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## DC's time to shine

Our panel of experts explain why the reputation of defined contribution has taken a turn for the better

**Chair [Emma Douglas]:** It really is a big time for change in DC – now perhaps more than ever. Whether we are talking about auto-enrolment, the minimum income requirement and what that does to annuities and drawdown, or whether it's the fact that workplace savings platforms are now becoming a reality, all these things add up to change.

The first question on our agenda relates to some feedback that Pensions Age has had in relation to DC – that sentiment is positive in the DC space. Do we agree? Are we feeling upbeat about what's going on?

**Lyne:** A few weeks ago I was at a conference where there was a debate about DC's inability to replace DB. What was interesting was that, when

they did the voting beforehand, the majority felt that DC wouldn't be able to actually replicate DB, but after the debate, the DC vote won out.

People were talking in a much more considered way about the brutal realities of the pensions world today – it's not a question of 'if' DC is the answer; DC is the answer. What you are getting today is more innovation in terms of platforms, innovation on the investment side and so on. We are making real progress in terms of getting the right solutions in place.

**Watts-Lay:** We went through a period where companies moved from DB to DC and, because DC was still deemed as an inferior option, there was a tendency for HR, reward or pensions departments to do as little

communication around it as possible, because it was always a bad news story.

Over the last few years, however, there's been a heightened reality that employees really do need to start saving, and DC is going to be part of that. Employers are now starting to think about what messages they need to be communicating to their employees in order to raise awareness of DC and workplace savings generally.

**Chair:** DC isn't an embarrassing secret anymore. You can actually talk about it which is good.

**Hodges:** We have been through an extended period of bad news stories – DB schemes closing, state benefits being reduced, company contributions being cut – so it's not surprising there has been some disengagement with pensions. What pleases me, though, is that the elements are starting to come together to make DC more workable because, like it or not, responsibility has shifted to employees.

I'm a big fan of auto-enrolment; I'm

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**Chair:** Emma Douglas is UK leader for Mercer workplace savings. She previously

worked at BlackRock where she was head of DC sales, responsible for sales strategy and execution for their bundled and investment-only business as well as the management of DC client relationships and leadership of their comms team. Prior to this, Emma was head of DC pensions and institutional client relationships at Threadneedle Asset Management. She is a co-optee on the NAPF Retirement Policy Council and on the Advisory Panel for the new FTSE DC Default indices.



**Panel:** Martin Palmer is head of marketing, corporate, at Friends Life.

He joined Friends Provident in 1987 and held a variety of different roles across the company. He is currently responsible for the development and communication of Friends Life's corporate pensions and savings proposition and policy, as well as the development and delivery of Friends Life's member engagement and communications proposition. Friends Life is a new group that brings together the UK business of Friends Provident and part of AXA's UK life and pensions business.



**Panel:** Dave Hodges is client relations and services director at

Zurich Financial Services. 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:** Paul Healey is head of workplace savings at AEGON, a

new role which will see his involvement in developing a platform for the firm. Healey has been with the company in a variety of roles for more than fifteen years. Prior to this newly held position, Paul was corporate account director at AEGON. Before joining the firm, Paul was a pension consultant at Standard Life for a number of years. Paul is passionate about the future of pensions and workplace savings, and is a regular contributor to the press, at industry events and roundtables.



a big fan of default positions for young people who aren't that interested in pensions; and I'm a big fan of multiple methods of engaging with employees through workplace savings and making available flexible choices throughout the lifetime of their plans. Legislation is starting to become supportive to this goal and that's good to see – for example, getting rid of fixed rules around retirement ages and flexible annuity rules are great, but including a £20,000 buffer is sensible legislation to me and it encourages people's interest.

**Palmer:** The real test will be when

auto-enrolment comes in because that is when the media are going to make or break it. If it comes in and there are loads of negative stories about it, that's going to have a big impact on NEST, on auto-enrolment and on the pensions industry as a whole. What's promising from our perspective is to hear employers saying things like "we don't want to go to NEST, we want to use the existing provision we have in place," because that shows we are doing something that employers actually value. It's fantastic that DC is also getting much more attention on the regulatory side, compared to the past.

