# Agenda

- Elements of a funding rate or quotation
- Evidence for equity risk premium
- Volatility in equity returns
- Balancing volatility and return

# Question

- Do you think that pension projections/funding rates are:

1) **About right**
2) **Too optimistic**
3) **Too pessimistic**
4) **Pointless**

# Key elements of a Projection

- Expenses charged by the life company
- Investment return
- Interest rate at retirement
- Longevity/mortality
- Inflation

# The Easier Assumptions:

- Expenses – company specific
- Longevity
  - Rules set by Society of Actuaries
  - Allow reasonably for future improvements
  - Will soon be gender neutral!
- Inflation – linked with Investment Return
- Interest Rate at Retirement
  - Use 4% interest rate
  - Higher than current risk free rates but lower than long term average
  - Consistent with pre-retirement investment assumptions

# Investment Return

- This is where it gets hard
- Guidance sets a cap of 6%
  - Lower for bonds and cash
- Set in the context of 3% inflation
- So 3% real yield assumed
- Is this realistic?

# Analysis of history

- There are many surveys of past performance of “equity risk premium”
- Most detailed is from Dimpson, Marsh and Staunton
- Updated annually to reflect latest position
- Dates back to start of the 20th Century
- Examines many different markets

# Dimpson, Marsh, Staunton Conclusions

- Historic average equity risk premium 5.5% per annum
- Some of this attributed to falling bond yields
- Likely to be a little lower in future
- They predict 3.5% per annum as a reasonable assumption
- Of course this is over the long term!

# Typical Fund Mix

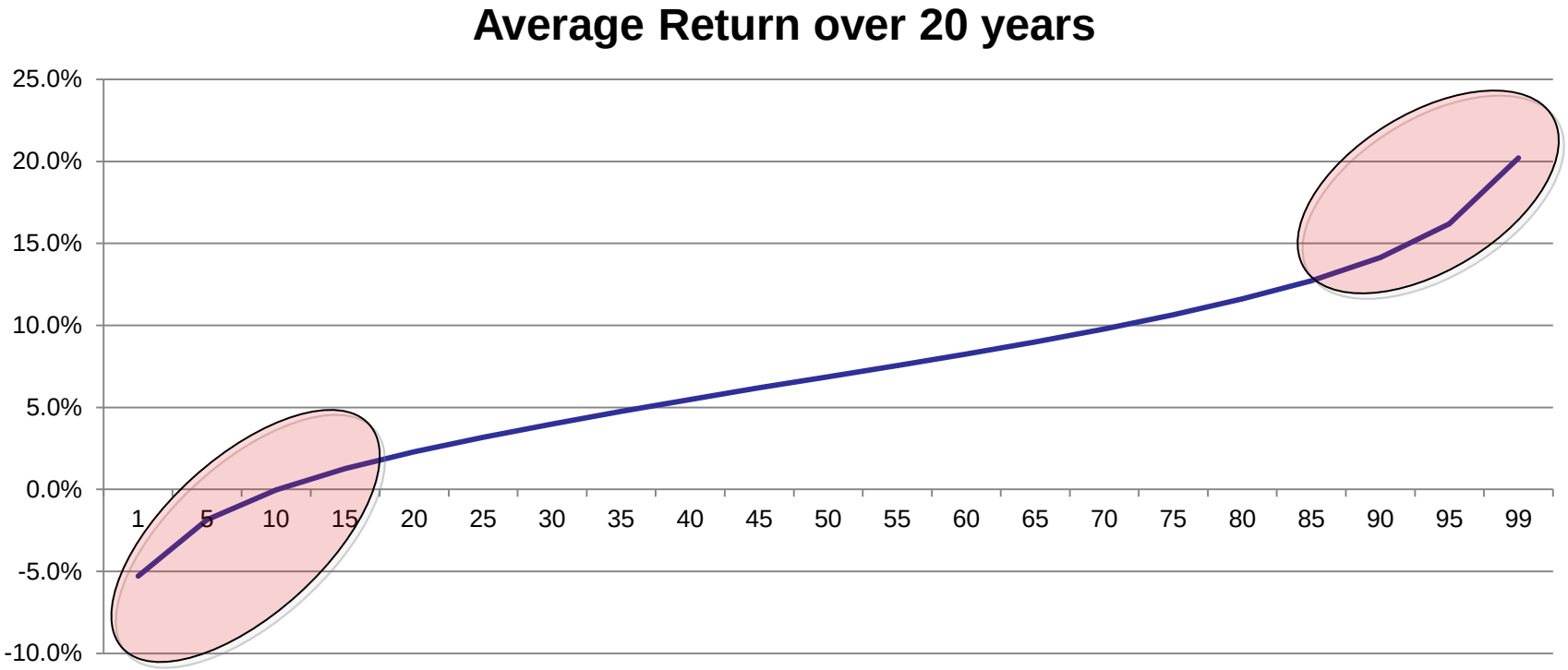
- 75% equity (say 6.5% return)
- 5% property (say 5.5%)
- 15% bond (4%-4.5%)
- 5% cash (2%-3%)

- Just about delivers a return of 6% per annum

# How long is long term?

- 110 years if you can wait that long!
- Volatility is quite high over shorter durations
- Even 20 year periods can show high levels of volatility

# Variability of Equity Returns



# Approach to planning

- Determine contribution rates based on acceptable level of risk
  - If risk profile is lower be prepared to pay a little more
- If taking high risk be prepared to increase contributions if markets are poor
- Do not take excessive exposure to equity markets in years prior retirement

# Key Lessons

- Understand the risk levels
- Set expectations in light of the risk profile
- Continually review the performance and amend accordingly
- Ideally include some tools to balance risk
- Perfect for the Independent Broker

# Question?

- **You are 5 years from retirement. You are offered the following options. Which would you take:**
  1) Guaranteed pension of €20,000
  2) An expected pension of €22,000 but with a possibility that it could fall to €15,000
  3) An expected pension of €24,000 but with a possibility that it could fall to €10,000
  4) A shot at a pension of €100,000 but with a 50/50 chance of getting nothing

*Thank you for your attention*