

In association with



FriendsLife



barrie+hibbert

The evolving DC landscape

Our panel of experts explains the latest developments in the DC arena

Charlton: We are now at the point where we are 12 months away from the first employer staging date for auto-enrolment. How responsible is the industry for ensuring that auto-enrolment is considered a positive step by employers?

Watts-Lay: The age-old problem is whether they're going to see it as positive because of the value that it will hopefully ultimately bring them, or actually whether they see it as a negative and just see it as a tax on their pay slip at the end of the month. I've had quite a bit of feedback from a range of companies, they tend to be smaller businesses although some are larger and they actually have a high turnover of staff in certain divisions and they're not part of the main pension. A lot of providers in the industry aren't interested in that business anyway so they'll be quite happy to just leave it to Nest.

Rowlands: We have to recognise the role that government is playing. Government is the only institution that can change perceptions and behaviours on a mass level. Sometimes the industry is obsessed with narrow vested interests and over analyses some of the marginal issues auto-enrolment and employer duties. If you look at the big picture; five to eight million people coming into a pension scheme for the first time has to be good news. This is just the first step, as we all know the contribution limits will be increased and the ban on transfers removed within a few years.

Lyne: I think one of the responsibilities we have as an industry is to try and persuade government and politicians that pensions isn't some form of football to kick around as you see fit. Auto-enrolment has to be a stake in the ground which doesn't move around in terms of the economy or the politics

but actually is a starting point for the continuum between Nest and SIPPs or whatever it is, and that people have a very clear view of why auto-enrolment is coming in, what it does and how they can benefit from it.

Palmer: Clearly the media are going to be very focused on this, so I think there's a great opportunity for the industry to work very closely with DWP, and also potentially with Nest in the way that we talk about things. We really need to go in with joint and consistent messages about the need to save. I think the employer role is going to be crucial; especially given that by matching contributions the employer can really galvanise employees to save. There is going to be quite a lot of extra undertaking on them; in many cases there will be increasing cost alongside the extra admin, so whatever we can do to make that process simple for them at a time when they're under big financial pressures will be invaluable.

Jenkins: We clearly have a savings gap. That's an established fact. Auto-enrolment will help with that but it's not the totality of the solution. I think we'd

DC roundtable



Chair: Steve Charlton is a principal at Mercer. Steve Charlton joined the Mercer DC leadership team in July 2008 and has most recently led the new Mercer workplace savings solution to market. In his time at Mercer, Steve has led Mercer's DC intellectual capital development group and still undertakes many of Mercer's DC based speaking engagements. Steve has also led Mercer's cross business consulting team on the issues around the employer duties under the Pensions Act 2008 and Nest. Steve has spent the last 15 of his 25 years in the industry consulting with clients in the ever-changing DC environment.



Panel: Paul Healey is head of workplace savings at AEGON UK. Paul is part of a small core team within AEGON responsible for the development of its platform proposition that will support both it's core markets in the UK of at-retirement and workplace savings. During his 17 years with AEGON he has held a number of roles, most recently leading AEGON's corporate solutions sales and account management teams across the UK.



Panel: Jamie Jenkins is head of workplace strategy at Standard Life. Jamie has worked in financial services for over 20 years, most of which he has spent in the corporate pensions area – operations, product development, strategy and policy. He currently advises on strategy for corporate pensions, savings and flexible benefits. He has worked extensively on the development of Standard Life's employee wealth and benefits plan, Lifelens, and is heavily involved in the work on pensions reform and the Retail Distribution Review. Prior to his move to marketing, Jenkins led the corporate pensions operation.



all agree that eight per cent - even if we get there - is not enough, but it's a good starting point.

Charlton: Nest has already opened for business. They already have firms that have adopted them and are using them for collecting contributions for employees. What do providers have to do to showcase their propositions?

Jenkins: I don't think we should lose sight of the fact that publicity and ease of use is core to both Nest and provider

offerings. If you look at the demand that's coming from larger employers to providers around the sophistication of investment options, the way that you construct lifestyle funds, construct the default funds, the addition of things through a corporate platform, it is quite distinct from where Nest sits and what population it serves. For people who move around jobs, particularly, Nest will suit that population very well. This is more difficult for current providers to

operate. So the simplicity and mobility of Nest I think works very well, and we can expect many providers to work with them to produce joint propositions for employers.

