Time to retire the pension?

The future of long term savings and the role of investment managers

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ACROSS THE EUROPEAN UNION, THE ANNUAL PENSIONS GAP IS €1.9 TRILLION
As governments and regulators around the world grapple with the issue of paying for retirement, they’re increasingly looking to the experience of other geographies.

Pension provision varies from country to country, depending on their economic situations and their customs but, following major pension reforms, the UK can been seen as a test lab for many long-term savings innovations. British pensions, which are primarily provided through insurance companies, have moved away from the Defined Benefit (DB) model towards Defined Contribution (DC) with the risk of under provision for retirement being met by the customer rather than the provider. Having already become prevalent in the US and Australia before the UK, this is now firmly the direction of travel across European populations as state pension provision reduces.

But still across the European Union, the annual pensions gap is €1.9 trillion. As well as learning from one another, countries are having to take an international perspective with long-term savings because more and more of their citizens are working abroad. Increasingly people will work in a number of countries during their careers, one of which they might or might not use as a base for their retirement savings.

Demographic changes, inadequate personal savings, new pan-European regulation aimed at improving transparency and the rise of technology mean that instead of being the last link in the long-term savings value chain, investment managers must now think of themselves as being at the start – the point at which the industry meets the customer.

As a result, the industry globally is evolving to become increasingly customer needs centric. Investment managers are now having to focus on customers and not simply on products. A move towards a direct to customer (D2C) model will also require them to be more transparent on risk and pricing. Intermediaries are clearly going to have to rethink their role. This will clearly mean adding value but may also include helping to devise new products and targeting specific audiences.

International regulators are seeking to accommodate this trend with initiatives such as the Institutions for Occupational Retirement Provision Directive and a single European market in pensions is slowly emerging. Cross-border retirement savings will also increase choice for all consumers, whether they work internationally or not.

As well as taking an international perspective, countries are having to take an international perspective with long-term savings because more and more of their citizens are working abroad. Increasingly people will work in a number of countries during their careers, one of which they might or might not use as a base for their retirement savings.
TIME TO RETIRE THE PENSION
INVESTMENT MANAGERS NEED TO TALK TO CUSTOMERS

To meet the needs of today’s workforce, whether they work internationally or not, another clear global trend is emerging – investment managers will increasingly have to engage directly with the end customer.

With the focus increasingly shifting towards customers and away from pensions products this offers exciting new opportunities for forward thinking investment managers who are willing to become customer-centric – and it sounds the death knell for those who aren’t.

The pensions industry is still very much focussed on the Baby Boomers – the generation that saved all their lives, got married once and retired at 60 or 65, living another 10 or 15 years. Today’s consumers are very different. They have less to invest, with a greater need to save given the disappearance of guaranteed retirement income. They are more likely to move jobs more frequently, might get married more than once, they’ll move into a retirement phase, rather than finishing work abruptly, and they’ll live longer than any previous generation.

As the well-established pattern of pension’s savings changes, it’s becoming less binary and less distinct at both ends. During the accumulation phase people will increasingly choose a range of investment goals and dates rather than a conventional pension targeted at a single date. At decumulation instead of finishing work on the Friday and starting their retirement on the Monday they will draw down funds as they move away from their salaried work into a phased retirement.
Instead of segmenting their customers in terms of wealth and age, customer-focused investment managers will have to think of them in more sophisticated ways, based on their behaviour and preferences.
These long term savings consumers, enjoy greater choice but also increasingly trust and look for advice from alternative sources. Most importantly, they are more likely to have a suite of investments and they may consider non-traditional alternatives to ‘traditional’ savings and retirement products. They’ll look to the financial services market for a solution not a product for their long term financial support, which may include medium term investments and assets such as property.

This means that instead of segmenting their customers in terms of wealth and age, customer focussed investment managers will have to think of them in more sophisticated ways, based on their behaviour and preferences as is the case with successful retailers. Using technology and the sophisticated algorithms already familiar to the retail sector they’ll look for particular purchase triggers. They’ll know how, when and where their customers research and buy financial products and they’ll respond accordingly.

Already, for example, the US based Future Advisor digital investment management service employs an algorithm to analyse the retirement and brokerage accounts held by an investor and then makes investing recommendations based on their goals. The programme might tell investors how best to divide their assets and can also suggest new investment funds that can potentially save them thousands of dollars in fees over the lifetime of their investment. It even executes trades on clients’ behalf for a monthly fee.

The UK regulator, the Financial Conduct Authority sees innovation along with competition as the way to deliver a new model of asset management that will service consumers as well as stimulating economic growth. The authority’s ‘Project Innovate’ offers to help financial start-ups comply with regulations to provide new services to consumers.

About 100 firms from the financial technology sector have already signed up and the FCA acknowledges that its challenge is to enforce regulation while providing an environment in which new, disruptive business models can flourish. Investment managers will need to take an active role in the development of these new models, rather than simply regarding their role as the creation of new funds.

