JPMorgan Asset Management
May 2008

Setting guidelines for financial well-being in the UK

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JPMorgan Asset Management is one of the largest investment management companies in the world, managing assets of approximately £600 billion on behalf of private investors, corporations, Government institutions, charities, foundations and pension funds in over 60 countries.*

At JPMorgan Asset Management, we recognise our responsibility in promoting prudent financial practice. We are committed to working with Government, regulators and the advisory industry to help individuals understand their financial planning options. In particular, we have invested in a range of initiatives to support IFAs and their clients to build wider understanding of financial markets and how they can be harnessed to improve individual financial well-being.

*As at 31 March 2008

Foreword: Do the right thing

'There is now an urgent need to communicate clear and universal messages as to what constitutes good financial planning and what doesn't.'

It has been well documented that many people in the UK are severely underfunding their financial future. This has been attributed to, among other factors, the decline in state and employer-based pension funding, longer life expectancy, rising housing and living costs and a general reluctance to lock away capital for tomorrow that could be spent more pleasurably today.

These are all important factors. But we would like to propose that an equally prevalent reason is a widespread lack of engagement and understanding as to how individuals can plan their finances effectively.

We would suggest that basic errors in financial planning are leading even well-intentioned individuals, who are making attempts to save, to compromise their future financial security – particularly now that the security blanket of ever-increasing property values may have been removed. Attractive, tax-incentivised schemes such as ISAs and pensions already go under-utilised and yet people are being asked to make more and more risk-based decisions about their financial futures.

In this paper, we have pulled together a range of research to explore the most fundamental errors that we believe individuals are making in their financial planning. Left unchecked, these mistakes could severely exacerbate what is already regarded as a financial planning crisis.

Many laudable initiatives are taking place to increase individual financial capability in the UK. These include the Retail Distribution Review into access to financial advice, the Thoresen Report into the provision of a national 'money guidance' service and plans to introduce auto-enrolment into personal pensions from 2012.

We are concerned that these new initiatives will fail unless more individuals are aware they have a problem and are willing to take advantage of these efforts to improve their long-term financial well-being. To this end, we believe there is now an urgent need to communicate clear and universal messages as to what constitutes good financial planning – and what doesn't.

Governments in a free market economy have always shied away from telling people how they should be using their money. But without laying down and promoting some basic principles, it may not be possible to turn around the state of personal financial planning in this country.

Government messaging has been successfully used to educate citizens on – among other things – the dangers of drink driving, poor diet and smoking, as well as encouraging virtuous behaviour such as recycling and energy efficiency. We think these proven strategies can be applied to the same effect to raise financial awareness in the UK.

In this paper, we would like to put forward some first steps as to how this might be done.

Jasper Berens
Head of UK Retail, JPMorgan Asset Management

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Executive summary

Part One: The need to raise awareness

Many initiatives are in progress to improve levels of personal financial capability in the UK. These include broadening access to financial advice, introducing a national money guidance service and encouraging financial education in schools, the workplace and online.

Alongside all these highly welcome initiatives, we believe it is now appropriate and expedient to raise awareness about financial well-being for the following reasons:

1. Self-diagnosis

The shift of risk from pension providers, Government and employers to the individual for the provision of their longer-term financial well-being and the growth in direct financial distribution channels is resulting in more of us having to self-diagnose our financial situation without any intermediation. Individuals are, therefore, more vulnerable than ever to making bad financial decisions unchecked or without support and assistance.

2. Pull-through advice needs to be matched by push-through guidelines

Currently, the Government is focusing on giving people access to financial guidance and to channels offering high standards of individual financial advice. Such services, which an individual must actively choose to access, could be more effective if they are underpinned by other 'push-through' mechanisms (e.g. national guidelines) that simultaneously impose ideas regarding good financial planning.

3. The need for consistency

As financial guidance and advice become accessible through more and more channels, it is essential that the messages surrounding good financial planning are consistent.

4. The need for speed

Our research shows that consumers are not willing to invest significant time in their financial planning choices. Rather than attempt to re-educate the population in depth, the Government should focus on communicating simple but powerful messages about good financial planning.

Part Two: The mistakes we're making

Any guidelines should look to tackle the most basic financial planning mistakes that individuals are making. We have identified four key mistakes that are especially pernicious, because they are made by well-intentioned individuals – not just those who are reluctant to save for their future.

1. The perception gap – underestimating how much we need to save

Our research indicates that a large proportion of the population are underfunding their retirement. But what is more serious is that many underestimate how dire their future situation may be. The pension that individuals expect to receive repeatedly outstrips what they are likely to get, based on their current level of provision.

For this reason, we believe it is now essential to introduce simple, bold guidelines indicating how much of their income individuals should be saving for retirement.

2. A nation of savers – but not investors

While many people in the UK maintain low-risk savings, far fewer focus on higher-risk investments. Research from the Financial Services Authority (FSA) suggests that 43% of individuals want to take no risk with their capital and subscriptions to Cash Individual Savings Accounts (ISAs) have steadily outstripped Stocks and Shares ISAs.

Yet risk-based assets are essential if most individuals are to achieve sufficient funding for their financial future. Given that the burden is now on the individual to fund their retirement, it is essential that individuals are encouraged to take sufficient risk with their assets.

Guidelines are, therefore, urgently required to show the place of risk assets in financial planning.

3. Tackling the debt silo

The average unsecured debt per household now stands at almost £9,000. Yet debt is such an acceptable aspect of modern life that many people choose to maintain their debts even if they have resources to repay them. This can be a costly decision: savers who maintain high-cost debt are effectively wiping out the returns they are making on their other savings and investments.

To understand their real financial position we believe it is essential that individuals are encouraged to think of debt and assets as two sides of the same coin. At the same time, guidelines are urgently required to indicate to consumers how much debt is too much debt.

4. Squandering the tax breaks

A unique set of tax breaks is offered by pensions and ISAs, yet take-up and levels of investment into these schemes are still modest. Optimisation of tax breaks is one of the most effective means to enhance returns, even before an individual takes on any investment risk. We, therefore, believe tax-efficiency should be explicitly promoted as a key means of promoting financial well-being.

Part Three: Getting the message across

To tackle the mistakes outlined above, we believe clear and bold guidelines are required to assist people in improving their financial planning skills.

1. How much debt is too much – the JPMorgan Debt Obesity Scale™

First we have proposed the introduction of an index that can help people gauge their financial well-being, based on their levels of secured and unsecured debt relative to their income. Such an index could give consumers clear guidelines as to critical levels of debt. It could also act as an early warning system, enabling borrowers to see when their debt is approaching dangerous levels.

2. Getting our priorities straight – the Financial 5 Steps

Next we propose outlining ‘Financial 5 Steps’ – five essential stages of financial planning that every individual should address. The five steps can clearly indicate which areas of financial planning individuals should prioritise – e.g. life cover, paying off debt, savings and investments – to ensure their capital is working as efficiently as possible.

3. How much should people be saving – the 15% rule

We would propose that government guidelines recommend saving at least 15% of income towards future financial security. While saving higher amounts is ideal, it is essential that consumers are given a guideline saving level that seems attainable and is easy to calculate.

Part One: The need to raise awareness

Suggesting what private individuals should and shouldn't do with their money is fraught with difficulty. Received wisdom is that everybody's circumstances are so different, and financial matters are so complex, that the right diagnosis can be made only on a case-by-case basis.

But this conveniently laissez-faire attitude may inadvertently have been instrumental in creating a nation that has undersaved and overborrowed.

We want to put forward a number of reasons why setting out guidelines for good personal financial planning is now expedient and necessary as part of the review into national financial capability.

1. Financial self-diagnosis is becoming more prevalent

Much of the debate on improving financial capability in the UK – such as the FSA's Retail Distribution Review (RDR)* – has focused on creating greater access to financial advice for the individual. But as we have argued in a previous report (Surviving the Storm: opportunities for investment advisory firms in a changing market, JPMorgan Asset Management August 2007), most Independent Financial Advisers (IFAs) will have to focus on the highest income earners to make their business viable, particularly if regulatory pressure to move from commission to fee-based remuneration intensifies. In that report we showed why we think it is unfeasible that any but the highest-earning 5-10% of the population will be able to afford truly bespoke and truly independent fee-based advice.

Equipping people with the basic tools for self-diagnosis of their financial solutions will become more essential in the world post RDR, not less. Setting some basic guidelines for good financial practice needs to be a key plank in this process.

We think this is especially true given the growth in online financial platforms, which are making it easier than ever for individuals to arrange their finances themselves without any intermediation. While these channels can potentially increase take-up of savings and investments, they are also making it easier for well-intentioned individuals to make inappropriate choices completely unchecked.

2. Pull-through advice must be matched by push-through guidance

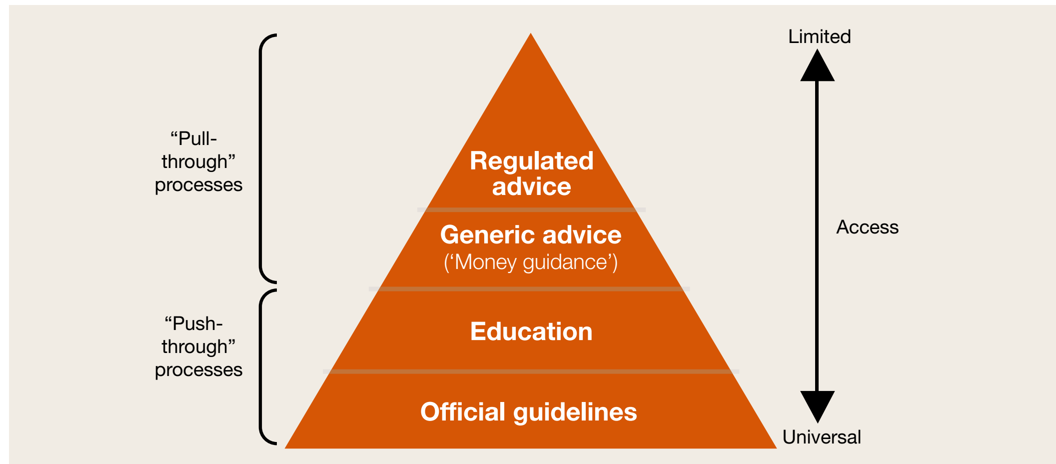
We warmly welcome recommendations put forward by Otto Thoresen* to introduce a generic financial advice service that will give more people access to basic guidance in money matters. But such a service is likely to rely on individuals being proactive and seeking out advice themselves – in other words, it is a 'pull-through' process. This being the case, there is a strong risk that many individuals will not use the service – or will seek it out only when they are already in financial difficulty.

We believe such services must be matched by 'push-through' activities, that impose awareness of basic financial principles in order to influence those people who are less engaged in their financial planning. For younger people this might be financial education in schools (currently spearheaded by the excellent work of the Personal Financial Education Group – www.pfeg.org.uk). For older people, the most effective medium is likely to be workplace-based guidance. But these education activities should be underpinned by universal and highly publicised guidelines for financial planning.

With these 'push-through' mechanisms complementing 'pull-through' forms of generic and personalised advice, it may be possible to create a reasonably sturdy framework of universal financial awareness within which most citizens will get exposure to ideas regarding good financial practice – see Diagram 1.

*The Retail Distribution Review is a wholesale review by the Financial Services Authority into how financial products and services are distributed in the UK. Currently in the discussion phase, it will ultimately lead to revised rules governing the advice and provision of such products and services. Otto Thoresen was asked by the Treasury to carry out a study into how a national generic advice service could be implemented. His initial findings were published in the Thoresen Review 2007.

Diagram 1: Creating universal financial awareness



Source: JPMorgan/TNS, January 2008

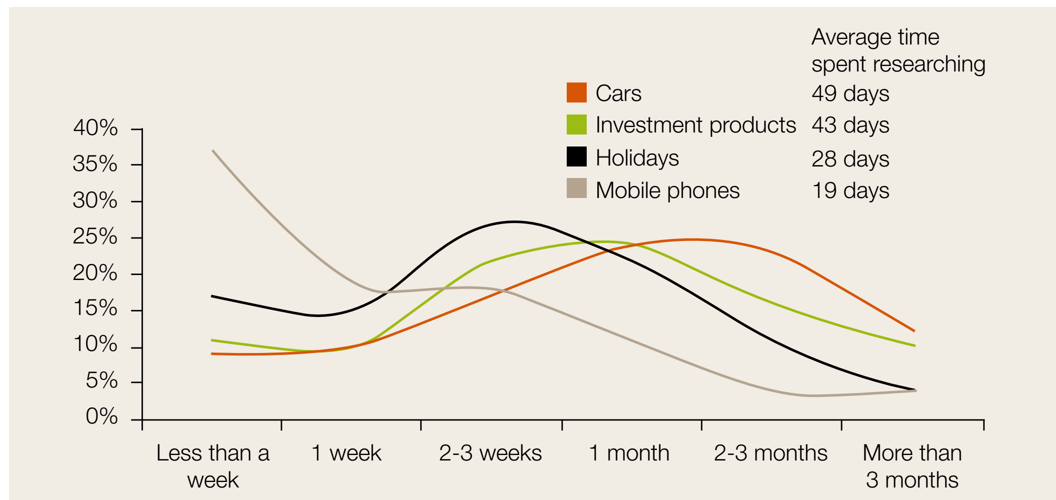
3. The need for consistency…

The Government is planning to improve financial capability through a range of channels, including schools, the workplace, online tools as well as encouraging banks and product providers to educate consumers. If individuals are to be bombarded from so many quarters, it is essential that any messaging is consistent and underpinned by universal agreement on what individuals should be told.