Charlton: We're seeing the likes of Now: Pensions and all sorts of master trust arrangements popping up in to the market. Are they more likely to be more direct competition than Nest or should we be working with these organisations bearing in mind the market sector that they're chasing?

Healey: Two thirds of employers haven't got any arrangements at all, so I think Nest have a big job to do here. They will also be complementary to what we do with other schemes. Some of the other new entrants to the market will be targeting employers for certain schemes that have a similar profile and turnover to the larger schemes that Nest are perhaps looking to pick up.

Charlton: Jonathan, can you see any difference between the level of opt-outs where some people auto-enrol into Nest compared to auto-enrolling into a scheme with another provider?

Watts-Lay: I think it will probably

DC roundtable



Panel: Stephen Lefley is head of corporate distribution at Zurich Financial Services. Stephen joined Zurich

in 2007 to define and implement the strategy for the distribution of DC pensions via leading consultancies to the UK corporate market. With 20 years of experience in the sector, Stephen has been involved in delivery of consultancy, proposition design and distribution of all aspects of DC provision.



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.



Panel: Philip Mowbray, is head of product risk at Barrie & Hibbert. Since joining Barrie & Hibbert as a quantitative analyst

in 1998, Philip has worked on a wide range of projects both developing and applying Barrie & Hibbert's stochastic models and investment analytics capability. He has published a wide range of research articles in industry journals. As head of retail products and consultancy, Philip has had responsibility for strategy and product development in the retail financial services sector. Here he is focused on applying Barrie & Hibbert's models and expertise to support retail product design and communications.

In association with



FriendsLife



barrie+hibbert

come down to that whole education and communication process ultimately. Do people understand what they've been auto-enrolled into? In that sense, it's no different from what we see generally in the DC world anyway. In some ways, because these people haven't been in a pension before, the detail of the pension is probably not actually that important. As long as they understand why they're in it, as long as they understand what they're going to get out of it as long as there's that process of communication, then I think people are likely to stay in it.

Lyne: I think this new segment of the market, which is going to suddenly be seen for the first time, bank accounts are probably the maximum exposure they've had to financial services. I think there's a real risk that they will look at that deduction of their wages, and they will opt-out. Not because of communication, not because of anything specific, they just see that money, they want to spend it or pay their electricity bill.

Charlton: The quantity of opt-outs might be reflective of the quantity of contributions being deducted in the

first years, when people look at the compliance level of contribution and you've got a one per cent employee contribution less tax relief, that comes down to pennies a month. Is a deduction of pennies a month going to be enough to drive people to opt out or when we get to 2017, when we're at the eight per cent and that's five per cent for the employee, will that have a greater impact on the numbers of people opting out?

Rowlands: Nest raises the bar for lots of reasons, it's a bit like stakeholder 10-11 years ago which reduced charges by 60 to 70 per cent. I expect industry will compete and differentiate itself in the segments it wants to. So I think the industry will evolve and there will be a lot of competition at the top end of attractive employers. I don't think there will be a lot of competition in the micro employer end with less than five staff, although millions of people work in those organisations. There will be competition from B&CE, NOW: Pensions for Nest but I think distribution is key to which of these organisations will be successful.

Charlton: And if the experience isn't good from an investment performance perspective, how's that going to impact people's decision-making, if they remain auto-enrolled and don't opt out?

Lyne: Nest will be quite interesting in terms of the way they've structured their investment options, people who don't have experience of investment, the first three years is so fundamental in driving behaviour, any sort of negative return will really impact in the long term on people's perceptions of saving. That's why schemes just being driven by fees tends to lead to more passive-type options meaning its more difficult to deliver absolute return type strategies.

Charlton: Do DC providers need to adapt their charging structures? Is charging the be-all and end-all or should we be looking at something more dramatic in the sense of trying to persuade people to have targets for the income they need rather than just throwing money in and having charges deducted.