So, on the whole, there is a positive sentiment but we are still on a journey.

**Rowlands:** The brutal reality is that there is no alternative. People can talk about other alternatives but the majority of employers aren't going to go for them, and if employers don't go for them, what's left is DC.

DC over the last 15 years has been going through an evolution, from being

a poor relation with basic scheme designs, to what we are doing now which is making it much more fit for purpose. A lot of energy has gone into designing contribution structures, better fund solutions, better default designs, integrating everything onto platforms so there is more communication available so members do start to engage. Now that people are starting to come out of the savings period, to actually take their pension, the industry is starting to react. There's some legislative flexibility coming in there too which is all good because, at the end of the day, pensions is all about replacing income.

**NEST and auto-enrolment**

**Chair:** Moving on to auto-enrolment, what are you seeing in the marketplace? Are schemes talking about this yet or is auto-enrolment the big issue that no one is really engaging with?

**Healey:** Larger employers are starting to become more aware – they

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**Panel:** Julian Lyne is head of global consultants and 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 was also a judge for this year's European Pensions Awards 2011.



**Panel:** Mark Rowlands is head of financial institutions at Partnership

Assurance, the longest established UK insurer specialising in the design and manufacture of financial products for people whose health and lifestyle means that their life expectancy is likely to be reduced. He has spent his working career in financial services specialising in DC pensions in numerous senior roles including business development, strategy and marketing. Mark is focused on improving retirement through improvements in the decumulation stage.



**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 an MBA.

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have a budget for auto-enrolment. Further down the chain, though, it's early days. NEST itself is talking to about 50 employers about starting over the summer with a NEST product. NEST have also been very clear that they don't want to compete with the private sector, they only want to complement it, and they have started to talk to providers about forging links to run NEST alongside existing DC schemes.

**Chair:** How engaged are employers in terms of auto-enrolment?

**Watts-Lay:** There's a bit of a mixed bag. When it comes to the big companies, it depends on which type of company you are talking to. I have been talking to big companies that employ some low paid people who are not currently part of the corporate pension provision and, while it's on their agendas and they know they need to do something about it, they are just trying to find the cheapest way to deal with this. These companies will end up going with NEST for this portion of their workforce.

When you go down to smaller companies, some don't have any idea whatsoever of what's coming up and it will come as a complete surprise to them when somebody sends them something saying: 'Why aren't your people in a pension?'

Others, though, are starting to wake up to it but simply do not know the implications. That's partly because a lot of the small to medium-sized companies not only do not have pension managers, but they don't even have HR managers. So who's actually looking at this stuff and picking this up for them?

**Palmer:** The DWP, TPR and similar groups are going out and talking to people about what the implications of auto-enrolment are, but we need to be getting people together to talk about

how it's actually going to work as a joined-up experience for employers and members. Some of the TPR requirements on employers are quite onerous and employers are assuming their pensions provider or their payroll provider will deal with it. The reality is, though, that all three have a role to play, so the key is actually joining all that up and making sure that there is a clear strategy. I'm not sure that's happening at the moment. We haven't got long to go either – in fact, it is actually quite worrying how little time there is before this goes live.

**Chair:** What worries me is that in 2013, practically every company in the UK, from 50,000 employees down to 500 employees, has a staging date. How is that going to happen? Isn't there going to be an almighty traffic jam of people who haven't thought about it, think about it too late, and then are rushing around trying to get advice and solutions from us? There's a finite level of supply in the industry.

**Hodges:** There are some real challenges with auto-enrolment. A lot of conversations have taken place and many of the bigger companies are clear in their own minds that NEST is generally not the answer for them.

