial situation was relatively small and well known to us, the less discriminatory approach of social networks has resulted in far larger circles of 'friends' and distant family with whom we are now in regular contact. Witness those with circles of c.500 friends; an amount which is incompatible with any sense of truly knowing people or with them truly knowing you.

Sharing information

The perceived anonymity of the Internet means that people are sharing far more information with this wider group than would previously have been the case. As a result, individuals are far more likely to post questions regarding financial matters to this larger group and to reveal more of their personal financial situation than they ever would in real life. If the same 500 people were assembled in a room, nobody would stand up in front of them to discuss their personal financial decisions and yet they will give out this information to the same group in the virtual room of the social network. So financial services firms are now competing to give advice against a much larger group which have attained 'trusted' status with the individual consumer.

Secondly we have to look at the information and advice that they receive. There are those who claim that the wider group can provide better advice, based on the fact that they comprise a bigger pool of experience, and that they are just as disinterested as the original close-knit family and friends circle. This is not necessarily true however. People who have bought various products tend to look for affirmation by encouraging others to do the same thing. Therefore they are far more likely to recommend that people follow their own example and purchase the same products to solve what they believe are the same issues in order to validate their own decision-making process.

Thirdly, it is amazing how the Internet age can quickly spread rumours and what is pure speculation on behalf of one individual can quickly become accepted fact as it is retweeted and passed from one social media environment to another. Sometimes this is harmless, as in the case of celebrity gossip. In other cases it is distinctly harmful; racist abuse and accusations of criminal behaviour have circulated across the Internet and achieved the status of accepted truth without anybody bothering to pause and confirm the facts of whatever is being reported.

Catastrophic consequences

Similarly, trends in terms of consumer purchases have also seen major surges based on Internet chatter. Again, in terms of a lot of consumer goods, this is relatively trivial as it doesn't really matter which brand of jeans or coffee is currently in vogue or what type of accessories achieve the 'must-have' status that leads to mega-sales.

Financial products are different as the effect of their purchase can echo down through the decades and for long-term products such as pensions or investments, the consequences of getting the approach wrong can affect a person's whole life. This is where the practice of trusting people who don't have any training in the market rather than getting professional advice can be severely detrimental to the financial well-being of the individual and has the potential to ruin their life.

Trust in the advice you are getting is vital in order to feel confident you are making the right decisions. People will always trust their family and friends and so rather than fight against it, financial services firms need to work out ways to be included within the trusted networks rather than just trying to contradict it from the outside. The question for all of us is how can we get ourselves "friended" as a social or virtual friend by our clients and prospects?

At the outset, we need to be active participants in the social media sphere but this activity must be controlled and focused. We need to know our role in the network. Think of a group of friends. Generally, they are not all alike. They integrate well as a group because each brings different personalities and characteristics to the group. Everybody can't be the organised one or the wild one or the quiet one. What will work for a trendy fashion retailer or for a music supplier will not work for a serious financial services company. People will be wary of anything that smacks of gimmickry from those who are looking after their money, much in the way that groups on holiday often leave the travel arrangements to the more efficient member of the group rather than to the wild one whose contribution to the group is more about bringing fun to the group and getting them to do things they wouldn't have done before.

We shouldn't be afraid of being serious – it's not the same thing as boring. Nor should we be afraid to be quiet when we've got nothing to say. At least that way, when we do communicate across the social networks, our words will be taken seriously. Once expertise is established, we are more likely to be consulted directly when financial decisions are being made, more like a wise elder uncle than a madcap best friend.

Devising a strategy

Understanding the role of social networks and the role of the company within it is vital for all companies and financial services are no exception, but growing a role on the networks is not straightforward and will require a careful strategy, thinking about what the company's role in the network should be, and will need significant resources devoted to it.

Social networks – like them or loathe them, we can't ignore them. While the popularity of individual sites such as My Space, Facebook or Twitter may wax and wane, the interlinking of people through the Internet is here to stay. Financial services firms need to understand this new environment and amend strategic plans in order to put themselves at the heart of this huge number of virtual networks.

"Caveat venditor" – Another Superficial Solution // Ralph Tucker - UK Sales Director - Exaxe

The establishment keeps contradicting itself over the entire pensions' area because they won't face up to the basic fact that investment is a 'risk' business and people who take risks sometimes lose out.

The starting point for the government is that the taxpayer can't afford to pay for people in retirement in the future, as the bill is growing too big. Therefore, a flat amount should be given, which is controllable, and people then encouraged to save in order to top up that amount. As a nudge towards this saving, auto-enrolment is being introduced in order to get people in to saving and make them make a conscious choice to stop.