Mowbray: Thinking about outcomes here is absolutely fundamental. Any



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

in 1987 and held a variety of different roles in a broad range of departments 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: Mark Rowland is head of financial institutions at Partnership Assurance. Partnership is 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. Mark has spent his working career in financial services specialising in DC pensions undertaking numerous senior roles including business development, strategy and marketing. Mark is focused on improving member outcomes in retirement through improvements in the decumulation stage.



Panel: Jonathan Watts-Lay is a 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.



decisions made about investment choices, the impact of charges, or anything else that defines the construction of a defined contribution pension scheme should be put in the context of the outcome to the member. It is only by a greater focus on long term savings and investment outcomes that members and those with fiduciary responsibilities will be able to make decisions on an informed basis. In particular this will enable employers to make decisions that are fit for their scheme and their member profile.

Palmer: We're focusing so much on charges and not necessarily thinking about the actual services and the value that the member gets. So if you cut charges too much then that can have an impact on the engagement and the quality of the communication that you're sending out to the member. I think our view on this is that charging structures have to be reasonable, they have to be well communicated and they have to freely reflect the services that the member's getting. It's very much up to the employer and the adviser to agree a charging structure with the provider that really reflects the needs of that particular scheme.

Active member discount is something that's got quite a bit of publicity from The Pensions Regulator. Our view on

this is that active member discounts actually encourage positive behaviour from employers.

For example, many employers are looking to effectively provide subsidies to their employees by paying for certain parts of the services on the scheme and don't want to do that for the members that have left the scheme because they're probably going to work for a competitor. So I think it's very important that as long as those charges are reasonable for leavers and they are communicated, that should be fine.

Mowbray: In general, charges over the last 10 years have fallen substantially. That reflects increased competition in DC and more efficient admin processes. So we've made huge progress and in that sense stakeholder served that purpose even if it didn't necessarily work as a product. I think there's a lot of misquoted facts around charging, taking an example of already being charged 1.5 per cent over the lifetime of a group scheme is not what I see as typical.

Charlton: For the vast majority of schemes that we've seen recently we're talking about a percentage of the assets under management as a charge. Does that work better with smaller pots as we have in DC at the moment? Is there a potential in making it fairer as DC pots

increase in looking at capping that or looking at moving towards pounds and pence charge?

Watts-Lay: The point I was going to pick up on, was around tailoring both the pension provision and financial education to different employee segments. Pension platforms provide a very cost effective way to provide different views with different fund choices to different staff but all with a transparent platform price.

Healey: Well I think AMC's quite a blunt instrument because there is real cross-subsidy. Those actives who contribute for 15 years pay an awful lot more in pounds per annum than the early leavers. So I do see charging structures continuing to evolve. It is a competitive market we're in and DC pensions are probably the best value they've ever been so I think employees get a fair deal. Recent DWP research on charges backs that up. Sometimes as an industry we're guilty of focusing a little too much on price. Outcomes are more important and paying the right level of contributions for long enough to fund your aspirations for income in retirement, and using your open market option to get the right type of annuity are massively more value to the employee than if they're paying 0.75 per cent or 0.5 per cent AMC.

Charlton: Is the value chain complete? Is there anything that is missing from the chain as we see it at the moment?

Watts-Lay: For the value chain to be complete, it is important that interactive financial education (through face to face seminars or online tools for certain employee groups) is supported by regulated advice - particularly at retirement when employees will make what may be the biggest financial decision of their lives. Major companies are now realising this.

Lefley: I think that there's an evolving

In association with



FriendsLife



barrie+hibbert

DC roundtable

respect between the providers and the consultants as to who is best placed to provide what service. You can look at the TPR's checklist for example as to what constitutes best practice in DC pensions. There are certain aspects that a provider can fulfil and a consultant probably cannot, such as making sure members are best informed to pay an appropriate level of contribution. On the other hand, the provider community is arguably not best equipped to create and advise on the underlying funds suitable for the workforce of a specific employer. Advisers and providers can work to each other's strengths to maximise the employer experience of the value chain.

Charlton: If the value chain is well looked-after and complete, are members getting the best service or is there more we can do to improve that?

