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## Improving DC in the workplace

Our panel of experts asks what new regulation means for DC providers, employers and the schemes they manage

**Chair (Steve Charlton):** The first topic on the agenda is 'market and regulatory update'. At Mercer, we think there are about 14 issues at the moment that could conceivably have an impact on DC, whether that is from a regulatory, a consultation or a guidelines perspective. Interestingly, the first item on our agenda today, about the impact of the recent market volatility, is not on that list, so I thought I would ask the panel about market volatility and whether you think it has had an impact on the DC market?

**Lyne:** Market volatility has been an issue for the last 10 years or so, so it is not new. But the situation in the DC market at the moment is that we see a combination of regulatory changes, market volatility and a change in

corporate focus, but one of the biggest shifts that we face in the DC world is the introduction of NEST and what that will mean for the market. Saying that, even though DC is slightly higher on trustees' agendas, a lot of pension schemes are still focussing more on their DB schemes. This means we are not getting the innovation and we are not getting the developments in products and solutions that one would expect in DC, bearing in mind all the issues that DC schemes are facing.

**Watts-Lay:** There are a number of issues worth highlighting here. The first is the low take-up rate of DC plans and what can be done to improve that. It's the whole 'free money' argument: people don't even take contributions that are available from their

employers. If you gave someone £1,000 as a pay rise they would almost rip your arm off for it, but when it is given as a pension contribution, somehow it doesn't seem as attractive.

One approach which is beginning to gain some traction is looking at all benefits more holistically, rather than looking at just a pension scheme in isolation, and trying to segment the workforce a bit more. The problem has historically been, particularly with larger companies, that they send out their pension brochure to their 10,000 employees when they join the company and they maybe put a bit of info about it on the intranet, and that's it.

So there needs to be some stepping back on two fronts. Firstly, the company should be asking why they are offering any benefits at all, what is the gain? All benefits should be offered because companies really believe this is going to drive staff recruitment and staff retention. So there is a key cost motivation issue from the employer's

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**Chairman:**  
Steve Charlton is a Principal in Mercer's DC Leadership

team. He joined Mercer in 2008 to help further build on the depth of knowledge and experience in its DC services team. He has nearly 25 years' experience in the pensions industry with the last 15 years spent advising clients on a variety of issues from DB to DC transitions to member engagement and benefit adequacy. Steve is currently helping employers understand how they may be impacted by auto-enrolment and how they can manage any increase in pensions cost between now and 2012.



**Panel:**  
Dominic Fryer is head of strategy and risk at Friends Life.

He joined the company in 2007 having previously working for Aviva corporate benefits. Since joining he has held a number of management roles. His principal accountability is for the development of strategy across the whole of UK Corporate business including corporate pensions, group risk, and future developments in workplace savings. This includes refining the business approach to regulatory change including Pensions Reform and the Retail Distribution Review.



**Panel:**  
Dave Hodges is client relations director, at Zurich

Corporate Pensions, UK Life. Dave joined the Zurich group in 1984 and became the client relations director for Zurich Corporate Pensions in 2006. He is responsible for managing relationships with existing clients and transitioning new clients into Zurich. Dave is a member of the ZCP executive, chair of the client services committee and a UK Life accredited media spokesperson for corporate pensions. He is also a trustee of the Zurich Financial Services UK Pensions Fund.



**Panel:**  
Julian Lyne is head of global consultants & UK institutional

at F&C Asset Management. Julian joined F&C in June 2008 and is responsible for managing the UK institutional business and relationships with the global consultants. Prior to this, he had worked for HSBC Investments since 2003 latterly as head of global consultant relations and was previously head of UK institutional business. Julian has a BSc Hons in Psychology from City University, London. Julian is also a judge for this year's European Pensions Awards 2011.

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perspective.

But then you look at things from the employee's perspective and, for a 25 year old, a pension may not be the most attractive thing in the world, whereas there may well be some other benefits that can ultimately feed a pension, like a Save as You Earn (SAYE) scheme. Such a scheme gives the employee some accessibility to cash, and then ultimately if they don't use that cash for buying a car or putting a deposit on a flat or whatever, it might motivate them to transfer some or all of that into a pension.