4. …and the need for speed

Finally, financial guidance needs to be sharp and swift to be effective. Our research shows that people are willing to spend more time choosing a car than deciding how to invest for their financial security. An average of 49 days is spent researching a car and 43 days when selecting investment products.

Diagram 2: Time taken to research a potential purchase

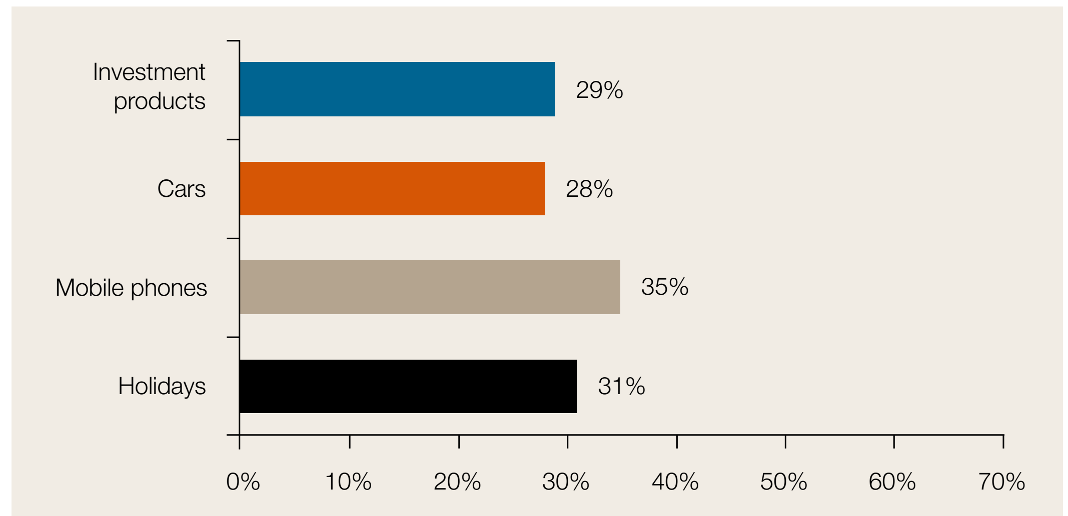


Source: JPMorgan/TNS, January 2008

This doesn't necessarily mean that consumers make poorer investment choices (and it may be a welcome surprise to many quarters that people claim to be willing to spend more than a month researching their investment choices). However, it does indicate a reluctance to spend significantly more time researching financial planning options than any other 'consumer' decision. This is regardless of the fact that the potential value at stake may be far higher – and the time span over which the asset is to be utilised is usually far longer.

Moreover, once a decision is made and action has been taken, consumers are extremely reluctant to review their choice to ensure it really was appropriate. Once an investment has been made, 29% of consumers say they wouldn't review it – about the same percentage as for other consumables.

Diagram 3: Percentage of consumers who would not review a purchase or investment after making it



Source: JPMorgan/TNS, January 2008

Summary

In short, finance may be a serious business, but few people appear willing to spend more time on it than any other spending decision.

Any financial capability solution that requires individuals to devote significantly more time to their financial planning and understanding is – we believe – doomed to failure. Financial planning simply isn't an area of life that the majority of the population want to spend much time thinking about and we believe there is little anyone can do to change this mindset.

Rather than hoping to educate the adult population in depth, we believe the Government should focus efforts on communicating very simple but powerful messages about good financial planning. To determine what these messages might be, we will next look at what we believe to be four of the most common errors that people are making in their financial planning.

Part Two: The mistakes we're making

There are plenty of shortcomings in financial planning we could dwell on in this report. However, we want to focus on four basic mistakes that may be especially pernicious, because they are not made only by people who are reluctant to save, but also by well-intentioned savers who believe they are doing the right thing for their financial future.

2.1 The perception gap – underestimating how much we need to save

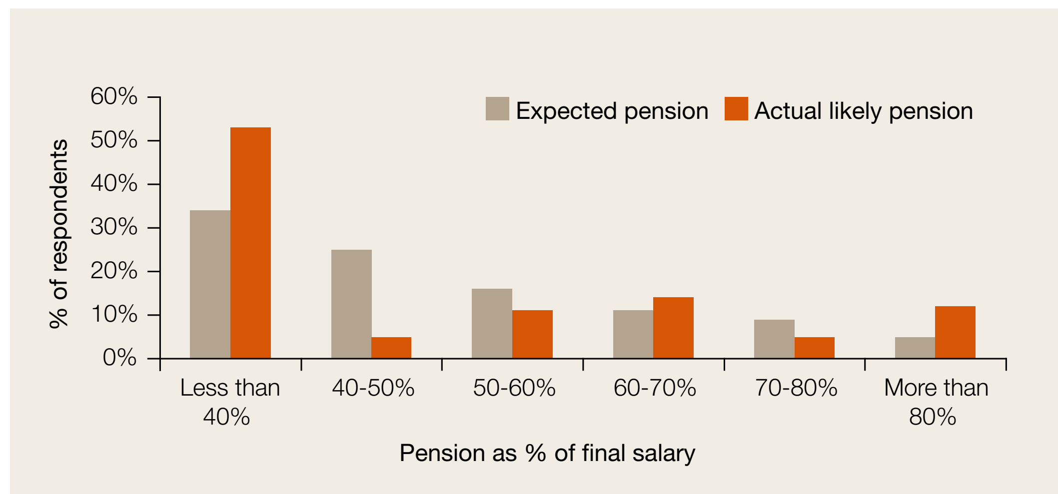
It is not news that many people are not saving enough for retirement. Two years ago, for example, JPMorgan Asset Management calculated that at current pension savings levels, almost two thirds of the UK working population are set to have a pension income of less than £2,500 a year above the basic cost of living. That's two thirds of the population with less than £50 a week to spend after basic living costs (source: JPMorgan UK Pension Map 2006).

What may be more surprising is just how few people are aware how dire their situation is. Our research indicates that individuals continue to overestimate massively how much income they are likely to receive in retirement based on their own current provision.

For example, only 34% of people expect to retire on a pension of less than 40% of their final salary. However, our data indicates that 55% of the population will be in this situation, based on their current retirement savings. Likewise, a quarter of people expect to achieve a pension equal to 40-50% of final salary, but our research suggests that only 5% of the population will achieve a pension of this size at current contribution rates.

Diagram 4: Pension expectations vs pension reality

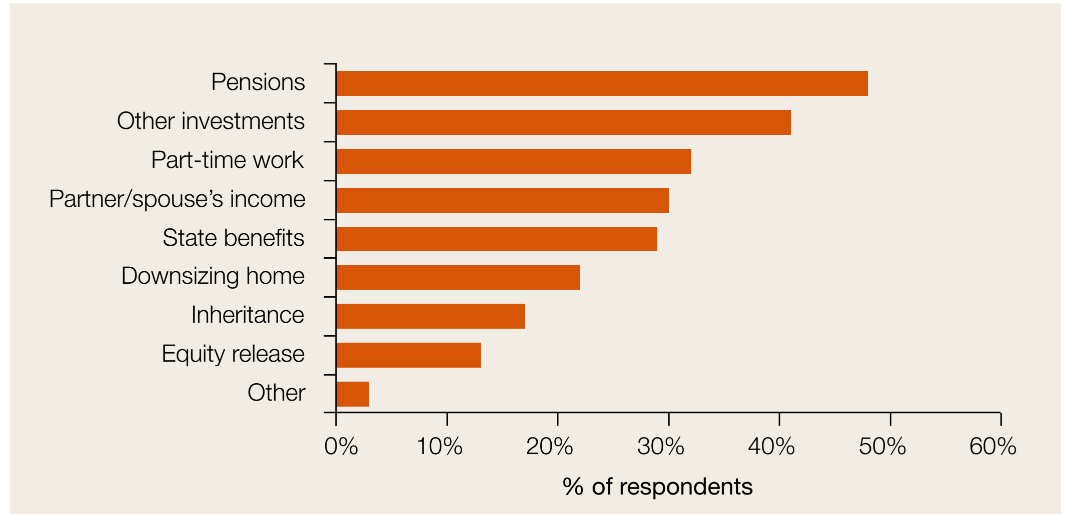
What level of pension income do you expect to receive in retirement, expressed as a percentage of your final pre-retirement salary?



Source: JPMorgan UK Pension Map 2006

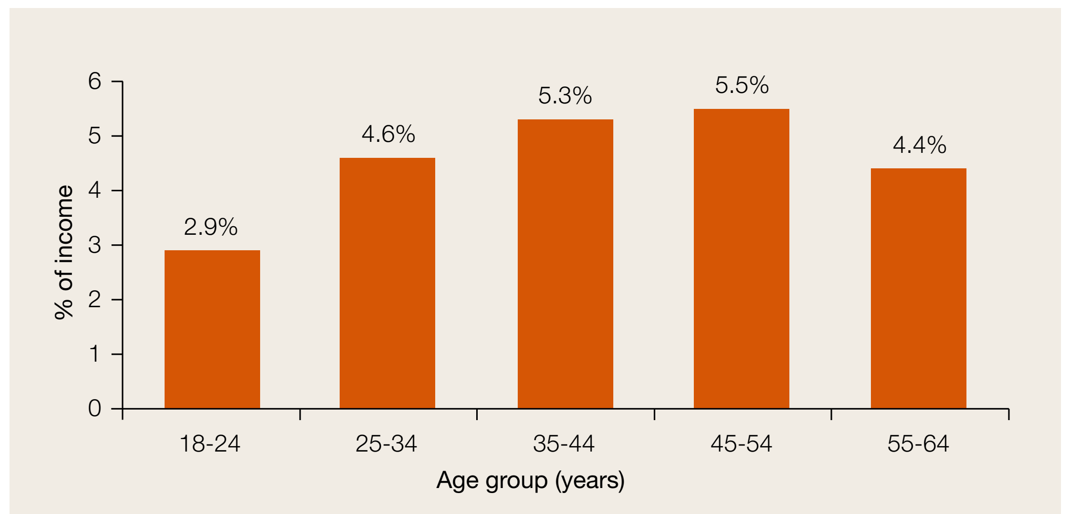
More than half of working people expect their pension and other savings and investments to be their primary source of income in retirement – see Diagram 5. Yet on average we estimated that people are saving less than 5% of their income into their pension – a figure that drops to 3% among the youngest members of the workforce – see Diagram 6.

Diagram 5: Expected sources of income in retirement



Source: JPMorgan UK Pension Map 2006

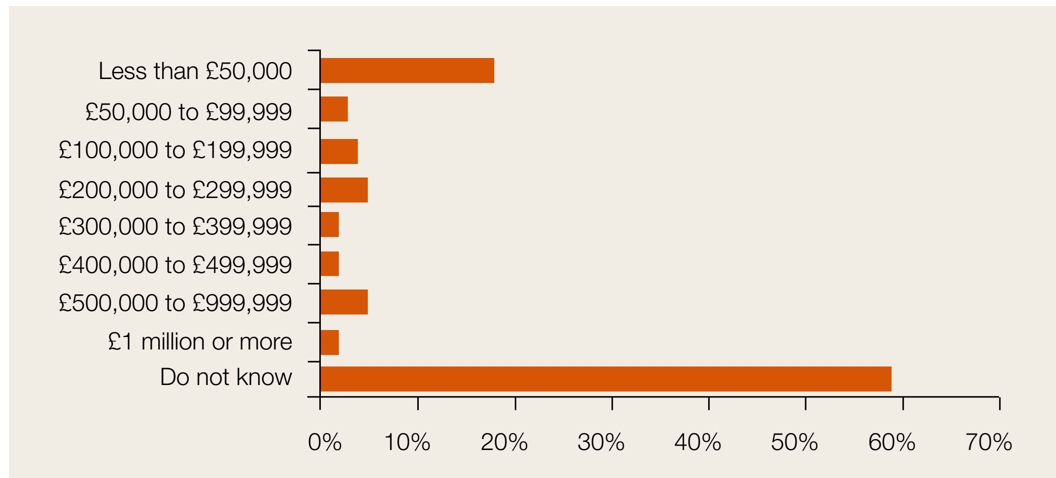
Diagram 6: How much of your income (%) are you saving towards a pension?