Palmer: Member engagement has got to be an area of focus for us as an industry. We do need to do more as an industry around that whole member engagement piece and at different life stages as well. The problem is that we've tended to focus on members when they join the scheme. Clearly when auto-enrolment comes in, individuals will be automatically enrolled into a scheme so we need to think much more around how we actually deal with those individuals at different stages of their

lifetime. I think the other point I'd just make is around governance. Who is actually responsible for the governance of the scheme, so for things like the default fund, who's actually responsible for choosing that scheme and how does that work for people who have left the scheme that are paid up, and how does it work for people who are working for that employer, because I think effectively the employer has some responsibility but clearly they're not going to see themselves as having responsibility for the members that have left. So does the responsibility then sit with the advisers or does it sit with the provider?

Mowbray: Defined contribution markets around the world are much more focused on the consumer end of the value chain. So if you look at any of the markets with existing auto-enrolment or compulsory schemes like the Australian superfunds market, a lot of the focus is on the engagement with the scheme member. I think we are shifting that information gap back towards the investor and I think providers and various participants in auto-enrolment are going to have to make much more effective use of technology to be able to communicate and engage sensibly with the many millions of investors who were not previously active.

Lyne: One thing we haven't really spoken about is innovation on the investment side. I don't think the asset management industry itself has covered itself in glory and I'm including consultants in this as well, in terms of bringing all the investment technology and skills and sophistication that we've got in DB to the DC world. I sit in DC conferences and hear that we need innovation, and yet I see the innovation we have delivered, for example in annuity matching solutions or our equity futures over gilts fund for lifestyle strategies. I think there's lots of innovation that's been done by different managers but the transmission process to get this into schemes and into members' accounts just has not happened yet in many circumstances.

Charlton: Is that because the focus of perhaps much of the work that's been done over the last five to 10 years is about controlling costs on DB rather than shipping out innovation to DC?

Rowlands: DC is very immature and if we take a step back from our own perspectives, it's failed to deliver good consistent outcomes for customers. When the regulator and government look at it, they see a small group of people who get brilliant outcomes, people who are in proper schemes with a generous employer, with good workplace advice, good tools, good modelling and they get decent outcomes. But that's a very small percentage of the working population, so as a generalisation, DC is immature, inefficient, and it's failed to deliver good outcomes for consumers. So thank God it's evolving because it hasn't worked very well so far. It's interesting that the two biggest periods of innovation in our market have been driven by government interference. Stakeholder reduced charges from a total expense ratio in excess of two per cent to less than one per cent and the introduction





of auto-enrolment and Nest will be the next stimulus that drives genuine differentiation. Actually DC is about outcome for the member; industry keeps forgetting this and obsesses about charges, funds innovation, the workplace, but the measure of success should be about what the outcome for the member is. Efficient decumulation solutions are guaranteed to improve member outcomes but so few schemes and their advisers prioritise these.

Charlton: How do we measure the outcome? What is a good outcome? Are we looking at replacement ratio? Is it an income plus state as a replacement ratio? What are we looking at to measure a good outcome?

Jenkins: We've just done a bit of research which broadly states that with state pensions somebody on an average salary of about £25,000 might get an 'income replacement ratio' of about 30 per cent, based upon state pension, any credits, and minimal savings. Auto-enrolment, we believe, with the right communication to make it work, might take this to 45 per cent and that gives us some ideas on how we might build on this to get that to 60 per cent. In reality, of course, nobody has any idea or any understanding of replacement ratios. It's a meaningless phrase that nobody understands, so what does that mean

in real life? What does an income of X actually look like in terms of lifestyle? I'm saying we need to speak to people in terms they can relate to.

Lyne: What investment do you put in place to give certainty? Because if I'm a 25 year old and I know that if I put in £50 a month, that in 40 years' time it will give me a specific level of income, then that fits in beautifully. But the problem we have is that the investment solutions we have in place do not work like that - there's too much volatility, so the provision of certainty is currently a myth, and I don't know how we solve that.

Lefley: You might not be able to solve it in terms of certainty but it is well within DC capability to provide a member an 'on demand' view of their likelihood of meeting their specified goal. So whilst the funds might be volatile, as long as the employee has tools to enable the effect on his original goal to be demonstrated then he is able to do something about it.