Technology, though, is only an enabler, not a complete solution. Hitherto the industry has been siloed, expecting consumers to choose between distinct products such as equities, fixed income, and alternatives among others.
IF INVESTMENT MANAGERS DON’T BECOME MORE CUSTOMER CENTRIC, THEY’LL LEAVE A GAP IN THE MARKET TO BE FILLED BY OTHER COMPANIES
LOOKING AT NEW PRODUCT DEVELOPMENT FROM THE OTHER DIRECTION

According to a survey by the Said Business School, over half (59 per-cent) of millennials believe they haven’t seen products targeted at people like them. Putting together investment products based on asset classes will no longer work. Instead “mass personalised” products will be marketed to customers in a way that meets their own individual circumstances and their particular life stage. US Small Cap Equity, for instance, will make way for the Get on the Property Ladder or the Baby Starter Pack investment.

As consumers move into a phased rather than an abrupt retirement today’s Target Date Funds will need to evolve to cater for multiple points throughout a phased retirement and adjust for changes to these dates.

The preference for fixed income that is appropriate for pension savers now will be replaced with a greater variety of products.

In the same way that consumers buying a car from a manufacturer might choose a family or a sporty model and will then specify the colour, the quality of the music system and the interior design among other elements, they will expect to customise an investment product, mixing fixed income, equities and other asset classes to meet their individual needs.

If investment managers don’t become more customer centric, they’ll leave a gap in the market to be filled by other companies that have grown rapidly over the last few years by knowing about their customers in great detail.

It’s possible that Google and Apple could be the next powerhouses in investment management. After all, they’re among the top three in Fortune magazine’s World’s Most Admired Companies List of 2014. They have brand ubiquity that is increasingly trusted by younger generations. Being agile and lacking legacy practices they can develop propositions that engage consumers and are relevant to them quickly and efficiently, testing them and refining them equally rapidly.
These brands have business models that put customers at the centre of extensive networks designed to understand and anticipate consumer requirements, removing “wrinkles” in the purchase process and making the lives of their customers easier. They capture, analyse and aggregate data to solve problems and customise their products to meet customers’ individual needs.

Rather than trying to compete, some investment managers could collaborate with these well-known and much respected brands sharing their sophisticated market intelligence operations to white label investment products. Following the launch in 2013 of the Virgin pension, could we see the Apple First Time Saver investment or a range of Google ISAs?
Recently we’ve seen the emergence of Fintech driven investment providers such as Nutmeg. There could well be considerable M&A activity in this area with banks and wealth managers acquiring tech companies and vice versa. Financial services firms need to find new ways in which to interact with customers and many tech companies are, as small, fast growing enterprises, ready to sell out to larger enterprises. Acquiring these tech companies means that they don’t have to spend time and money researching, developing and testing technology themselves. With margins under increasing pressure they may look at buying other management capabilities.

Research by AT Kearney shows that while acquisitions of financial services firms by other financial services firms achieved returns of 4 per-cent to 6 per-cent after 12 months, the figures for tech acquisitions by financial services firms rose 10 per-cent to 15 per-cent over the same period.³

As well as creating more transparent products and rethinking the advice and guidance they offer, these new customer-centric investment managers will have to improve customers’ financial literacy.

Nearly half (48 per-cent) of millennials and nearly two thirds (61 per-cent) of those under the age of 23 “don’t how pensions work.”⁴ Saving for a house, travel, education, car and other consumer products all ranked higher than saving for retirement.

In Europe, regulation is pushing transparency, simplification and standardised formats in order to make it easier for consumers to compare products. Last April the Packaged Retail and Insurance-based Investment Products regulation introduced the Key Information Document requiring new disclosures for all structured products, not just investments.

These regulations go some way towards establishing a European wide level playing field and its requirement for improved transparency should give consumers access to a greater range of products. There have also been calls for an EU wide quality standard for pension savings products to improve public confidence, investment managers should push for this.⁵

The challenge will increasingly be for investment managers who are increasingly talking to consumers directly and who are becoming more responsive to the needs of their D2C clients to ensure that they comply with these new regulations.

The development of a Capital Markets Union is accelerating. Not only will companies looking for investment benefit from increased access to capital across Europe but so can the long term savings sector if investment managers take the initiative and look for strategic alliances across borders. Similarly, European Long-Term investment Funds offer investment managers the opportunity to pool investments and offer products directly to consumers across Europe.

³ / Tracking Banking M&A: Why Bank-Tech Mergers Are Winning, September 2014
⁴ / The Generation Game, September 2014
⁵ / Communication from the Commission to the European Parliament and the council on Long-Term Financing of the European Economy, 2014
Investment managers will need to develop products that meet the changing needs of a new, more diverse, more demanding and more unpredictable consumer base more closely than ever before.

To reach these customers directly and to restore trust in the investment management business investment managers need to be more transparent around pricing and risk. Pricing is currently too complex and uncertain. Consumers need to know exactly how much they can expect to pay in fees as they would if they were buying something from retailer.

Over the last few years, following a number of mis-selling scandals, the financial services sector has had to put its house in order. Regulation has played a key role but the ultimate aim has been to provide a service focused on the needs of the customer and not the wishes of the providers. Now this needs to go further.

“The value of your investments can go down as well as up,” will be seen simply as a get out clause rather than an attempt to be helpful. Investment managers need to rethink their guidance around risk to create a lexicon and a scale that is easy to understand and to act upon giving investors confidence their target outcomes can be achieved.

Investment managers who accept these challenges and rethink their roles in order to deal with customers directly via a D2C model can expect to see their businesses enter an exciting new phase of growth, while those who don’t are likely to be looking at retirement themselves.
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