Source: JPMorgan UK Pension Map 2006

Low pension contributions may be a result of budgetary constraints. But we also believe there is a widespread lack of understanding as to how much capital is required to generate a decent income in retirement. As part of the UK Pension Map 2006 research, we asked members of the public what size of pension they would require to generate an annual income equal to £25,000 a year in today's money.

Diagram 7: What size of pension fund would you require to generate a pension income of £25,000 p.a. in today's monetary terms?



Source: JPMorgan UK Pension Map 2006

At today's pension annuity rates, an individual would require a pension fund of more than £340,000 to generate a pension income equal to £25,000 a year. Yet only 11% of those questioned thought that an amount of £300,000 or more might be required. About one in six people believed they would need a pension fund of £50,000 or less. More than half of people said they have no idea how much capital would be required.

Comment: We are concerned that, even where people are saving for retirement, they may be severely underestimating how much they should be contributing – and/or massively overestimating how much income their savings will give them in retirement. Such misconceptions still appear prevalent regardless of the fact that pension planholders now receive annual personalised illustrations indicating what level of retirement income they might achieve based on their current funding.

To date the official message has simply been that investing in a pension is a good thing. We think it is now essential to introduce bold and simple guidelines indicating exactly how much of their income individuals should be saving towards their retirement. We will address this further in Part Three.

Perspective

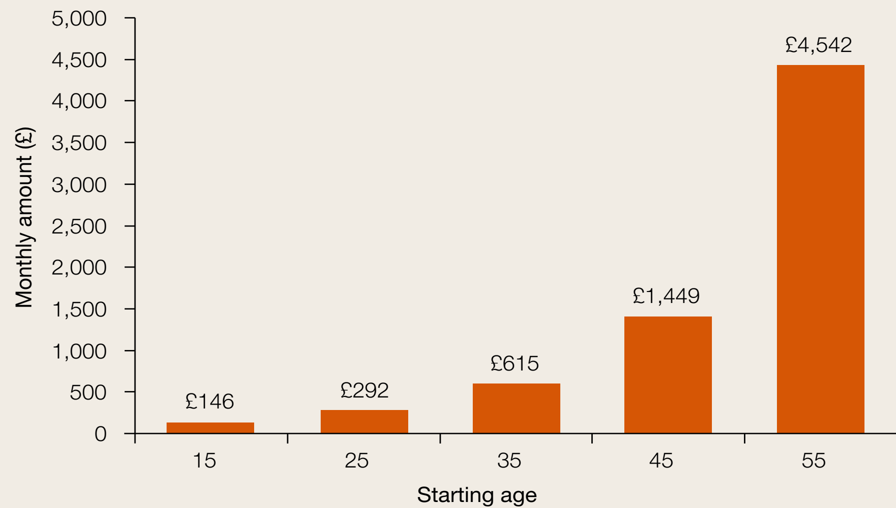
Putting time on your side

The ability to leave savings and investments to grow is one of the most important factors for achieving strong returns. This is particularly true where investments are receiving a regular income (e.g. dividends) as the effects of compounding (consistently reinvesting income to create a greater capital base on which more income can be earned and reinvested) can be one of the biggest contributors to growth over the longer term.

The younger an individual is when they start investing, the greater the returns that can be achieved. Or to put it another way: the younger you are when you start investing, the less you will need to invest to achieve the same result as an older saver. As Diagram 8 shows below, a saver of 15 would need to contribute about a tenth of the monthly amount that a saver aged 45 needs to contribute in order to achieve the same value of fund at age 65 (based on certain assumptions shown below).

Diagram 8: Building a £1 million pension

Starting monthly pension contribution required to build £1 million pension fund (in today's terms) by age 65.



Source: JPMorgan Asset Management Pension Calculator

Assumptions: Fund growth rate of 7%, annual charges of 1.5% for first 10 years and 1% thereafter. Monthly contributions assumed to increase by 2.5% a year in line with inflation; real value of capital assumed to be subject to 2.5% annualised inflation.

Starting early could be the most important message to communicate to savers and investors

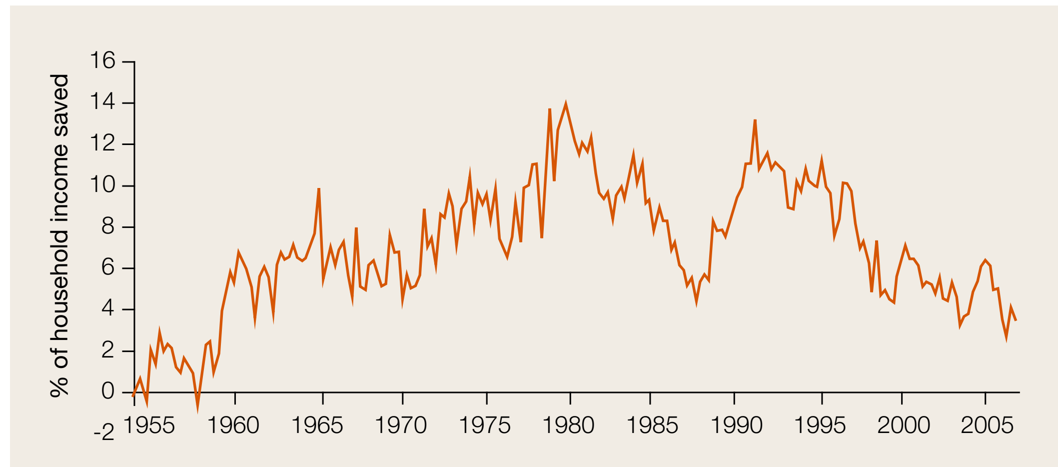
For this reason, we applaud the launch of the Child Trust Fund (CTF), which gives official endorsement to the idea of building up assets from birth. The idea to allow CTFs to be rolled into tax-efficient ISAs at age 18 is also praiseworthy.

However, we feel there is much more that can be done – by the Government as well as the private sector – to communicate the benefit of starting to save and invest at an early age, given that this dramatically reduces an individual's cost of funding for their future security. Starting early also means individuals can potentially afford to take less risk with their capital – a major issue for many individuals, as we shall see in the next section of our report.

2.2 A nation of savers – but not investors

There is conflicting evidence relating to whether or not people are saving more than they used to. The Savings Ratio published by the Office for National Statistics indicates that the proportion of income that people are choosing to save rather than spend hit a 50-year low in 2006 – although it has subsequently experienced a slight uptick.

Diagram 9: The UK Savings Ratio



Source: Office for National Statistics

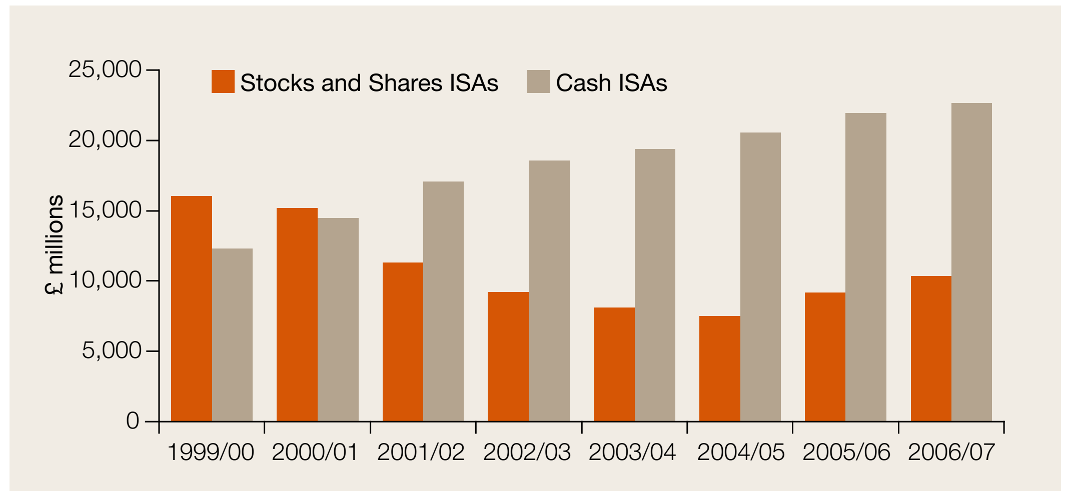
Conversely, National Savings & Investments (NS&I) reports that the British have increased their savings 39-fold in real terms since the 1960s (source: NS&I A Century of Saving, 2008). However, NS&I also suggests the actual proportion of people saving regularly has risen only marginally from 37% to 43% of the population. In other words, about the same proportion of the nation is saving – but saving more.

So, it is hard to determine whether or not people are saving more. But what is clearer is that savers are focusing primarily on low-risk assets such as deposits. In its initial Wealth & Assets Survey, the Office for National Statistics reports that over half (54%) of people surveyed had a savings or deposit account, 34% held an ISA and 19% had life-assurance-based investments. Moreover, a survey by the Financial Services Authority (FSA) in 2006 reports that 43% of people claim they do not want to take any risk with their savings (source: FSA: Levels of Financial Capability in the UK; baseline survey, March 2006).

ISAs become a cash magnet

Even when equity investment is made highly accessible and backed by tax incentives, consumers prefer the ‘safety’ of deposits. If we look at inflows into ISAs, for example, the amounts invested in Cash ISAs have steadily outstripped Stocks and Shares ISAs since the end of the dot.com boom in 2000/2001 – even though the ISA rules allow investors to put far more capital into stocks and shares than into cash. What were originally intended as personal equity plans have – once the rules were widened – swiftly become personal cash plans.

Diagram 10: Amounts invested in ISAs 1999-2007

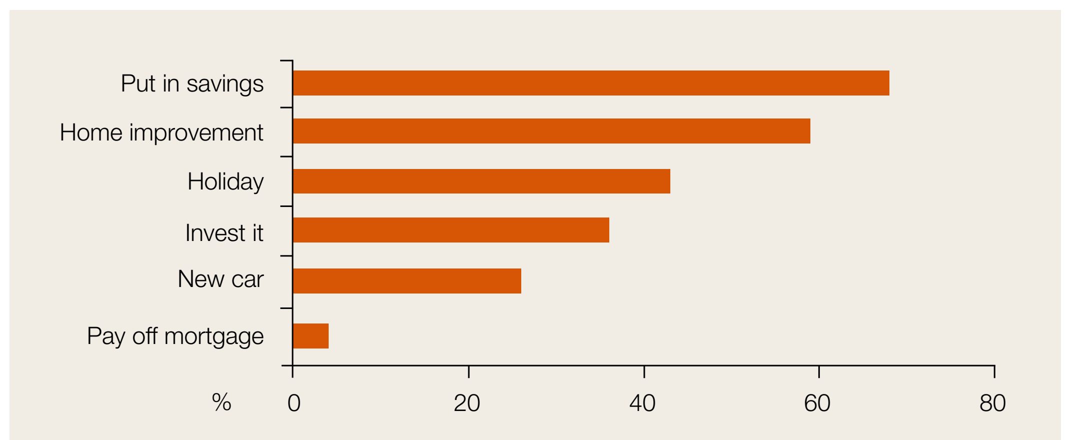


Source: HM Revenue & Customs

The £15,000 question

Likewise, when we recently asked people what they would do with a £15,000 windfall, an overwhelming 68% said they would put some/all of it in savings. However, only about a third (36%) said they would put it in investment products. This suggests that while the impetus to save may be reasonably strong across the broad population; the impetus to *invest* is not.

Diagram 11: If you had a £15,000 windfall, how would you use it?



Source: JPMorgan/TNS, January 2008

Addressing the new nature of saving

Low-risk, deposit-based savings are a crucial element of financial planning. As we will discuss later in this report, we believe it is essential for individuals to build a cash fund to guard against financial emergencies and to limit the need for expensive borrowing.

However, as the NS&I A Century of Saving report points out, the reason why people save has changed dramatically over the last 50 years. In the past, people were saving weekly to fund short-term expenditure and could not take much capital risk. Therefore, liquid deposits were highly appropriate. However, today, more people are looking to their savings for long-term funding and therefore need savings vehicles that will allow their money to keep its value in real terms against price inflation.