But the real challenges haven't yet been overcome and this includes the challenge to providers of the average salary coming down. I haven't seen too much evidence as yet of levelling down which is encouraging. Nonetheless I think the challenges around average salaries and average contributions dropping, and therefore the pressure being put on pricing, are ones that need to be addressed.

**Palmer:** In my opinion, small pots will be one of the ultimate challenges that we'll have to deal with. People are going to be putting in two or three contributions before realising they have been opted in automatically, and



then they may stop. That would result in lots of these £200 – £300 pots with providers and we will have to find a way of moving that money around and accumulating it.

**Rowlands:** Do you not think the ban on transfers will be removed in 2018?

**Palmer:** I'm sure that will happen, but I'm not sure it's just about the ban, it's about the process. We've got to find a way of simplifying the transfer process. The DWP is going to have to start looking at this issue because we can't make it difficult for someone who has got £500 to move it from one place to another.

**Watts-Lay:** The same issues are going to crop up in industries where there is a high turnover, such as retail. People will end up with lots of small pots because they might only stay with an employer for two to three years, and their salary might be quite low so their contributions will be low.

**Lyne:** If we don't get employers thinking about all this constructively and proactively there's a danger that they will just default to the lowest common denominator and that's not what anyone wants, be it NEST or any other solution.

**Chair:** What about how employees are going to perceive this? Is there a danger that because people who didn't join a pension are now going to be auto-enrolled, we're actually going to lose some of this positive momentum around DC?

**Healey:** The press is going to be a



huge driver in this but also what's being said in the pub, what the man on the street is saying about auto-enrolment and pensions. Word of mouth is a very powerful thing and the right messages need to be out there.

**Palmer:** We've also got to think about when we engage people and what information we give to them at various stages. At the moment, when we set up a new scheme we send our worksite team out to provide financial education and convince members about the merits of joining the pension scheme.

The reality is, in the new world, that might be relevant for some employers, but for others it may not be viable. It may be more sensible to try and get these messages across online. It might actually be that employees don't need that much information at this stage – maybe it's enough that they understand why they should save into a pension and it might be better to go out and engage those employees two or three years down the line when they've got a reasonable pot and they've actually got some decisions to be making.

We must not forget that we are dealing with a totally new population of individuals here and we have to start thinking about how we engage with them, what kind of media we use and what messages we want to get across.

**Hodges:** I have slightly different views about employees. I think at best they'll be lukewarm and at worst apathetic. Auto-enrolment is not a new concept – it has been operating in occupational pension schemes for a very long time and take-up has been high. So I don't think employees will see it in a very negative light – unfortunately I don't think employees feel that strongly about pensions.

**Watts-Lay:** It depends on who these people are and the salary level they are

on. There's always the danger that all people will see at the end of the month is that they've got less money and if they don't know why that is, then they are going to phone their payroll department and ask questions.

So, as an employer, you either take the view that you've got to do this anyway, so you might as well make the most of it; communicate it to your staff in whatever way is deemed right in the hope that at least some of them will see the value in it.

Or you take a more negative view and you don't communicate the benefits, which will cause problems.

**Lyne:** One of the things we always talk about is having financial education in schools and what NEST does is give you a central pension scheme that everyone will be touched by – a vehicle on which to hang our education hat.

**Rowlands:** We have a wonderful opportunity to start putting pensions in a positive light and our industry is making the mistake of thinking people are stupid. People aren't stupid – they know they need to save for the future, but what we've failed to do is find effective ways of delivering that. What auto-enrolment will do is actually force and encourage them to save. Now if the communication is right, the evidence from auto-enrolment both in the occupational market here, the States and Australia is that people can actually be quite thankful that somebody has taken that problem off their shoulders.



So, if we can get a message across that says: "This problem has been taken away – you are in a pension scheme, your employer is putting some money in and yes it's not enough, but it's a start", then we actually get positivism back into pensions.