The flaw in this process comes from the next step. No one is prepared to be honest with the new generation of savers and tell them that they are taking a risk and that it may not pay off. This is self-evident to those in the know because any investment by its nature is risky but for all the talk about the need for clear communication, the politicians, experts, and the industry providers are all shying away from telling people the cold truth: Investments can go down as well as up and you may end up with less money than you put in once inflation is taken into account.

As a result of this lack of honesty, the powers that be are resorting to higher levels of regulation of the industry thereby causing a lot of people to become even more wary of giving their money to the financial services sector. After all, if the financial services sector is a safe and secure place to put your money, why does it need such constant regulation, investigation, and intervention?

The fact that nobody can admit that pension investors can lose is causing the powers that be to make convoluted twists and turns as they try to justify what they are doing. Having realised that everybody can't be educated to understand the products, and having decreased the amount of advice available to help consumers by first blaming and then reducing the distribution industry, they are now turning on the providers of the products themselves.

The latest output from the Pensions Institute – Caveat Venditor – has recommended turning away from the Caveat Emptor (Buyer Beware) approach that has been the cornerstone of consumer law for so long. They recommend a Caveat Venditor (let the seller beware), putting the onus on the seller to make sure that the right decisions are made in terms of investment for each individual.

This essentially puts the provider in the place where the IFA used to be, except the provider will not have the personal relationship with, or level of detail about, the consumer that the IFA always had. As with so many solutions in the pensions' world, it superficially appears to do something positive but actually seeks to give responsibility for the risk to the providers when the fundamental point of individual pensions is to transfer the risk to the pension saver. This central contradiction dooms this approach to failure. When will the politicians wake up to the fact that the starting point for fixing the pensions system is to be completely honest with the public?

Regulation to Safeguard Savers is Self-defeating // Stewart Reeder - Client Director - Exaxe

We need to grow up and accept risk. There is no way that we can invest money and hope for significant growth outstripping inflation without undergoing some risk that investments may go wrong and the final amount we get will be less than our original contributions.

Because of the nature of auto-enrolment and its approach of enticing people into saving, the FCA seem to be very afraid that they will be accused of poor regulation if savers end up with less than they would have had if they had simply stuffed their money into their mattress. They are attempting to respond to this by bringing in guidelines that are aimed at ensuring that only low-risk funds are recommended to those with lower amounts to save.

There is a flaw in this. Surely those with less to save are the most in need of high-returns in order to accumulate a worthwhile pension pot? And yet, they are the very ones being steered towards 'safe' low-returning investments that are not capable of giving anything like the return that those savers require. It is as if they are being kept in a poverty trap – ensuring they have

We need to grow up and accept risk.

no chance to break out of it. Far from improving the likely benefits of auto-enrolment, this approach appears to copper-fasten a poor result for those first time savers whom the government are most anxious to drag into the savings net.

A survey of 500 advisers by the business consultancy BDO has found that more than half believe that the arrival of the FCA will have a negative effect on their business with 55% believing that they would have to recommend cash-based rather than equities-based investment in order to prove they were not taking excessive risk with their clients' money. And yet 89% of all advisers believe that equities-based investments are the most appropriate for long-term savers.

This shows the danger of regulatory zeal in what is essentially a risk-based business. The fear of being found in breach of the guidelines is going to force highly qualified advisers to recommend the wrong products to their clients.

So the advisers are saved from being publicly criticised for risking their clients' money and the regulators can relax because there won't be headlines in the Daily Mail claiming that some pension savers have been robbed.

Shame about the poor-returns for the clients, leaving low-paid workers trying to survive on a pittance in their old age!

Actuarial Post: Perpetual Motion – The Lives We Live Today // Tom Murray - Head of Product Strategy - Exaxe