**Panel:** Jonathan Watts-Lay is founding director at WEALTH at work. He is at the forefront of the

latest developments in the use of financial education and the provision of savings within the workplace. With a background in both financial and online HR services Jonathan has 20 years experience of innovative thought leadership in these areas. Jonathan is widely quoted in the media for his expertise in workplace education and has been responsible for many of the corporate clients secured by WEALTH at work. His qualifications include a MBA and a Chartered member of the Chartered Institute of Marketing.

So we need to reconfigure how people think about pensions as part of an overall benefit rather than pensions in isolation.

**Chairman:** At Mercer, we have been looking at ways in which we can better communicate and make communication easier, simpler and more effective, but we still face the challenge of getting people to actually learn.

**Fryer:** At Friends Life, we have done a lot of work around what it takes to get people more engaged. Some people don't trust 'pensions' as a brand and for others it doesn't meet their current financial needs. I think that relates back to which employees join a pension scheme today. Take-up on employer-sponsored schemes is directly correlated with different socio-economic groups. If we segment the workforce, there are parts that are engaged with pensions and who want to join the scheme, and there are others that have different objectives, for example they might want access to capital. So we are seeing a trend whereby some of the bigger employers want something to sit alongside pensions where employees can get access to capital to fund other things in their lives, like trying to save to buy a house, or looking at options such as share investment schemes.

We work with some employers where there is a very high take-up on those types of arrangements, but when

compared with a pension scheme, unfortunately there just hasn't been the same sort of interest.

To get more engagement it is essential to offer a benefits package that the employees value. You can do this by working with employers to actually understand their workforce and align the communications with the right groups. All the research that we have done agrees that communication should be tailored and also that employees do value guidance and advice at certain points in their lifetime.

**Chairman:** Dave [Hodges], you must have an awful lot of conversations with employers about exactly what they want to offer their employees. Have you had any thoughts on what type of products should be available on corporate platforms which are not necessarily purely DC?

**Hodges:** A well as pensions there are a number of tax efficient savings products such as stocks and shares ISAs, cash ISAs and more general investment products aimed at meeting short, medium or long-term savings goals. However by offering such choice I think there is an element of paternalism that is still required both from the state and the employer who need to have the mindset of: "I am going to give you this choice, but by giving you this choice comes some responsibility". If employees haven't got the information, guidance or advice they need to make the right decision or don't have the aptitude to make that decision, then we potentially have got a catastrophe in the waiting and that choice will have been wasted.

**Lyne:** Picking up on the segmentation point, I think the key focus has to be on employer segmentation. The industry is looking at offering things like corporate wraps, and so on, and there will be those

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employers who don't think these things are appropriate in their circumstances and the circumstances of their employees. They feel they are already giving someone a job so they will either just offer a 'straightforward' pension or refer them to NEST. And then there are the others. How does that pan out?

**Watts-Lay:** Well, it depends on the type of employer too, not just the size. People normally make a distinction between large employers and small employers, and there is an element of that, but there is another distinction which is the type of employee you have. So that consideration goes back to that fundamental question as to why an employer is offering the benefits they are offering at all? It is a great point in time for a lot of companies to take a bit of a rain check and think: actually why are we doing this?

**Fryer:** I think some employers are taking a step back. It is interesting when you look at the figures in this country. From 1.2 million employers currently in the UK, about 800,000 are micro employers and about 15% of them have pensions. So that is very much the target market that NEST is aiming to capture. But that isn't the part of the market that has typically been serviced by private pension providers.

All the planned regulatory and legislative changes are going to improve participation in pension schemes in the UK and, over time, undoubtedly that is a good thing because it is going to get more people saving for their retirement.

For those employers that have been offering pensions for a long time, NEST will mean they will want to ensure that they are differentiating away from what might be perceived as a standard pension arrangement

**Hodges:** I think the introduction of

auto-enrolment and NEST indicates that common sense is starting to prevail in the area of pensions policy. I am not saying for one minute that things are perfect, but the use of auto-enrolment is sensible. The big risk with NEST is that it starts to wander from its target market. In its most basic form, auto-enrolment and NEST should be bringing in those people who don't otherwise save into pensions. Using the auto-enrolment and the opt-out mechanism rather than relying on financial education is positive. Auto-enrolment throws them into the deep end of the swimming pool and the opt-out lets them get out if they really want to. It sounds harsh but it works. So it is good to see this thread of common sense finally coming through pensions policy which is very helpful to the general take-up rate of pensions.