**Workplace savings**

**Chair:** That's a very strong message. My only counter to that would be whether it is right that everyone should be in a pension? Is a pension the only option that we should be giving people in the workplace? This leads us on to the topic of workplace savings. It is great that we are going to be auto-enrolling people into pensions, so let's make the most of it, but do we think there is more to life than pensions, particularly if you think about the differing generations in the workforce, their differing needs, and so on?

**Lyne:** The market segmentation point is important and you need to understand the means of your workforce. If you've got a sufficient income, then you clearly have a range of more flexible options available to you, such as investing in an ISA; but if you haven't then a pension, which locks your money in for the long-term, has to be the right answer, however painful a message that may be.

**Hodges:** We've got to get away from talking about retirement savings and talk more holistically about savings full stop. What the workplace savings concept does is give you a range of other savings options which are more accessible than pensions. I think that's one of the key attractions here.

**Healey:** The workplace is also a good place to start because most employees trust their employer more than they do their advisor, and if you can get people into a savings habit by deducting from their payroll, then you are more likely to create a savings

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culture, even if it's a short-term one with them investing in an ISA or something similar.

**Palmer:** The difficulty we have in this environment is that people are living longer and they are working longer, but ironically they are much more short-term in their way of thinking. The way they think about job security, for example, is nowhere near what it used to be. When DB pension schemes were the norm, people used to stay in their jobs for 20 or 30 years. People today have much shorter-term time horizons and so it is a challenge trying to engage these people with pensions, especially at a young age, as they will have to be working for 40 years or so before they'll be able to access that money.

Therefore it will be more relevant to them if we engage them in other short-term savings options which could be made available in the workplace. Yes, there is a danger that they will spend those savings if they are not tied up in a pensions vehicle, but at least we are getting them into savings.

**Watts-Lay:** You're right. The one thing that people often miss is the fact that they can drive more value and more savings in the workplace than they realise. This can be in relation to any salary sacrifice benefit – for example, where people take up things like childcare vouchers, if they made a £500 tax and NI saving on those vouchers, they could effectively put it into a share incentive plan, and because their company might match one for one, it turns into a £1,000, plus they receive another lot of tax and NI saving on the contribution to the share scheme. What a great way to encourage workplace savings.

The employer should feel happy because actually it is the tax system driving most of that benefit, and the employee should feel happy because,

not only have they got their childcare vouchers, but they have turned that saving into something much greater which should further encourage a savings culture.

**Healey:** The DC positive on that when you introduce things like 'flex' and 'bike to work' and childcare vouchers, even though you've got a massive difference compared to what traditionally has gone into DB versus DC, people will still start to engage more in the benefit.

**Lyne:** But my point is about segmentation of the market – you are talking about people who pay £500 for childcare whereas I am talking about the group of people who have never saved – that's the segment of the market which poses the biggest challenge. It is going to be very difficult to make them start saving.

**Rowlands:** That's why compulsion may ultimately be the answer. The Government is trying to take a soft approach with auto-enrolment but they will take a harder stance if it doesn't work.

I think auto-enrolment will be a huge success personally, although I agree there may be a need for compulsion for that group of people who have never saved and for the smallest employers. The challenge is that we are a spending society rather than a saving society – people like to have things and they don't like to save. In the workplace, though, we have a wonderful opportunity to try to encourage savings.



**Healey:** Inertia should help with auto-enrolment.

**Watts-Lay:** Whatever is done in terms of advertising around auto-enrolment and NEST is key because, whether people save because of inertia or whatever reason, if that campaign is done well, it might stop a lot of people opting out.

**Palmer:** Also, one of the biggest challenges that we face in the current environment is the fact that people's real salaries are actually falling and encouraging them to dip into their dwindling salaries to fund a pension is going to be tougher than ever.

**Hodges:** I agree with the segmentation point, but this was never meant to be the silver bullet to deal with that lower tier – there is a segment of the UK population that isn't in employment at all and earn so little that even auto-enrolment doesn't touch them. These tools are about getting the average savings ratio up and making less people a burden on the state going forwards in order to meet the longevity challenge.