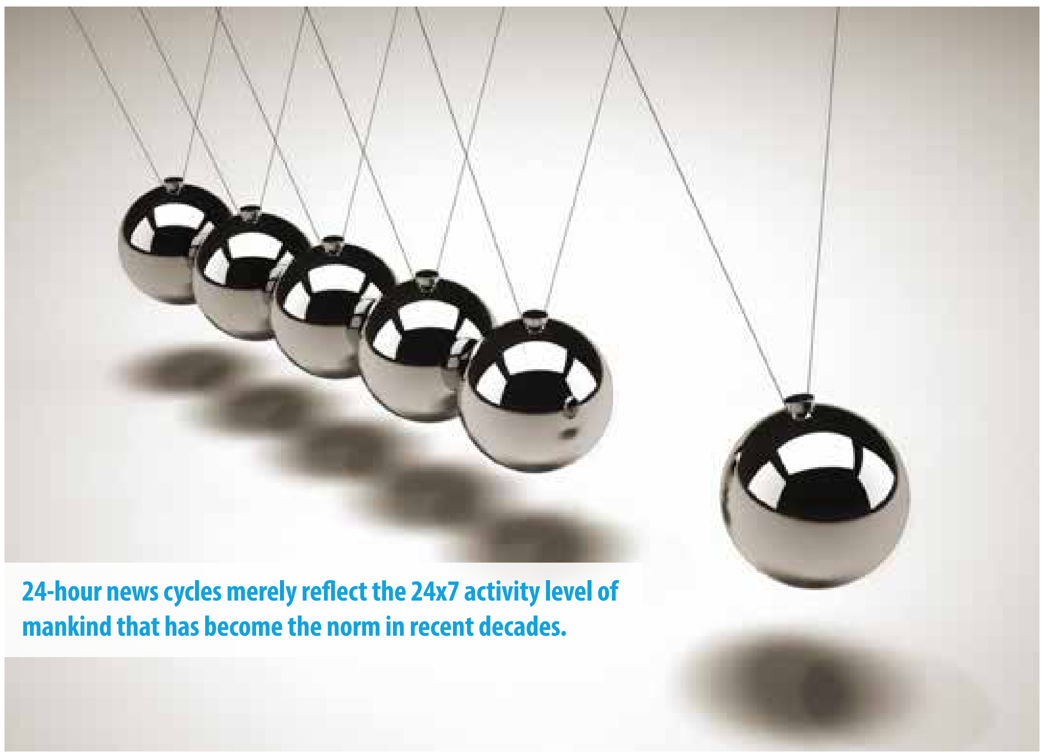
ACTUARIAL POST

The UK Patent Office refuses to grant patents for perpetual motion machines on the basis that they have no industrial application. While any perpetual motion machine would obviously have enormous industrial application, the ruling of the patent office is designed to prevent them from having to wade through tons of patent applications for machines which are designed in such a way that they blatently defy the laws of physics and to date have never managed to transfer to working viable models.

However, the search for the elusive perpetual motion machine is now over. Observation reveals that the answer is the human race, which over the last few decades has reached a state of activity and mobility the likes of which has never been seen before on the planet. 24-hour news cycles merely reflect the 24x7 activity level of mankind that has become the norm in recent decades. After thousands of years of working in harmony with nature, humans have now conquered nature and have achieved mobility and activity levels that bear no relation to their own physical capacities or to the natural rhythms of the planet.

The starting point for these lives of frenetic activity was the invention of the mobile phone, allowing people anytime, anywhere access to each other. Communication changed because it became independent of place and therefore allowed people to move into a virtual reality. Since then, the Internet and the multiplicity of devices that can access it have increased peoples capability to interact and collaborate at many levels, independent of time or place. Vodaphone's original tag-line 'connecting people not places' was prescient in describing how the world would change.

This independence gives humanity an ability to overcome the limitations of our own bodies and the restrictions of our environment to live our lives in a completely different way, which has impacted



24-hour news cycles merely reflect the 24x7 activity level of mankind that has become the norm in recent decades.

dramatically the way the world works today. To quote another well known advert, "work, rest and play", as the sum of human activities, have all changed far more rapidly in the last twenty years than they had in the two centuries before that. The rigid restrictions that mirrored the unyielding time-based approaches of nature have now gone; people can attend to personal matters during working hours and working matters during holidays despite being thousands of miles from their usual working environment.

No enterprise can ignore this and it is more than just a matter of looking at changing consumer habits. The effects also spill over into how companies engage with their employees and the mutual expectations of both in this dramatically different environment.

The life and pension industry is no different. Actuaries and underwriters are the same as other people and their lifestyles are changing just as swiftly. Accordingly, their expectations have altered and companies need to allow far more flexibility to their employees than ever before. If companies are to supply 24x7 services to consumers then their staff must be flexible to respond to customers' demands. However, demanding that level of service from staff requires that companies respond to the consequent demands from staff for a flexible working environment.

This will mean the adoption of new technologies that enable staff to work on that anytime, anyplace, anywhere basis so beloved of Joan Collins and Leonard Rossiter. Providing people with devices that allow them to work flexibly does mean allowing them to use them for personal purposes as nobody wants to carry multiple phones and tablets around to segregate their working lives from their personal lives.

The security challenge posed by this is a big issue as is the need to change management attitudes, which need to become far more empirical. If demands are being made of staff to work at what were traditionally regarded as non-working times, then management need to refrain from examing the detail of how working time is spent and judge performance on the outcomes rather than the activity. This is in line with consumer expectations where judgements of companies is far more based on actual delivery rather than how it is delivered.