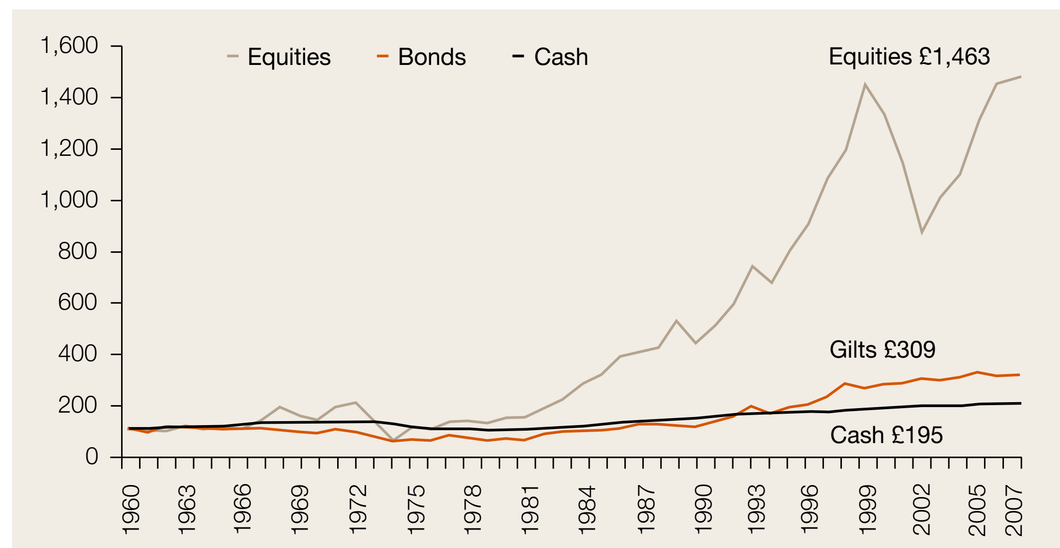
The dangers of low-risk saving

We are concerned that the national preference for deposits could cause savers to lose out massively on the real growth potential of their capital. It is also storing up trouble for individuals who are relying on their savings for their future financial security.

The Barclays Capital Gilt Equity Study has consistently shown how deposits fail to increase their purchasing power over the longer term compared to stock market investments – even given the recent benign inflationary environment.

For example, £100 invested or saved over the period 1960-2007 would have only doubled its real, post-inflation purchasing power if held in deposits (see Diagram 12 below). Held in bonds, it would have tripled in value. In equities, its real purchasing power would have grown on a compound basis more than 14-fold to £1,463, even taking into account the major market slumps that have occurred over the period.

Diagram 12: 'Real' value of £100 saved/invested 1960-2007



Source: Barclays Capital Equity Gilt Study 2008
Based on average real rate of return with gross income reinvested.

There is no guarantee that equities will repeat their previous growth and many savers will be deterred from entering the market by recent market volatility. However, the risk of equity markets falling absolutely over the medium to long term remains lower than the risk of cash being unable to achieve significant growth over the long term.

According to the Barclays Capital Equity Gilt Study 2008, which draws on asset returns since 1899, the probability of equities outperforming cash remains high at 71% over a three-year period, rising to 93% over a 10-year period, and 99% over an 18-year period. Given the long-term nature of retirement savings, this means the risk to most savers that equities will deliver less than cash deposits is almost negligible if past returns are a reliable guide.

Diagram 13: Outperformance of equities versus cash

	Period of consecutive years					
	2 yrs	3 yrs	4 yrs	5 yrs	10 yrs	18 yrs
Equities outperform cash	72	75	78	78	92	90
Equities underperform cash	35	31	27	26	7	1
Total no. of years	107	106	105	104	99	91
Probability of equity outperformance	67%	71%	74%	75%	93%	99%

Source: Barclays Capital Equity Gilt Study 2008

Perspective

Equity exposure in pensions

It can be argued that many people are achieving sufficient long-term exposure to the equity markets through their pension. This was certainly the case when the majority of pensions were managed on a defined-benefit basis where the pension scheme managers determined the most appropriate investment mix to meet their liabilities.

But what might happen with the shift to defined-contribution (DC) schemes, where it is the individual who chooses where their capital is invested?

Data suggests that four fifths of total assets under management in DC schemes in the UK are invested in the default investment option (source: Hewitt Associates, 2006), and two thirds of this money is invested in lifestyling options that aim to gradually move the investor from high equity exposure to high bond/cash exposure over time.

This suggests that members of DC schemes should be getting sufficient equity exposure to benefit from the superior growth potential of the stock market.

However, the lifestyle approach to DC pensions also raises concerns. As we have pointed out in a previous report (Putting Total Return and Alternative Investments at the Heart of DC Investing, JPMorgan Asset Management, 2007), the majority of lifestyling strategies are managed on a passive basis. While this means scheme members are achieving high equity exposure, it also means members are exposed to the full brunt of any future market downturn.

Managing risk aversion

Such unbridled exposure to the stock market may be beneficial to most DC members in the long term, regardless of market volatility along the way. But FSA data indicates that 43% of people do not want to take *any* risk with their money. Likewise, behavioural finance theory indicates that investors feel the pain of a capital loss two to three times more keenly than the pleasure of an equivalent gain.

There is a high risk, therefore, that members of DC pension schemes who are *unwittingly* invested in equities may move to lower-risk/lower-return assets in the wake of any sharp market downturn, thereby curtailing their future growth potential.

Focus on absolute returns

To guard against this happening, we have argued that default DC options should focus on absolute return strategies that are actively managed to capture growth potential while limiting downside risk. By following investment strategies that can offer greater protection against market losses, DC members might be less likely to react to market downturns with a flight to low-risk/low-growth assets.

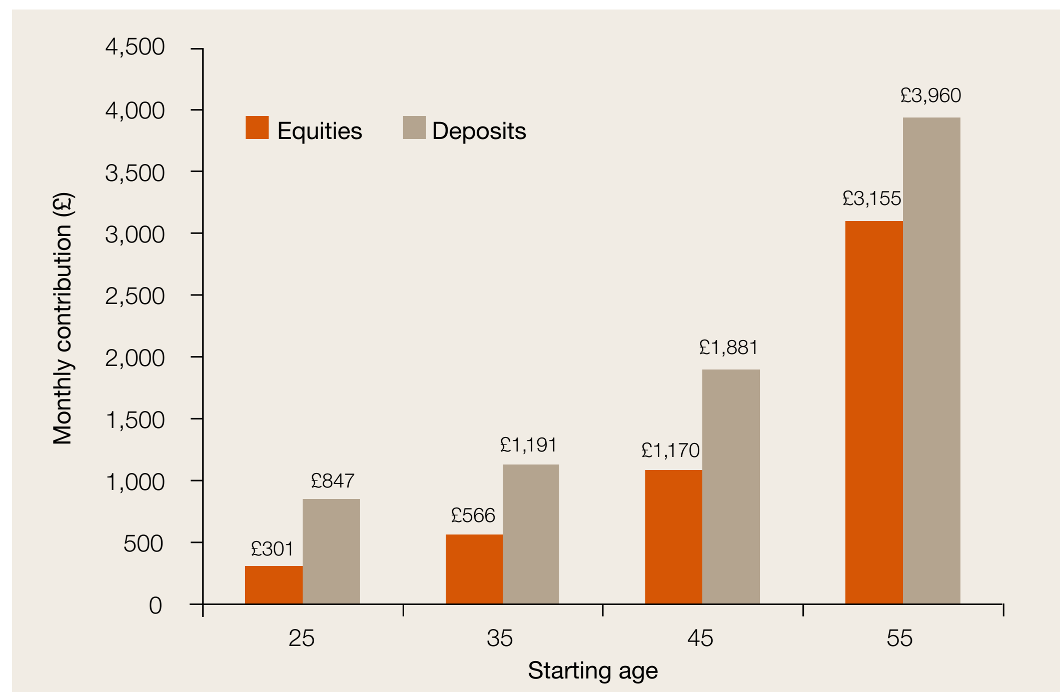
Reducing the funding cost

In short, while saving money on deposit is beneficial, few savers can afford to rely solely on deposits alone to safeguard their financial well-being in later life. For example, Diagram 14 below shows the monthly contributions required to build a fund worth £500,000 in today's terms by age 65 using either equities or deposits (based on the average returns these two asset classes have achieved since 1899). The higher growth potential of equities means that the contributions required to achieve the same outcome are significantly lower than for deposits – especially among younger investors.

Unless an individual can afford to divert a very high proportion of income to deposits, most savers need to have some exposure to the growth potential of equities and other growth assets if they are to have any hope of building sufficient funds for retirement.

Diagram 14: The funding cost of equities vs cash

Monthly contributions required to build a fund worth £500,000 in today's terms by age 65, investing in equities vs deposits.



Source: JPMorgan Asset Management

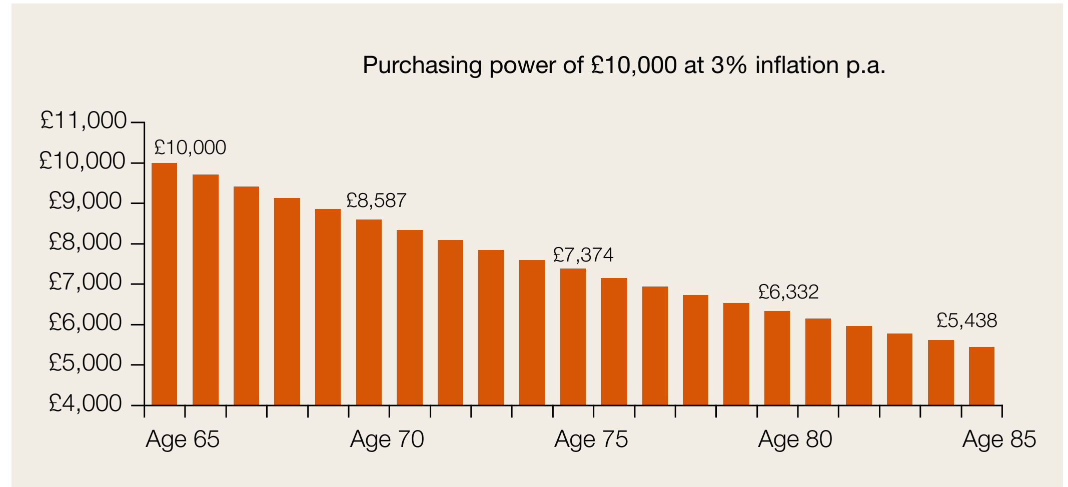
Assumptions: Contributions made monthly; real (after inflation) annualised rates of return assumed as 5.3% for equities and 1% for deposits (drawn from average annualised real returns 1899-2007 – Barclays Capital Equity Gilt Study 2008); gross income reinvested.

Maintaining purchasing power in retirement

Moreover, few individuals can afford to stop investing once retirement starts. Longer life expectancy means that retirement can now last two if not three decades, over which period capital can halve in purchasing power, even at low rates of inflation (see Diagram 15). Therefore, retirees will still need a hedge against inflation if their capital is to maintain its purchasing power.

This means that individuals need to be encouraged to retain exposure to assets proven to keep pace with inflation, e.g. equities and 'real' assets such as property, commodities and infrastructure, both before and after retirement.

Diagram 15: Impact of inflation of capital after retirement



Source: JPMorgan Asset Management

Comment: The Government is working to encourage greater levels of savings – for example through its Savings Gateway scheme, planned to be launched in 2010, which will encourage lower earners to save by offering tax credits and matched contributions.

Such initiatives are highly commendable. However, it is not enough to encourage people to save; it is just as important to ensure they are saving the right assets. The difference between savings and investments – and their very different risk/reward prospects – must be made clear to consumers.

Savers at all income levels need to build awareness of the long-term growth potential of the stock market – and how 'risk assets' can fit into their financial planning.

It is important to be aware that the nature of saving has changed radically, as the burden of funding retirement has shifted over the last decade from the state and the employer to the individual. Given the high funding cost for retirement, encouraging savers to take too little investment risk over the longer term is now just as dangerous as encouraging them to take too much.

Perspective

Investing is a matter of time – not timing

During periods of market volatility it is an especially hard time to convince investors to stay in risk assets. Many investors believe they can benefit from moving to cash when markets are rocky and then moving back into equities when prices have stabilised – in other words, 'timing the market'. Yet past performance repeatedly shows that simply staying invested throughout market volatility offers the highest rewards.

This is largely because the stock market's best days have come immediately after sharp falls. So, if you are out of the market on these days, you could dramatically reduce your overall returns.

For example, as the chart below illustrates, investors who remained fully invested in the UK market (as measured by the FTSE All-Share) over five years could have made an overall return of more than 64%. In contrast, investors who were out of the market for the 10 best days would see their returns cut to just under 20%, while those who missed out on the best 40 days would have lost a third of their money.

Effect of missing out on the market's best days

Five years to 22.01.08	Fully invested	Missing best 10 days	Missing best 40 days
Return from FTSE All-Share	64.3%	19.7%	-34.3%

Source: JPMorgan Asset Management

Moving in and out of investments may persuade investors they are benefiting from active asset management. But it also increases the odds of missing out on the periods of strongest performance.

Time not timing is the most effective message that can be conveyed to clients to maximise investment performance over the long term.