That's why I see this as being positive because the best way to engage individuals and make them more interested is to tell them that they have got a pot of £5,000 or £10,000 sitting there. This is achievable once people have been auto-enrolled for a few years, and that's a big step forward from where we've been.

**Rowlands:** That's intuitively correct but I've yet to see any evidence from any country that shows people start actively managing pots of money when a fund gets to a certain size. I hope it works but I just don't believe it will happen without some really forceful education.

**Healey:** I disagree. I think they are more likely to engage with an ISA when they have got a more sizable pot, and similarly once you've got a sizeable



shred of your salary in your pension fund, that's when you need to engage an advisor about proper planning.

**Rowlands:** Aspirationally that's correct, but where's the evidence that actually happens?

**Hodges:** Some things you have to instinctively rely on don't you? If someone sends me a letter about £20 and someone else sends me a letter about £50,000, I am going to be more interested in the £50,000. I'm an average human being and I think most people would instinctively agree.

**Chair:** I agree that there isn't much evidence to show that people engage more when their pots become more sizeable, but the question we should be asking is whether we actually want them to? Do we want them to actively engage in making investment decisions off their own backs? Can we make people better investors because they've got £50,000 in their pots? 'No' would be my answer but maybe at that point we would want to offer them some extra services, such as advice.

**Hodges:** Yes I would agree but I think it's the understanding of where the responsibility lies that is the risk here. You almost don't want people to take action because they may be ill-equipped to do so – you don't want them making reckless decisions. That's why defaults in the early stages are so important.

**Healey:** The internet will help here because if you look at some of the software being developed now and look

at people's buying and spending habits, and the way they budget month to month, you can really start to narrow things down to the short-term, medium-term and longer-term. So there are more opportunities to get certain messages across to people with the internet.

**Retirement options**

**Chair:** Let's move on to retirement income options because this is a whole new area of the market now. Again we've got some potentially quite sensible legislation coming through which could help us create new ideas that could be appealing to employees.

**Lyne:** What is interesting for me is that, in all of the years I've been in DC, the whole concept of DC members actually retiring has never really been broached. We've done some work in this area because a client came to us and said they wanted a better solution for the annuity matching piece. So in the last two years we have built a solution that tries to supersede and improve long-dated gilt funds as annuity matching, and the response to it has been very encouraging.

**Healey:** The challenge for employees though is the fact that these new type of fund structures are complex, compared to an annuity that is fixed.

**Lyne:** But these themes can be put in reasonably straightforward ways that people understand by asking three simple questions: "You are in a default fund did you know that? When are you going to retire? What sort of annuity and what sort of income are you retiring on?" Three questions which I think elicit an effective decision as opposed to allowing people to get to retirement only to ask the question, "right, what now?" That's what the trustees of this particular scheme are interested in doing – making sure the

right questions are raised early enough to allow people to make effective decisions.

**Palmer:** That is key – you can spend a lot of time looking at lifestyle funds and default funds but, invariably, people end up in the wrong fund because they picked a retirement age 30 years ago and it's targeted to that date, be it 55 or 60, which might be completely unreasonable for that individual. We need to find a way of getting back in touch with those individuals so we can try to design something around their actual requirements.

**Lyne:** Target-dated funds give the illusion of certainty of when you're going to retire but the one certainty that we have is that we don't know when we are going to retire.

**Watts-Lay:** That is why everyone involved – the employee and the employer – really needs to start re-thinking the whole retirement piece. Not only should people have some sort of handle on what they are likely to get on retirement, but they need to understand whether they actually want to retire at a particular age, or whether they want to take flexible retirement, for example. People do not have their heads around these sorts of things.

**Hodges:** One discussion we haven't touched on today is around roles and responsibilities and governance. We all know that we have to simplify the messaging, whether that is in relation to annuity products, defaults etc. With that comes greater responsibility on those charged with design.

Certainly as you come into the decumulation phase, I feel that some sort of advice is essential because it's just so complicated and there is a lot more choice now.