Shifting away from older technologies which enslave people to the whims of the machine and moving to embrace newer, mobile platforms is essential for all companies in the twenty first century. This means giving staff access to new platforms to enable them to break free from the need to be in a certain place at a certain time in order to do their work by allowing smartphone and tablet access to company networks. It also means readjusting work expectations to move away from measuring physical presence to measuring task outcomes and virtual presence at work.

On the bright side for companies, the breaking of the link between work and place should enable them to control fixed costs like premises a lot better although their will be a corresponding increase in the cost of supplying and maintaining that virtual workspace their employees will now inhabit.

Human lives have been changed irredeemably by the move to a more mobile technology-fuelled lifestyle. Those companies who aren't planning to adapt to these changes will quickly find both consumers and employees deserting them for those who will.

Platform Challenges in 2013 & Beyond // Stewart Reeder - Client Director - Exaxe

Platforms are facing an increasing number of challenges in 2013 and beyond. The number of Platform companies in the UK has increased from 7 in 2003 to over 30 companies in 2013. Competition has intensified rapidly in the past decade, in terms of both the service offering and value proposition.

In 2011, the total aggregate revenue for the top 20 adviser Platforms was £710m, up from 330m in 2006. However, total expenses grew from £365m to £760m over the same period. This indicates the net £35m loss incurred in 2006 has increased to a net £50m loss in 2011. The challenges associated with the increase in competition combined with an increase in costs already experienced will be further compounded by the population demographics.

The UK faces the retirement of the baby boom generation. This generation has enjoyed the wealth which enabled them to invest in products provided by Platforms, both Supermarkets and Wraps. In many instances, this has driven sales away from the traditional Life and Pension product providers. Over the years, consumers have accumulated increased wealth, which has contributed to the success of the Platform market.

As this generation enters retirement, assets are being moved from Platforms into "at-retirement" decumulation products, provided by at-retirement solution providers. This will cause momentous asset drain for the Platforms, potentially forcing consolidation within the industry and endangering the future of several Platforms completely. Platforms face losing billions of pounds of Assets Under Administration (AUA) due to not being able to service the retirement income sector sufficiently.

Platforms' current focus lies in managing the accumulation phase of the investment journey and their expertise in building and maintaining relationships with their customers. This expertise can also be used to retain the assets for a longer period of time by maintaining the relationship through the "at-retirement" phase.

Platforms that survive will be the companies that can quickly adapt to the changing market demands. They will offer new products and services to different segments for different life events, presenting a flexible proposition reflecting customer demand.

Exaxe can facilitate the retention of assets under administration by enabling Platforms to offer at-retirement products to their existing client base, thus increasing revenue and profitability.

The Solution for Platforms // Stewart Reeder - Client Director - Exaxe

The pension annuity market has quadrupled in the past 15 years due to the sustained growth of the UK's population aged 65+. Subsequently, the UK's rapidly ageing population makes it the largest annuity market in Europe. It is time for Platforms to take advantage of this and differentiate themselves in a competitive market.

To move into the at-retirement space, and thus retain the assets, two key capabilities are necessary:

1. An ability to maintain a relationship with clients and/or advisers
2. An ability to engage with clients and/or advisers through different life-stage events.

Platforms already have these capabilities and are uniquely placed to assist clients, providing them with a single view of both accumulation and decumulation. Platforms have two options available to them in order to offer their clients on-platform at-retirement solutions.

1. Platforms can create their own at-retirement investment style products and administer them internally
2. Platforms can create their own at-retirement investment style products and outsource the administration

Exaxe offers speed to market and efficiency of integration combined with expertise to deliver each of these options in very short timescale.

Exaxe is a s**pecialist at-retirement solution provider** with experience and extensive knowledge that allows its clients to launch new products faster, administer post retirement products more efficiently, and respond with greater flexibility to the marketplace.

Exaxe can offer the **full end-to-end at-retirement solution** via its flagship products **Illustrate Plus** and **Income Plus**.

Exaxe have **template at-retirement investment style products** which can be configured to the Platform's needs and to the markets' needs.

Exaxe's offering will integrate into the Platforms existing processes and systems. **'Plug and Play' integration** allows Platforms to easily make at-retirement style products available on their current Platform.

Why offer 'At-Retirement' Solutions?

- Prevents assets leaving platforms
- 500,000 converting from pension accumulation to decumulation p.a.
- Pension annuity market has quadrupled in past 15 years
- 2010 At-retirement market estimated at £18bn
- 2010 Pension annuity market estimated at £12bn. Forecast to grow to £23bn by 2014-2015
- The UK is the largest annuity market in Europe
- Growing demand for at-retirement investment style products
- Ageing demographics

Call Stewart today on +44 (0) 7825198752 today to find out how you can plug the leak!