2.3 Tackling the debt silo

Personal debt in the UK has reached record levels and many debt agencies have forewarned of a debt crisis. The Royal Institution of Chartered Surveyors has said it expects the number of home repossessions to rise by more than 50% in 2008, from 2007, to 45,000 as mortgage rates rise in response to the recent credit crunch.

In terms of unsecured lending, KPMG has reported that creditors wrote off more than £1.3 billion in bad debts in 2007 as a growing number of people entered into Individual Voluntary Agreements (IVAs). KPMG estimates that about 43,000 people used the IVA procedure in 2007 to help restructure/write off their debt. In 2008, it expects more than 130,000 people to enter into IVAs or be declared bankrupt.

Repossession and insolvency among lower earners is the highly publicised end of the debt crisis. But, we believe, there is an equally troubling crisis awaiting middle and higher income earners who may not fully realise what impact debt is having on their long-term net worth.

Divorcing debts from assets

Credit Action, the money education charity, estimates that the average unsecured debt per household is £8,956. Further figures from Thomas Charles suggest that 15% of adults in the UK struggle with over £10,000 in unsecured debt.

Because debt has become a highly acceptable aspect of financial planning, there is a tendency to treat it separately from savings and investments. Consequently, there are many savers who are putting money into the latter while still maintaining the former. This is what we call the ‘silo’ attitude to debt.

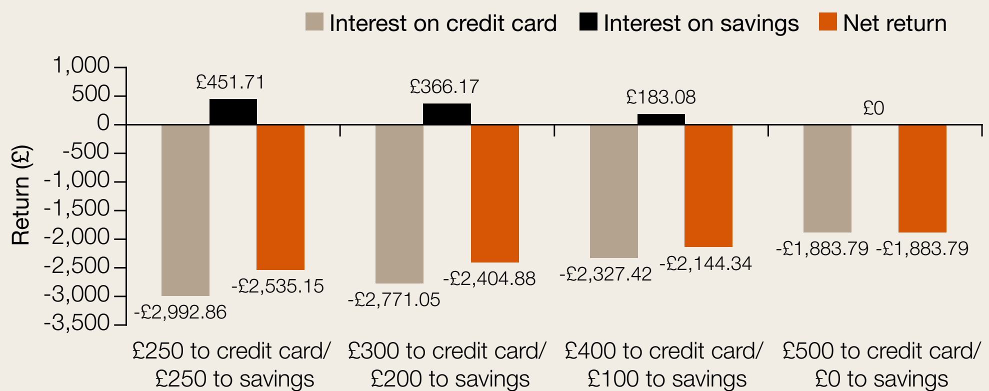
But the differential in interest rates on borrowing versus saving could mean that people who maintain debt are instantly wiping out the return on any savings they are building up at the same time. This is particularly true of unsecured debt such as credit cards and personal loans that charge a sizeable premium over the bank base rate – as the example in Diagram 16 shows.

The recent environment of rising property prices and cheap home loans means that most people view paying off a mortgage as an even less effective use of spare money. When we asked people how they might spend a £15,000 windfall, only 4% said they would put it towards paying off their mortgage compared to 68% who would put it in savings (see Diagram 11, page 16).

Saving vs reducing debt

John has £10,000 outstanding debt on his credit cards. Each month for the next two years, he has £500 spare from his income that he can use to pay off this debt or save in a deposit account. At average rates of interest, the interest paid/earned over two years could look as follows:

Diagram 16: The impact of £500 a month on debts and savings



Source: Credit Action

If John chooses to divide the £500 a month equally between paying off his credit card and savings – i.e. putting £250 a month in each, his net expenditure on interest payments will be £2,535.15. Conversely, if he forgoes saving and instead uses the full £500 a month to pay off his credit card, the net cost over two years will drop to £1,883.79 – a 'cost saving' of £651.36 over a two-year period.

Assumptions: Outstanding credit card balance of £10,000; average interest rate on credit cards – 17.31%; savings interest rate of 7% (no deduction made for tax on interest); minimum credit card payment is 2.5% of outstanding balance.

Comment: Access to debt has transformed the spending patterns of many ordinary people and without it a lot of economic activity would be curtailed. Nonetheless, it is now vital that individuals are encouraged to view the return on assets and the cost of debts as two sides of the same coin if they are to deploy their capital efficiently.

We believe two urgent initiatives need to be taken:

1. Instil a holistic approach to net assets

Savers and investors need to be encouraged to start considering their personal worth in terms of their 'net worth' – the value of their assets less the value of their debts. Conducting such an exercise may surprise individuals just how little real progress they are making in building assets if they are servicing debt at the same time.

2. Define how much debt is too much debt

We find it of deep concern that there is no official guidance as to how much debt is too much debt. Granted, the voluntary Banking Code states that banks must contact customers if they think they may be heading towards debt problems, but this is highly subjective and is a case of tackling debt at too late a stage.

Provided an individual can 'service' debt – i.e. they can comfortably pay off the capital as well as interest – then maintaining debt is not necessarily a problem. We are concerned that many people unwittingly hit a 'tipping point' where they are unable to pay off both capital and interest. In these circumstances, the individual can find themselves in a position where the debt is constantly building faster than they can reduce it.

Consumers need more guidance as to where this tipping point may be. Just as individuals can measure their physical health through the Body Mass Index, we believe it is feasible to construct a scale to allow individuals to gauge their likely financial health, based on their ratio of debt to earnings. Part Three of this report gives our suggestion as to how this might be done.

2.4 Squandering the tax breaks

Any guidelines to improve financial well-being need to include reference to tax efficiency. Savers and investors can improve tax-efficiency by a number of means, including reclaiming tax for non-taxpayers, moving assets into the name of lower-earning spouses – and using tax-efficient savings vehicles such as pensions and ISAs.

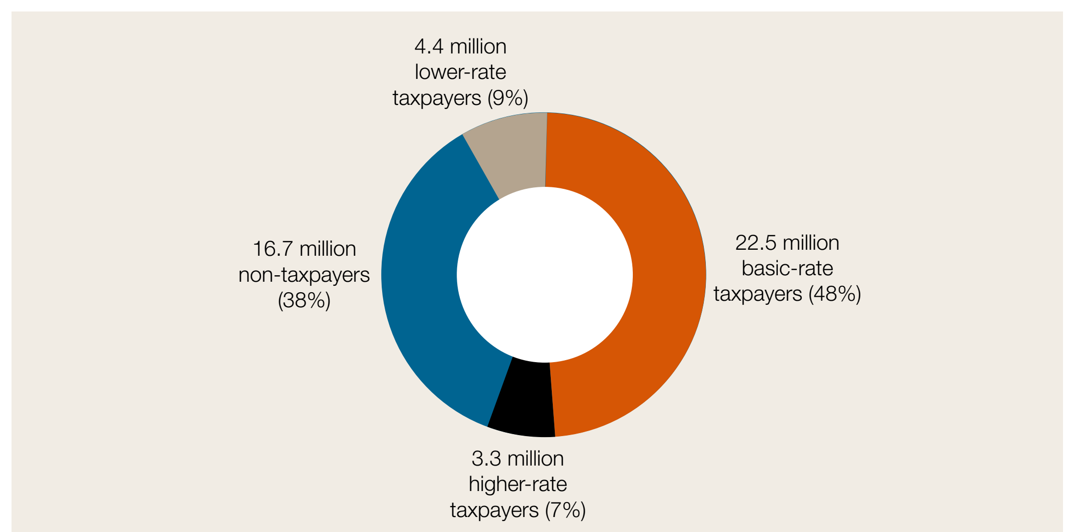
Maximising tax breaks on pensions and ISAs, is an especially effective means to optimise investment/saving returns even before a saver takes on any risk. We therefore feel it is expedient to incorporate guidelines to encourage take-up of tax-efficient products among savers of all kinds.

Take-up of ISAs

It could be argued that this is happening already via product providers. Annual marketing spend on promoting ISAs for example now stands at £30 million (source: Thomson Intermedia, 2007 figures).

Because of this activity, the take-up of ISAs appears relatively healthy. Data from the Department of Work & Pensions' Family Resources Survey shows that one in three (34%) of households surveyed had ISAs as at 2006. This is consistent with data from HM Revenue & Customs which shows that about 17.3 million individuals held ISAs as at the end of the 2004/05 tax year – about 35% of the eligible adult population.

Diagram 17: UK population by tax status (% of UK resident population over age 18)



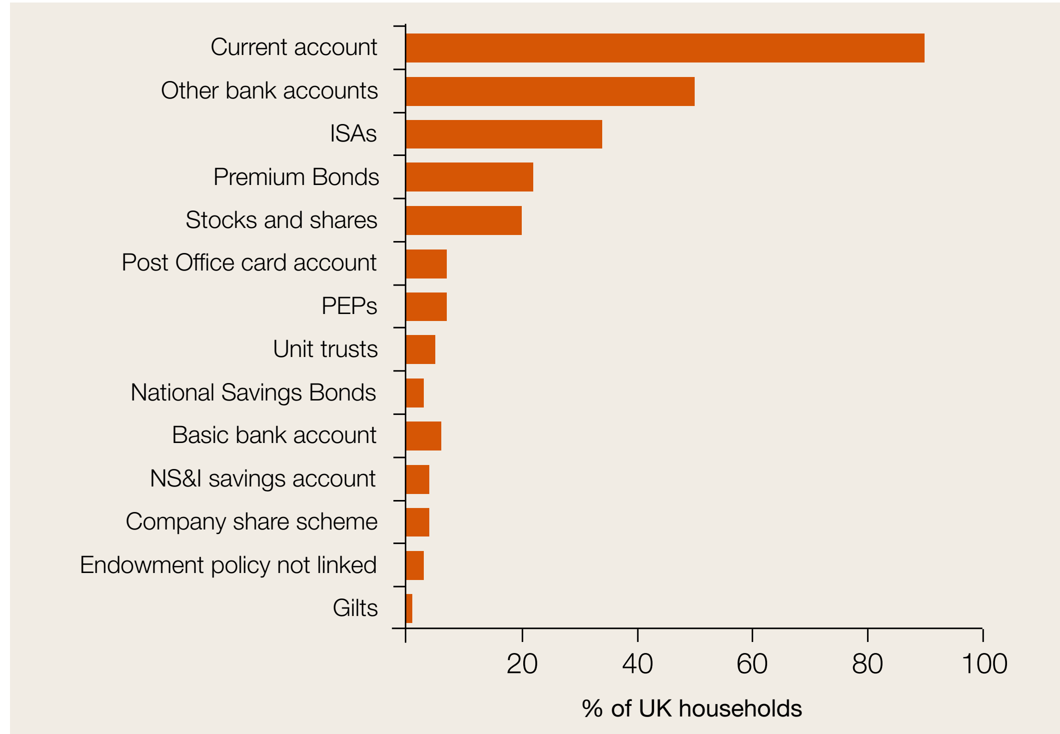
Source: JPMorgan Asset Management/ONS/HMRC

Calculated using data from Office for National Statistics and HM Revenue & Customs; population figures as at mid-2005, taxpayers as at end of 2004/05 tax year. Based on UK resident population over 18; does not account for taxpayers aged under 18. Lower-rate band included taxpayers at the 'saver's rate'.

However, just over 30 million people in the UK are classed as income taxpayers in 2004/05 (see Diagram 17 above). This indicates that about half of the taxpaying population are not taking advantage of this highly valuable tax break. In fact, if we assume that many ISAs are held by non-taxpaying retirees, then the proportion of current taxpayers who may be missing out on this tax break may be even higher.

Given that 54% of households have a deposit account but only 34% have an ISA (see Diagram 18), even individuals who are choosing to save may be paying tax unnecessarily on their hard-earned gains.