The good news is that those who have more than £20,000 are probably in the best place to afford some sort of

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advice; and that accumulated pot gives you some room to pay for it as well. That gives me greater confidence. But there is a sliding scale of information and advice.

**Healey:** There's been a shift change here. There's flexibility now – you have a retirement age that isn't necessarily fixed; people are going to have to work longer, potentially with flexible working patterns; they may be working part-time and phase in their retirement, so it's a logical step that advice should be brought in here.

**Watts-Lay:** Also, not only are there massive decisions to be made coming up to retirement, but for some there will be more decisions to be made as they go throughout their retirement. That's the new bit, isn't it?

**Rowlands:** We need to remember that the market is segmented between the minority of people who have significant funds and the vast majority who haven't. Last year, 600,000 people retired in the UK; this year it will be 800,000. 80% of people in DC had funds less than £40k last year, and of that segment, less than 70% didn't shop around.

The new rules look fantastic in that they offer the ability to defer annuity purchase for that segment of people who have the wherewithal to make use of those rules. That's a small group of decision-makers, though, who tend to be the senior people at companies – they are the ones that can have all sorts of advice around this.

Others, however, will have relatively small funds. For those people, deferring annuity purchase or maybe not having an annuity at all is probably a dream which they will never be able to afford. What's important to them is that, if they stop working in December, they need their pensions to kick-in in January. They want access to that income without there being a gap in

between, so we need to be careful with the framing of this debate that we don't just focus on the high net worth. An annuity provides guaranteed income for life – that's attractive for lots of people.

#### Final comments

**Chair:** Could we have everyone's final views for the future of DC?

**Watts-Lay:** The future of DC is potentially very bright but the caveat is that employees have got to understand it; they've got to understand it in terms of contribution levels; they've got to understand it in terms of pound notes when they retire; and they've got to understand what they can do with that money once they retire.

**Palmer:** I agree the future is bright but we have a new population of employees we have got to design our propositions and our communications around. Auto-enrolment is probably the biggest change that has ever happened to DC, and we need to be ready for it. Clearly NEST is improving the proposition around that and I think that will shape a lot of the things that we choose to do as providers, because it will represent, not so much a benchmark, but a key comparator.

**Lyne:** As an industry we seem to have got comfortable with the fact that DC is the future and whilst DB is not dead, going forward we need to put our collective brainpower into getting the right DC solution in place.

At one extreme you have the NEST solution trying to meet the needs of those people who are not currently saving into a pension scheme (and the benefits to society of NEST being a success shouldn't be underestimated).

At the other extreme, some of the developments that have gone on in the workplace marketing space are really positive. While innovation, platforms and new products are obviously fundamental, at the end of the day

when you are talking about DC it's all about getting people to save early enough and save enough.

**Healey:** NEST will be a positive and I think alongside that, if we simplify the state pension that will make things even easier for people to understand. The workplace stuff that is happening is very exciting and I think that will all help improve engagement.

**Rowlands:** If the measure of success is: How effective is DC as a retirement vehicle for replacing income for people who retire?, then I think the future is bright for DC because of everything we have talked about today – innovation around funding, around asset allocation and the conversion of savings to income. Technology will drive a lot of new solutions and increase accessibility which will drive better outcomes for members..

**Hodges:** The future of DC will be filled with opportunities and threats. The opportunities improve every year but what we perhaps haven't mentioned today is that we could see a combination of more holistic saving and greater accessibility combined with new communication methods, such as better internet tools and smart phone apps.

The threats come from areas that haven't quite been thought through yet – for example governance, roles and responsibilities and decumulation phase advice. How can we deliver meaningful, simplified guidance and advice in the decumulation phase, which will only get more complicated as we go forwards?

**Chair:** When I was in the US recently, they were talking about retirement being an 'income' not an 'age'. We have got to move away from the idea that, at 65, we are going to retire on whatever our income is, and instead try to build up a level of income that will allow us to have what we want in retirement.