**Watts-Lay:** Getting rid of the retirement age is another thread if you like, as some companies are bothered about it and it will make them think a little bit harder in terms of making sure people are saving and don't opt out because there is an inherent interest for that employer.

#### NEST

**Chairman:** What do we think of NEST in general? Do we think it will be a success?

**Lyne:** You need to applaud the fact that, at a basic level, it is targeting a market which historically has not only never saved for retirement, but never saved at all. Whilst this in itself presents its own challenges, it will be interesting to see what it will mean for the savings industry in the long-run - if NEST broadens the target market and whether they allow various opt-ins and contribution rates and so on.

But at a higher level, you need to agree that it is a positive step. The risks are the broadening of the remit and the

over-simplification of employer pensions. Of course, it will clearly also create a whole series of standards - not meaning high standards but standards in terms of contribution levels, fund selection, fees and communication and service levels. So, I think it is positive but it will be interesting to see how it develops.

I also think one of the key challenges will be the fees, and while having low fees is important, if you think about the levels of low fees that have been discussed, you do worry about how you are going to deliver the value-added education and vital communication elements that you are going to need to support the members.

**Fryer:** NEST, as it stands currently, has been targeted at this segment that hasn't been well served by the private sector. People will be auto-enrolled into these schemes and there will be a substantial increase in scheme participation and an increase in the number of paid up policies, so it makes sense for the industry to come up with a solution to allow transfers in a very streamlined way, even if they set a limit of £2,000 for example.

For a lot of employers, NEST, with its contribution limits of £3,600 and more complicated charging structure will not be a suitable solution for all their employees. Some employers, for example, are thinking about using NEST as a probationary vehicle to auto-enrol into NEST and then move into their main pension scheme thereafter.

The research we have done is still showing that a lot of employers are not actually making decisions and don't know how they are going to deal with the increased costs of auto-enrolment.

It's also worth mentioning that the workplace of the future is going to offer a range of different benefits. If we go back 10 years, employers offered a pension as their primary benefit. In the

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future, because of the changes in requirements of employees, they are becoming more challenging, wanting better value, wanting flexibility, wanting solutions that are tailored for them. That is something that the private sector is best placed to deliver, but I think NEST will be very successful in their segment of the market, subject to systems and infrastructure delivery.

**Hodges:** We all seem to agree that NEST is a good thing for its target market, but it is a problem when the legislation draws clients away from the target market and disrupts genuinely paternalistic employers in the execution of their pension strategy. There are a number of schemes out there that are trust-based, some of which are auto-enrolling already, so they are already operating a scheme that is equivalent to or better than NEST. However, they often have different eligibility periods and the contribution rates are at different levels. Quite often they have a substantial population who have already opted out and will need to deal with a repeated requirement to let them opt out every three years. These are practical and pragmatic points that employers have got to wrestle with.

What I have found from discussions with most larger employers is that actually they don't want to use NEST as part of the solution. NEST is not designed for them particularly and they don't want it. So for them it's all about how to work their way around the auto-enrolment legislation and that is providing some practical challenges. In the 'annual management charge' world that we live in, if you do the maths, actually the problems aren't around the opt-out process (although that could be better and cheaper), but it is the staging of the contribution levels and the question of whether an employer bites the bullet and moves to



a full scheme contribution on the whole of the salary from day one, which will be more expensive, or does the employer move at a later date, only when he is compelled to?

**Watts-Lay:** I think there is another opportunity there. With the use of technology now, you should be able to put a pension - something like a group SIPP - in place at a very low cost, but it should also have the additional benefit of building in the other benefits that the employer offers. So, for example, allowing seamless online in specie transfers of shares into pensions, allowing people to go in and change their contributions etc; and if you have got that true flexibility, you end up in a world where companies will be increasingly asking themselves why they even need a traditional DC plan at all, if a platform can deliver more value to members at a lower cost than DC.

I think therefore auto-enrolment creates a fantastic opportunity for mid to large companies that want to grasp it. Companies, of course, do not make those sorts of decisions overnight, so there is clearly a timeframe on all of this. But it starts changing the mindset of those larger employers.

**Chairman:** How does that concept work for a company that has a segmented workforce and a range of employees, some of whom want that flexibility and others for whom NEST is the right choice?