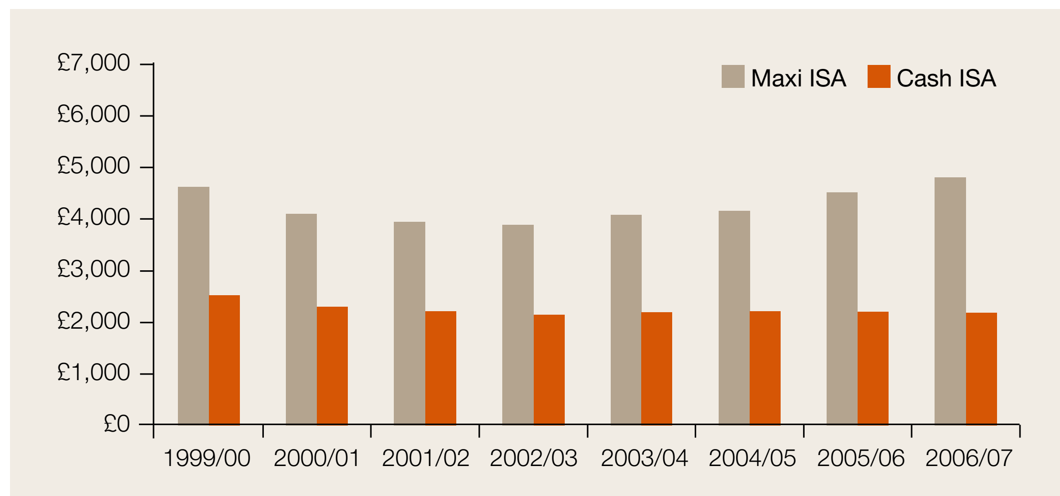
Diagram 18: Household take-up of savings products 2005/06



Source: Department of Work & Pensions

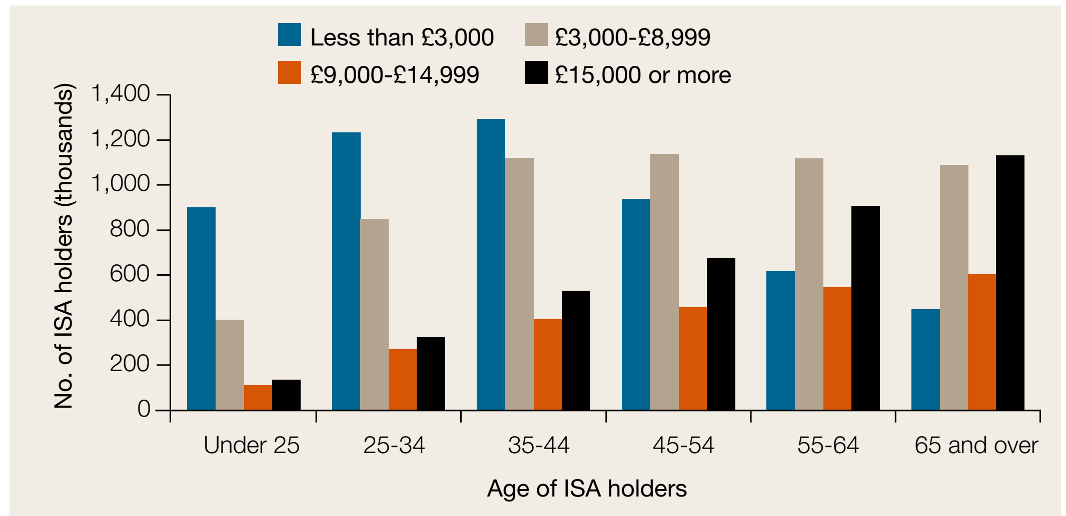
Moreover the average subscription into ISAs has consistently fallen well below the maximum allowance – indicating that even where savers have used ISAs they have been reluctant or unable to maximise the tax shelter (Diagram 19). Plus, if we look at the market value of ISA holdings (Diagram 20), we see that the vast majority of ISA portfolios have a value of £9,000 or less until we get to the most senior age groups. So, while take-up of ISAs is relatively high – the actual amounts being invested, especially among younger age groups, may be small.

Diagram 19: Average annual subscriptions into ISAs



Source: HM Revenue & Customs

Diagram 20: Number of individuals holding ISAs by age and market value



Source: HM Revenue & Customs

Estimates produced by HMRC based on a sample of individuals holding ISAs as at 5 April 2005. Imputation techniques have been used for incorrect or missing data.

Comment: The data above suggests that many savers and investors are highly receptive to the concept of ISAs.

The potential value of the ISA tax breaks will, of course, always vary, depending on the prevailing tax regime and an individual's circumstances. But their big benefit is that they can always protect individuals from the vagaries of tax reform and future changes to their own tax status.

We, therefore, feel it is now expedient for the Government to underpin the marketing efforts of the financial services industry by explicitly encouraging take-up of ISAs among savers in all tax bands and at all ages.

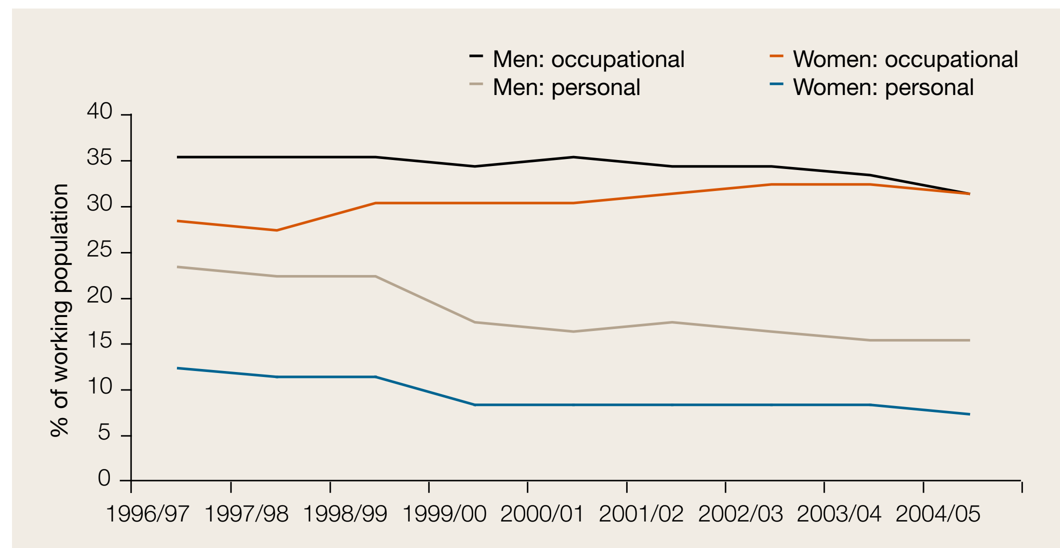
Take-up of pensions

Pensions offer a unique combination of tax breaks that savers cannot get anywhere else, including tax relief on contributions, tax-efficient growth and tax-free withdrawal of up to 25% of the fund value at retirement. As such they should be the first port of call for long-term saving.

Since 2006, the rules surrounding money-purchase-based pensions have potentially become more attractive for the broader population. Individuals can now receive tax relief on contributions up to 100% of earnings (subject to an annual allowance), up from between 17.5-40% previously. They also have more flexibility to contribute to different types of pension. Gradually, pension-holders are also being given more choice as to what they can do with their pension fund at retirement.

Data cannot yet measure whether this greater pension freedom has had a positive impact on pension take-up. But it is clear that some action is needed as membership of pensions in the private sector – both occupational and personal – has steadily declined over the decade up to 2005. The only segment that saw any rise over this period has been among female membership of occupational schemes. But even this saw a decline over 2003-2005 as Diagram 21 shows.

Diagram 21: Working-age membership of occupational and personal pensions by gender



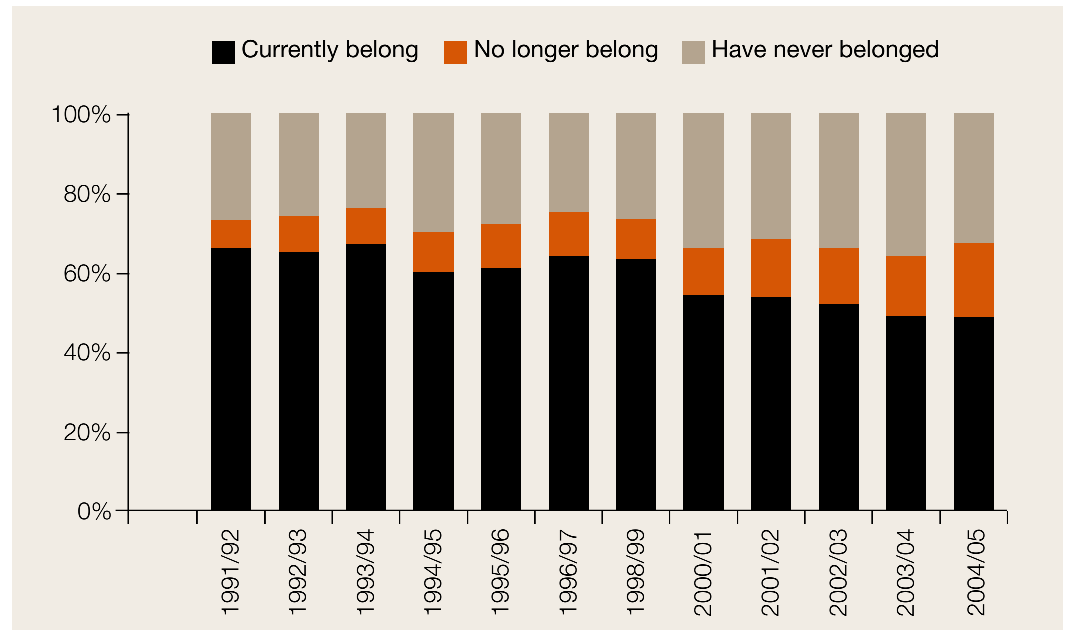
Source: Department of Work & Pensions

Men aged 16 to 64, women aged 16 to 59. Employer-sponsored or personal pension. Data from 1999/2000 onwards is not comparable with earlier data because of the implementation of improvements in Government surveys relating to pensions from that date.

This decline could be partly attributable to factors such as employees moving to the public sector (where there has been an increase in pension scheme membership as public-sector employment has risen since 1998). But the declining trend is reiterated if we look at the self-employed.

Thirteen per cent of employed people are self-employed according to the ONS 2006 Labour Market Review. Yet only 49% of self-employed males belong to a personal pension scheme – down from 65% in 1998. The remainder have either never belonged to a personal pension or have chosen to leave one.

Diagram 22: Personal pension scheme membership among self-employed men



Source: General Household Survey, Office for National Statistics; based on full-time self-employed male workers; no surveys carried out in 1997/98 and 1999/2000.

Alarmingly, very recent data from insurer Prudential also suggests that pension contributions are one of the first areas to be cut when personal finances get tight. The Prudential 2008 Retirement Savings Report, based on a survey of 1,500 adults, shows that voluntary pension contributions made by UK adults almost halved to £144.57 from £279.38 – indicating the average worker is now putting just £1,734 a year into a pension.

Comment: There are measures being taken to encourage greater pension take-up, including the introduction of automatic enrolment into personal accounts from 2012. However, this will do little to address low pension take-up among segments such as the self-employed. We believe more messaging needs to be put out to specifically address groups who may not be touched by auto-enrolment.

Perspective

Tax breaks – a great substitute for investment risk?

Making better use of available tax breaks is one of the most obvious means for savers and investors to reduce the cost of funding future financial security.

Tax breaks on pensions are the most compelling. A capital investment of £6,000 by a higher-rate taxpayer immediately gains an effective gross value of £10,000 when transferred to a pension by attracting £4,000 in tax relief.

Plus 25% of the final fund can be taken as a tax-free lump sum at retirement. In broad terms, that means that even if the £6,000 were to experience no growth throughout the life of the pension, you could take out a tax-free lump sum on retirement of up to £2,500 and still leave an amount greater than your original investment from which to generate an income (see panel below).

We haven't taken account of inflation or charges in this calculation nor the fact that growth is also tax-free within a pension. But it is clear to see that the tax incentives on offer make contributing to a pension a highly attractive proposition.

How to boost your money in a pension without taking any risk

Higher-rate taxpayer contributes	£6,000
Receives tax relief	£4,000
Total gross contribution*	£10,000*
25% taken as a tax-free lump sum at retirement	£2,500
Remaining amount used to generate an income	£7,500

Source: JPMorgan Asset Management

*Assumes contribution made out of gross salary where all tax relief is paid into the pension; on a personal pension, higher-rate tax relief will be given as a deduction on the individual's annual tax bill, not as a direct contribution into the pension fund.

With savers now able to save 100% of annual income in a pension (up to an annual allowance of £235,000 in 2008/09), the potential uplift to their pension funding through tax breaks alone is significant.

As we have seen throughout this report, UK savers are highly risk-averse. We believe that better use of tax-efficient saving – particularly pensions – would reduce the need for savers to take investment risk to achieve their funding requirements.

Part Three: Getting the message across

It is inconsistent, in our view, that there are extensive Government guidelines on a broad range of aspects of living including diet, exercise, smoking and drinking but absolutely none on financial well-being – even though financial security (or the lack of it) can have a knock-on impact on every other aspect of an individual's life.

To address the basic mistakes outlined in the previous section of this report, we would propose the dissemination of guidelines in the following areas:

1. Indicate how much debt is too much debt
2. Outline key priorities in financial planning
3. Indicate how much of their income people should be saving

To be successful, such messages need to be simple, striking and carefully rationed. Below are three proposals we would like to put forward to communicate these three key financial planning principles.

3.1 How much debt is too much – the JPMorgan Debt Obesity Scale™

Most people know that a high level of debt is inadvisable, but borrowing capital is necessary for most of us at some point in our lives, whether to fund education, buy a home or simply to enable us to spend when we want to, rather than when we can afford to.