**Watts-Lay:** We are already seeing

that segmentation. Right now, one of the things that we are busiest with is dealing with senior executives in companies who won't be able to pay any more into their pensions come April. So you have already got that segmentation starting to happen at the top end. Then you have got this mass in the middle, who may belong to a pension scheme, where pension contributions might be around the 12% level; and then you have people who have never joined a scheme before who are going to be auto-enrolled. I think those are the people that represent a challenge because you have got to justify to those people that this 4% of their income ultimately is going to be money well spent.

**Hodges:** I think we are all in the same place in terms of where the future lies - and agree that corporate wraps are the way to go - but I am just not sure that all the corporate entities in the UK are there yet. There is a segment of industry that is ready for that move but there are an awful lot of industries that are nowhere near a full corporate wrap solution yet.

**Lyne:** What I am hearing from the industry is that companies don't always see the corporate wrap platform as offering a win-win scenario for the employer and employee, because there is a cost incurred from an employer's standpoint, there is a risk from an employer's standpoint. They can either do nothing and reduce their costs and reduce their governance requirements, or they can offer a full range of financial services and take on board the governance issues, the threat of litigation ten years down the line when one of the policies blows up.

**Chairman:** With the implementation of a corporate wrap platform, is there going to be an increased upward pressure on costs for the employer because even more people are going to

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be receiving these benefits? And because pension pots are unlikely to be adequate when people come to retire, doesn't that put more pressure on employers who are unable to force these people out of the workplace?

**Watts-Lay:** Potentially it is not an upward but a downward pressure on costs. We have spoken to some companies who have said that if they get their benefits right, and provide the right flexibility allowing people to choose what they want, when they want it, they can actually reduce the overall cost of the benefit provision that they have right now, because what they will do is make it more attractive to employees but make it more system driven and thus more cost effective.

The other piece around that is, even if your costs remain flat, can you drive more value for the employees? And in a lot of cases you can.

**Hodges:** I think we all agree that choice is a good thing but so far, amongst larger employers, I think there is a paternalistic view about how we can adopt auto-enrolment into our organisation but in a way that plays well to our brand value and at the same time keeps the CFO happy.

**Chairman:** But will an employer feel paternalistic towards this portion of its workforce that it historically hasn't been looking after at all, to whom it now has to offer a pension scheme? Or will that employer say, actually, the NEST brand is fine for those individuals?

**Hodges:** You would have thought that would be the case but, so far, the larger employers' starting position is 'I want them in our strategic arrangement', which is interesting. I wouldn't have foreseen that because this is a population of employees who are not in a pension scheme because they decided not to join the current option as opposed to being deliberately



missed out.

**Chairman:** If we have got fewer providers providing more auto-enrolment schemes to more employers, how do we as an industry cope with the resources to be able to do it? I am not talking about the largest employers who will need to auto-enrol in October and November of 2012, but when we get through to the beginning of 2013 and then to the summer of 2013, by which time we have done most of the larger modest-sized employers. You have probably got 100,000 of those 1.2 million employers to auto-enrol in the first 6 months of 2013, so how do we as an industry gear up to be able to accommodate all of our clients' needs so that they can achieve compliance within their staging dates?

**Fryer:** That is a challenge for the industry and using technology effectively can help meet that challenge. A lot of providers have made big steps towards increasing the level of straight-through-processing. In my experience, in those schemes that are auto-enrolling already, the take-up is significantly ahead of where it has been through opt-in, to the extent that if we think about the level of participation post auto-enrolment, it may be as high as 85% or 90% for certain industry sectors.

#### Annuities

**Chairman:** The next topic on our agenda is the impact of the new legislation surrounding annuities in the DC market and whether that will drive more innovation in that space.

Also, do we think the £20,000 income is adequate?

**Fryer:** If you take that point around the £20,000 income then that probably translates at the moment to something like a pot of £380,000/£400,000.

**Chairman:** If that was just based on the income arising from that pot itself, but if you then take off state benefits from that £20,000, and maybe some legacy of a DB benefit, then it starts to get smaller.