It is unrealistic to expect people to have no debt – and gearing on appreciating assets such as property at reasonable rates of interest can make financial sense. However, we believe that consumers should have some guidance as to how much debt is too much debt.

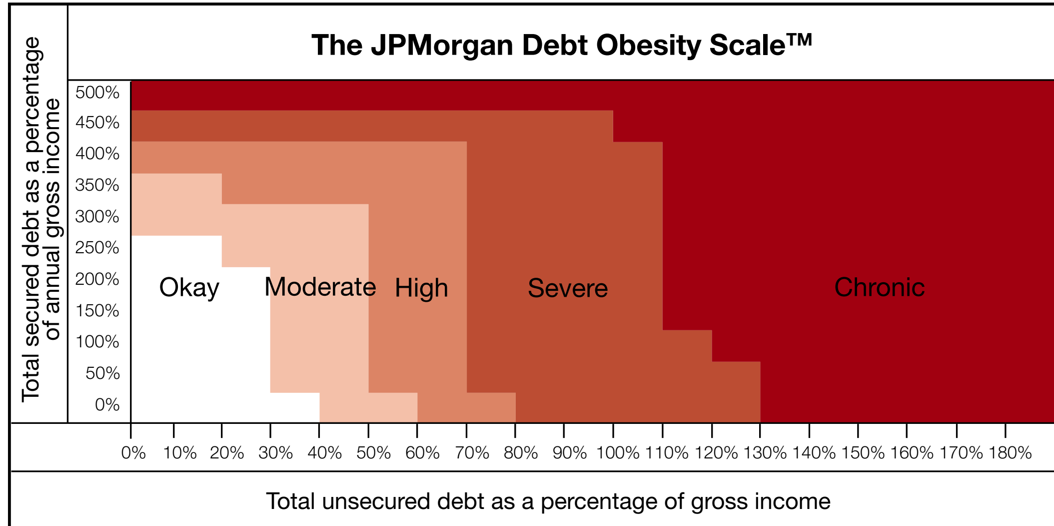
Currently, there are absolutely no Government guidelines as to an appropriate level of personal debt. In conjunction with Credit Action, the money education charity, we have, therefore, devised the JPMorgan Debt Obesity Scale™, inspired by the Body Mass Index (BMI), to help borrowers gauge how manageable their debts may be.

How the JPMorgan Debt Obesity Scale™ works

The JPMorgan Debt Obesity Scale™ is designed to show an individual's likely ability to service their current debts, by calculating their total secured and unsecured debt as a percentage of their gross (i.e. before tax) annual income. By 'servicing debt' we mean an individual's ability to make both interest and capital repayments out of their regular income, so that the debt can be reduced over time.

The JPMorgan Debt Obesity Scale™ rates levels of unsecured debt (e.g. credit cards and personal loans) more severely than secured debt (i.e. a mortgage). This is because the former is likely to charge a very high premium over bank base rates and the borrower does not have an asset to fall back on to help repay the debt.

Diagram 23: Introducing the JPMorgan Debt Obesity Scale™



Devised by JPMorgan Asset Management with Credit Action, March 2008

Calculating a Debt Obesity Rating

To determine their Debt Obesity Rating, an individual simply needs to calculate their total unsecured debt as a percentage of current gross annual income, and then do the same for their total outstanding secured (mortgage) debt. They can then see which Debt Obesity Rating these two figures put them in.

The JPMorgan Debt Obesity Scale™ has five ratings:

Rating	Description
Okay	Debt can easily be serviced by current income
Moderate	Debt will account for a significant amount of the individual's income but should be manageable
High	Debt will account for a high amount of income and may compromise an individual's ability to meet other living costs
Severe	Debt will account for a very high level of income and the individual is unlikely to be in a position to meet payments and other living costs as well
Chronic	The debt is beyond the individual's means and they are likely to be in chronic financial difficulty

Case study A – Mark

Mark has a salary of £25,000 per year before tax. He has £100,000 outstanding on his mortgage and has a balance of £5,000 on his credit card.

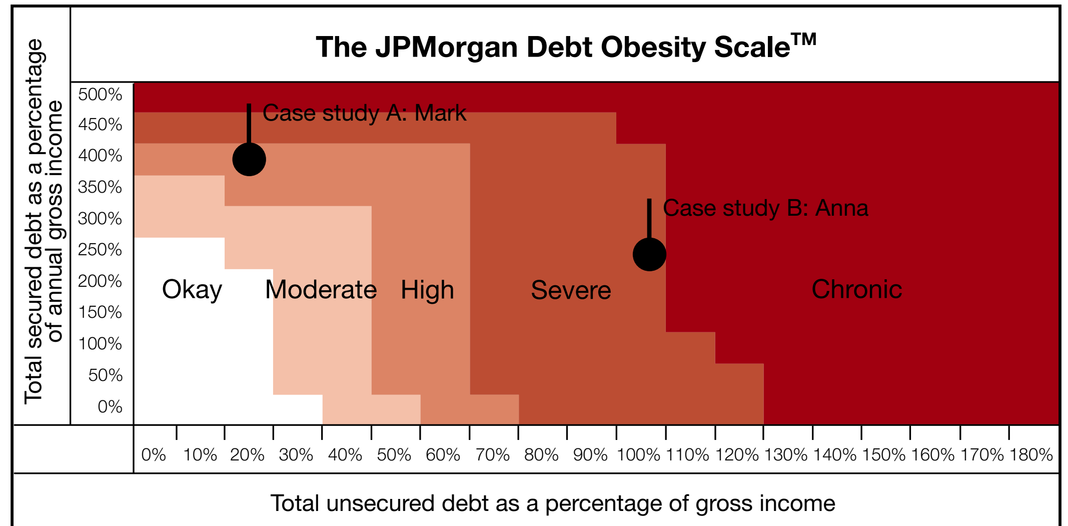
His total secured debt is 400% of annual gross income ((£100,000 ÷£25,000) x 100).
His total unsecured debt is 20% of annual gross income ((£5,000 ÷£25,000) x 100).
Mark rates HIGH on the JPMorgan Debt Obesity Scale™ – debt and associated interest costs will account for a high amount of income and may compromise his ability to meet basic living costs.

Case study B – Anna

Anna has a gross income of £30,000 per year. She has £80,000 outstanding on her mortgage, an unsecured loan of £15,000, £5,000 on a store card and £10,000 on her credit card.

Her total secured debt is 267% of annual gross income ((£80,000 ÷£30,000) x 100).
Her total unsecured debt is 100% of annual gross income ((£30,000 ÷£30,000) x 100).
Anna rates as SEVERE on the JPMorgan Debt Obesity Scale™ – debt and associated interest costs will account for a very high level of income and Anna is unlikely to be in a position to meet payments and other living costs.

Examples of Debt Obesity Scale™ ratings



Factors to consider

We appreciate there are other factors at work in an individual's ability to service debt (other financial commitments, other means to pay off the debt, etc.). However, the level of debt relative to regular income is, in our view, the most reliable indicator of an individual's ability to service debt and still meet their other living costs.

We are also aware that publishing guidelines can be seen as condoning debt up to a certain level. We have to, therefore, keep 'serviceable' levels of debt within highly conservative limits suggested by Credit Action. For example, 'three times income' is defined as the maximum acceptable limit for secured debt – while unsecured debt is generally advised to be less than 30% of annual income.

The role of the JPMorgan Debt Obesity Scale™

Constructing an index such as the JPMorgan Debt Obesity Scale™ could, for the first time, offer consumers a clear and unequivocal guide as to appropriate levels of debt – and provide an early warning system when debt is approaching unmanageable levels.

Moreover, individuals can graphically see the relationship between their debt and their income. Only by reducing their debt or improving their income/assets can an individual improve their Debt Obesity Rating.

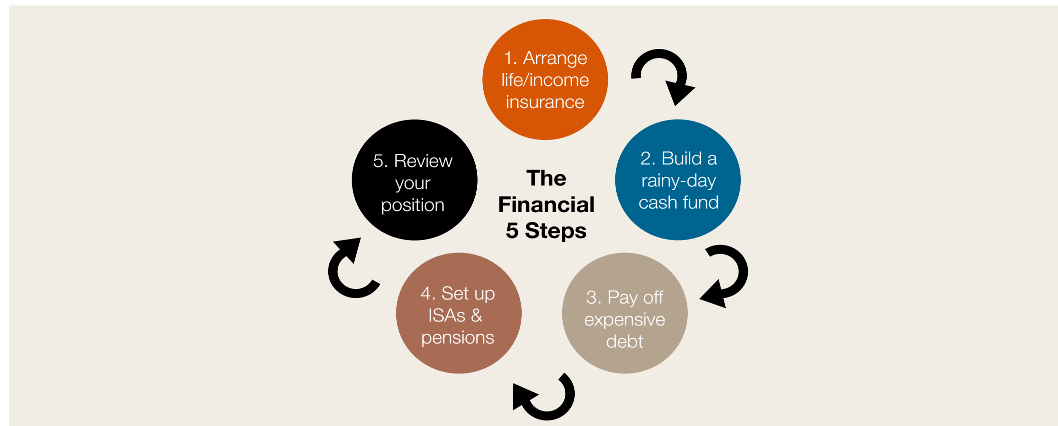
3.2 Getting our priorities straight – the Financial 5 Steps

To be used effectively, capital has to be deployed in the most efficient way. But, as we have suggested throughout this report, personal financial planning is often haphazard and illogical. We believe it is time for individuals to be given clear guidance on what their financial planning priorities should be and in what stages.

The '5 a Day' message for eating fruit and vegetables has passed into the national consciousness with impressive success, given the slogan was adopted as a national campaign only five years ago.

We believe a similar message is required for communicating the essential elements of personal financial planning. Again, the message needs to be kept simple and easy to remember. To illustrate how this might be done, we have devised what we call the Financial 5 Steps.

Diagram 24: The Financial 5 Steps



Structured as five simple steps, consumers can easily see what their priorities should be in order to deploy their money most effectively:

1. Arrange life/income insurance – Anyone with dependants should ensure first and foremost that they are properly protected.

2. Build a cash fund – Everyone should be encouraged to build up an instant-access savings fund that can be called on in an emergency (three months' earnings is generally recommended by IFAs). Once this is in place, consumers will be in a stronger position to consider stock market investments as capital won't need to be pulled out of the market unexpectedly.

3. Pay off debt – Building up savings and investments while still servicing expensive unsecured debts such as credit cards and personal loans is counter-productive. Individuals should be encouraged to reduce debt – at least to a size where repayments are having a meaningful impact (i.e. paying off capital as well as interest).

4. ISAs and pensions – Once an individual has built up a low-risk cash fund, they will be in a position to consider longer-term and higher-risk savings. We believe the focus here should be first and foremost on tax-efficient investment via ISAs and pensions – particularly as the differing tax treatment of pensions and ISAs (tax relief upfront versus on redemption) complement each other very well. It is debatable which a saver should focus on first. But whether individuals invest through a pension or ISA, the main point is to encourage stock market investment to give individuals a long-term hedge against inflation.

5. Review position – One aspect of financial planning that is regularly overlooked by savers is the importance of reviewing their financial arrangements to ensure they remain appropriate and are performing as expected. As mentioned in Part One, just under a third of consumers say they never review a financial purchase. For this reason, we think a Review stage must be built into the Financial 5 Steps.

Getting the order right

The most appropriate order of the five steps is, of course, open to debate. Many people, for example, will argue that a rainy-day cash fund should take priority over arranging insurance.

But the clear goal should be to make ALL of these important elements of financial planning explicit. Whatever order they take, a simple set of principles like these could help more of the population to become aware of the key pillars of their financial planning – namely, protection, low debt, savings, medium and long-term investments – all underpinned by regular reviews.

3.3 How much should people be saving – the 15% rule

As outlined in Part Two of this report, there is a prevalent lack of understanding as to how much individuals should be saving to safeguard their financial well-being. This is particularly dangerous given the move from final-salary to money-purchase occupational pension schemes – where the funding risk moves directly from the employer to employee.

To date, the general advice has been to save as much as possible, but this has been ineffectual in encouraging individuals to take action. We believe it is time for an official 'rule of thumb' for an appropriate level of saving for retirement.

Auto-enrolment proposals

The plans for auto-enrolment into personal accounts, planned to be introduced in 2012, has perhaps set an informal guideline for pension saving, with initial proposals suggesting a minimum overall gross contribution of 8% p.a.

However, we think this is a dangerously low guideline. Our calculations, based on certain growth assumptions and prevailing annuity rates, suggest that a male saver receiving contributions at this level from a working age as early as 25 would achieve an annual pension income equal to just under a quarter of their final salary – as Diagram 25 shows.

We therefore recommend that 15% of gross income should be promoted as the minimum ideal contribution into a pension – taking account of both individual and employer contributions.