**Fryer:** But in context, it is still going to be the exception rather than the rule. Most people will not have funds of this size, so the big change for me is this movement of assets into DC pensions. We have seen the shift already for defined benefit schemes closing for future accrual, moving into the DC environment. We have got this huge auto-enrolment impact, so a sizeable increase in contributions, all driving up participation of DC pensions. And when we look at the supply of annuities in the UK, you could see a situation in a number of years time where there isn't enough supply. We don't have enough annuity participants in the UK to deal with the size of assets and people coming up to retirement. That probably means that the cost of annuities potentially increases but also that the annuity options out there and the choices become a lot wider because of innovation in the product offerings.

That also goes hand in hand though with the need for more advice.

**Hodges:** I think that one of the trends that we are seeing is a move towards introducing more annuity bureaux for members of DC schemes. The advantage at the retirement stage, compared to at any other stage of the member's lifecycle, is that - with the larger funds anyway - there are sufficient funds to pay for some form of guidance or advice to the member.

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That's very helpful because we are seeing an emerging push by bodies like the ABI and regulators for the increased use of the open market option. We are now seeing more and more trustees and indeed sponsoring employers wanting to put in place some sort of annuity bureau type service. It may not always be a full open market, full advice type service, but at least it is a preferred provider/wider choice type of service.

So there are improvements all the time there. Again I like this thread of common sense with the £20,000 minimum for the very reason that if you are going to use drawdown, you do need advice. What this minimum does is ensure that the people that use flexible drawdown have the sort of fund size where actually the advice is more affordable. That's a good thing because the big risk is that the wrong people get pushed into flexible drawdown.

**Watts-Lay:** The road that we are taking with a lot of our clients is helping them provide good financial education to their employees as they are coming up to retirement - so signposting - helping people to understand broadly what options are on the table, and helping them make some sort of informed choice.

**Platforms**

**Chairman:** We have talked about platforms already - will we ever get to a point whereby we can put all the communications together and make choices and decisions as easy as possible for members?

**Fryer:** Platforms are an ideal mechanism to offer holistic workplace benefits. Having a platform where you have got a very broad range of products and propositions gives you the right balance to run the business more effectively from a provider's point of view. At the same time, from the

employer perspective, if they can get access to a really good quality range of products, that covers a wider group of workplace savings facilities, then I think that can reduce cost and deliver a more attractive package for employees

The communication can also become more holistic - we talk about a lot of different products sometimes in our industry and given names like ISAs, pensions and share savings schemes but they are all just tax efficient savings vehicles. So the platform can enable different communication and can bring together a range of benefits and allow the members to self serve some of those as well as provide some of the signposting as people move into different phases of their life.

At the moment, I don't think there are any fully fledged platforms that are really taking the market share, and the feedback we consistently get from some employers is that they don't want to be the first ones on there. So, whilst the wrap platform may be the right commercial model for the future, it will take a number of years to become the natural choice for employers.

**Hodges:** One thing we haven't mentioned today is the reality that when all these individual members get to retirement, they are long gone from the company they worked for when they joined the platform. So of course there is a big communication piece needed at the point of joining, but as you go through the lifecycle of the individual member, they will have been with multiple employers during that lifetime and it is really important that the communication from the provider brings all these benefits and savings together sufficiently well to allow individuals to make informed decisions.

**Watts-Lay:** For me you have got to

have that education up-front: do people understand the basic principles of tax efficient saving? Then the platform itself should be the enabler piece that allows you to mitigate the tax, or if you want to keep your company stock, you can keep it, if you want to diversify it, fine, but you do it within the tax haven, the ISA or pension.

**Lyne:** From my stand-point, platforms offer a real opportunity to actually finally deliver something that genuinely provides a much more holistic view of a members financial position, and that has to be a good thing - the challenge is that as an industry we don't have a fantastic track record of delivering, certainly not for members anyway. Maybe the wrap platform developments could be an opportunity to confound that reputation and improve that image, by actually delivering for members the level of support and service that everyone believes is possible - and if we do that then the DC industry will be in far better shape as we move beyond NEST and into the future.

**Chair:** Today we have heard from all parts of the DC market: providers, consultants and investment managers and we all agree that we stand at a point of major change in the DC landscape. But what is also clear is that each party is committed to making DC in the workplace better for members and employers by pushing for innovation, whether that is through improving investment options to better manage volatility, or better targeted communication to help achieve adequacy of benefits.

We are also equally convinced that corporate platforms will have their part to play in achieving this aim as we enter a period where millions more savers will be introduced to pensions for the very first time.