Why a 15% rule?

We have settled on 15% for the following reasons:

- Easy to calculate – 15% is a figure that most individuals should be able to calculate easily – and adjust as their income changes over time. With the power of Government campaigns relying on simplicity, we would caution against trying to suggest a more complex amount – such as the age-related percentages that used to apply to personal pensions.

- Aspirational yet achievable – Saving 15p in the pound does not sound so unattainable that it might demotivate would-be savers. Moreover, once tax relief is taken into account, the cost is just 12p in the pound for basic-rate and 9p in the pound for higher-rate taxpayers (at 2008/09 tax rates). The cost falls further if an employee benefits from employer contribution-matching and other employer-funded contributions.

  While it may be too optimistic to hope that all individuals are willing and able to contribute this amount, it is an appropriate figure to aspire to – and we believe it would be imprudent to set aspirations any lower.

- Significant impact on pension prospects – Our calculations suggest that 15% is the level at which contributions start to have a meaningful impact on pension prospects. With a 15% contribution, even someone who has not started a pension until age 45 might be able to achieve an income of just under 20% of final salary, while a 25-year-old could achieve an index-linked pension income equivalent to more than 40% of their final salary – a reasonable retirement income to look forward to, given that most people will have other sources of income and assets, plus the state pension, in addition to their own personal or occupational pension plan.

  It is worth noting that our calculations show that an individual aged 25 should be contributing over 20% of salary to achieve the 'pension ideal' of two thirds of final salary. However, we believe that telling workers they need to be saving at least a fifth of their income in a pension is unrealistic (except where employees are enjoying very generous employer funding) and could convey the message that saving for retirement is an impossibly expensive task.

The diagram below shows what percentage of final salary a male saver could achieve as a pension income, depending on the age he starts investing and his level of gross contribution. The results of saving 15% of salary are ringed.

Diagram 25: Determining the optimum pension contribution

Source: JPMorgan
Assumptions: 7% annual investment return; 1% annual investment charges; 4% annual salary increase (based on salary increases of 1.5% above inflation of 2.5%); contributions are paid mid-year. No tax effects have been taken into account.

Annuity rates of 4.48%, 4.42% or 4.37% for a male born on 1/4/63, 1/4/73 or 1/4/83 respectively for an annuity of: single life; 5-year guarantee; monthly in advance; 4% expenses; 0.6% net interest rate, to provide RPI increases; calculated in accordance with FSA projection guidelines for pensions. Annuity rates advised by DST International Pensions & Actuarial Services Limited.

Assumes total pension fund is used to purchase annuity.

Perspective

Sports car or a pension?

The reluctance among consumers to save money for the future if it means compromising current living standards is well documented. In its initial Wealth & Assets Survey conducted July 2006-2007, the Office for National Statistics recorded that two fifths (39%) of people below state pension age agreed that they would rather have a good standard of living today than save for retirement – a figure that rises to almost half (47%) among respondents with no current pension scheme.

But could savers be more persuaded if they could see what impact a small compromise to their current living standards could have on their financial future? For example, just over one in four households (27%) run two or more cars (source: ONS 2002 General Household Survey).

If the costs of financing and running just one of these vehicles were diverted to a pension, we estimate it could boost a 25-year-old's eventual pension income at age 65 by the equivalent of almost £48,000 a year (in today's money). By running one less car, a 55-year-old could boost his pension by the equivalent of over £6,000 a year by age 65.

Diagram 26: Average cost of running a car

Cost	£
Depreciation	2,357
Fuel	1,129
Cost of finance	1,160
Insurance	446
Maintenance	273
Tax	129
RAC membership	133
Total cost (per year)	5,627
Total cost per month:	**469**

Source: RAC – Q2 2007

Diagram 27: Impact of investing the monthly cost of running a car into a pension

Starting age Investing £469 net (£586 gross)	Value of total pension fund in today's money at age 65	What pension income (in today's money) could this provide?*
Age 25	£748,426	£46,752 a year
Age 35	£454,141	£28,368 a year
Age 45	£246,827	£15,420 a year
Age 55	£100,781	£6,288 a year

*Pension income will be lower if saver chooses to take some of their pension fund as a tax-free lump sum.
Source: JPMorgan Asset Management Pension Calculator

Assumptions: Monthly investment of £469 net (£586 gross with basic-rate tax relief of 20% added on). Male investor retiring at age 65; no tax-free lump sum taken; pension annuity is index-linked, with no spouse's income; inflation rate of 2.5% used to reduce the value of the pension pot and pension; the fund growth rate used is 7% and an annual management charge of 1.5% for the first 10 years and 1% thereafter is applied. Monthly contributions are assumed to increase each year in line with inflation (2.5% each year). Pension income based on average industry annuity rates. Male life expectancy assumed to be 76.6 years. Please note that this calculation is for illustrative purposes only, it is not to be taken as investment advice and should not be relied upon to make investment decisions.

Last word:

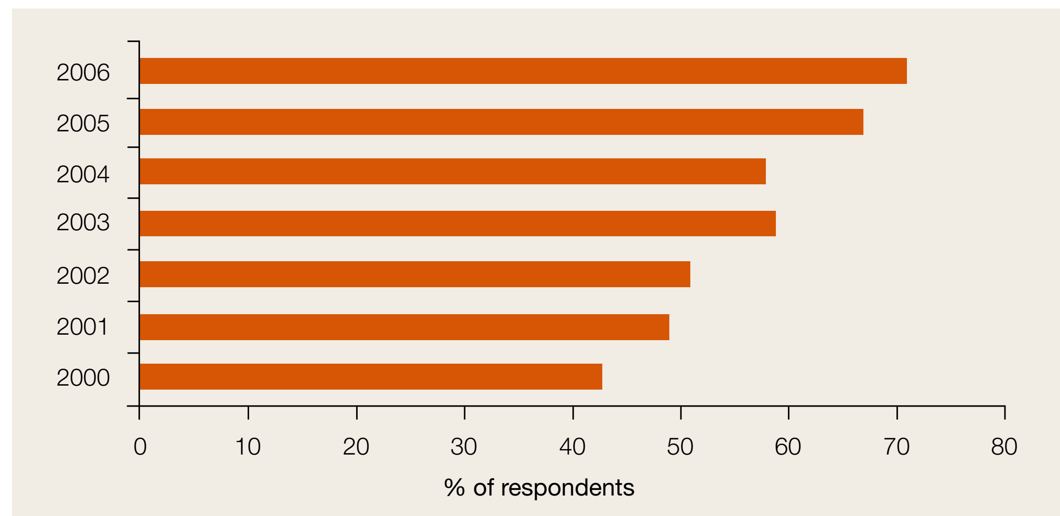
But would it work?

Learning from the Department of Health

It may seem fancifully idealistic to expect savers and investors to sit up and take notice of Government-led messaging on personal financial planning. But experience has shown that orchestrated Government campaigns are effective – even essential – in building awareness and promoting action in many aspects of our daily lives.

The Department of Health's '5 a Day' campaign to encourage greater consumption of fruit and vegetables was introduced in 2003 and metrics suggest it has been successful in promoting greater understanding of good diet.

Diagram 28: Correct knowledge of the '5 a Day' message



Source: Food Standards Agency

The Food Standards Agency's Consumer Attitudes Survey 2006 indicated, for example, that 72% of people were aware that they should eat at least five portions of fruit and vegetables a day – an awareness that has consistently increased from 43% in 2000 – with significant improvement in 2003 when the 5-a-Day campaign was first launched.

Of course, awareness is one thing; action is quite another. However, a Department of Health report also shows that the percentage of school children achieving their 5-a-Day consumption has risen from 27% in March 2004 to 44% in November 2007 – thanks to an integrated campaign that included improvement to school meals and engagement with parents.*

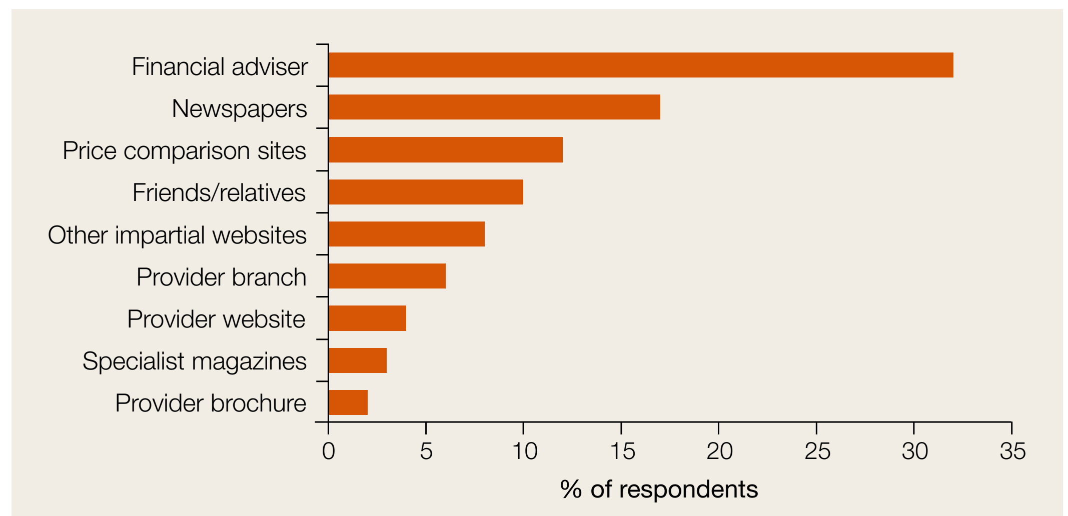
*The Further Evaluation of The School Fruit and Vegetable Scheme, Department of Health, September 2007

An integrated approach to building awareness

This last point above is key. Any guidelines on financial well-being must be disseminated through a concerted campaign using all available channels, including schools, the workplace, the press, TV, product providers and financial advisers.

Our concern is that such messaging for financial planning is often left to the private sector – and financial product providers in particular. Yet, product providers rank as one of the least-used sources of primary information among consumers, as Diagram 29 shows. (Which raises a separate question as to whether the regulatory resources spent on policing provider marketing could partially be diverted towards promoting financial well-being via the sources of financial information and advice that consumers do commonly pay attention to.

Diagram 29: Preferred sources of financial information and advice



Source: JPMorgan/TNS

While product providers, trade bodies and financial advisers can go some way in building awareness of good financial practice, they cannot be expected to operate alone. Any campaign to promote financial well-being must be centrally spearheaded by the Government, and supported by the media, to be effective.

Conclusion

Otto Thoresen, who led the recent Government-commissioned report into the provision of a national Money Guidance service, says that good money sense needs to be as much a part of people's lives as healthy eating and keeping fit. We couldn't agree more.

So, given that there are extensive official guidelines about what we should eat and how active we should be – it seems increasingly curious that there are no guidelines on how much we should save or which areas of financial planning we should prioritise.

As we have stressed throughout this report, we recognise the dangers of telling people what they should and shouldn't do with their money. And many a health worker can point to large swathes of the population who remain resolutely unmoved by million-pound Government campaigns urging them to eat five pieces of fruit and veg a day or cut back on cigarettes.

Yet these are not reasons enough for holding back from setting out clear and bold guidelines on what is and what isn't good financial practice.

Setting universal principles

We acknowledge the general view that 'everybody's financial circumstances are different'. We also recognise that defining 'good' and 'bad' personal financial planning is not so clear cut as a 'good' or 'bad' diet.

But there are basic principles of good financial planning that are universal – from reducing debt and increasing savings, to having a rainy-day fund and maximising long-term investment potential.

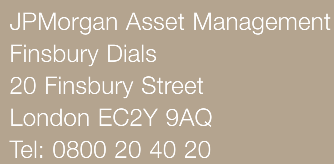
Failure to acknowledge these basic principles and focus solely on individual complexities only serves to reaffirm the idea that financial planning is always difficult and always needs specialist (in other words, expensive) advice. Better to lay down broad principles that suit 90% of the population than lay down none at all.

There are, as we have mentioned, many initiatives now taking place to improve financial capability in the UK – from Thoresen's Money Guidance service to financial education in schools, to the FSA's new array of online tools on its MoneyMadeClear website.

But all of these initiatives are predicated on individuals actively seeking out information and guidance. By underpinning such services, with consistent, bold and universal messages about good financial planning, we believe it may be possible to reach far more of the population. Otto Thoresen's own report suggests that only about 25% of the population feel they would be 'very likely' to use a free, highly accessible and highly publicised Money Guidance service. So, clearly, other mechanisms will still be required to get basic financial planning messages into the national consciousness.

Opening up debate

The ideas put forward in this report may be bold and radical. But we hope we have been able to open up further discussion into ways that the Government could be more prescriptive in its bid to improve personal financial planning in the UK. After all, if we want more people to do the right thing, the least we can do is be very clear as to what that involves.



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