Mowbray: If somebody starts paying in £50 a month when they're 25, and expects to get X out at the end, based on an annual return of perhaps seven per cent, then unless they keep track of their pension plan, they could find themselves with less than half of X when they come to retire 30, 40 or 50

years later. The problem is there's only two ways you can really avoid this downside risk. One is some sort of insurance, another way is by ensuring that you're reviewing that pension plan on a very regular basis to offset poor performance, either by increasing the contribution level if you can afford to do that, or review the investment strategy.

Charlton: I'm going to move us on to the open market option, one of the pieces in the DC value chain which has possibly been neglected in the past. How do we make sure that mistakes aren't made in the context of a one-off decision to annuitise at the point where you reach retirement?

Rowlands: We did a survey of 40 pension professionals which ranged from consultant to independent trustee and independent scheme managers, and their conclusion was that 30 per cent of pension professionals do not believe that defined contribution members achieved good outcomes at retirement. The DC industry has failed members, the reason for that boils down to not enough thought being given to the end position by trustees and consultants and providers. Annuities aren't sexy, yet how else can you guarantee to improve outcomes? Members are apathetic, engage too late, are caught by inertia and the fear of making the wrong choice so do nothing. The consequence of this cocktail is the bad result for a member.

Charlton: If we're going to get people to start making decisions, good decisions, on what kind of annuity they take, when should you start talking to employees? Is it six months before retirement? Is it five years before retirement?

Healey: Well, I think the communication and education piece is once again key here. We're seeing the emergence of technology not only for advisers but for members as well to actually help bring to life some of these

In association with



FriendsLife



barrie+hibbert

issues with choice being one of them. It's how we get employee's to engage with it, which is still the challenge. I think communication as people plan towards retirement is crucial as well, making sure that it's very clear that people should consult an adviser or at the very least a self-service annuity portal to help guide them beyond the pension and tax-free cash lump sum they're being offered from their ceding provider.

Palmer: I think there is a need to look at individuals at different life stages. At present when people take out the plan they select a target retirement age at which they want to retire at. The reality is that it is not going to be the age that they do eventually retire. The danger is that as an industry we have set up schemes where everyone's got a retirement age of 60 and then five years before they reach that point we send them a letter which says that we will be kicking off the lifestyle process and moving them to fixed interest. As a member however, how likely is it that you're going to be able to retire at 60? I think what we have to do, and what we're starting to do, is to get out to employers and talk to people when they're at a point in their lifestyle when they really are thinking about that whole retirement piece, probably around age

50, when it's really in their mindset and they actually start to think about what retirement age they're going to actually go for.

Charlton: We are starting to see employers adopting corporate platforms where you have not only the DC pension but you might have ISAs, (cash or stocks and shares) and share schemes etc, you might also have perhaps some more creative types of DC schemes like SIPPS and so on. If we're offering employees choice, and that's choice to move their contribution away from the DC scheme, which is wrapped up and they can't touch it until age 55, is there a danger in the eyes of the employer that people will put money into accessible savings plans, spend that money, then not have sufficient funds in their DC plan to be able to retire and so go cap in hand to the employer at 55, 60, 65 or even beyond, and say I can't afford to retire? Therefore the employer has an aging workforce that is unable to retire. Is that a danger that we're building up? Or can governance help that?

Rowlands: I don't think that's the case. I think employers are interested in pensions, historically for two reasons – to recruit the right people and retain them in the business and I think it's now about recruit, retain and exit. Because people must have enough

available pension income to be exited. HR departments don't like an elderly workforce. That may change over a generation but at the moment they don't like elderly workers. They don't think they contribute enough, they're inflexible, they don't think they've got the right skills. Whether that's right or wrong, this perspective is reflected in surveys of HR professionals so they like to exit the elderly workers out of the business. There's a track record of pension funds funding this, so I think those HR professionals will very much be looking to reduce that risk of being stuck with an elderly workforce and employers have a choice to force them out or to help fund their exit via retirement savings and income.

Charlton: And a final question, what will DC look like in 10 years?

Watts-Lay: It is a question of ongoing financial education to ensure employees understand how to calibrate their workplace savings between ISAs, share schemes and pensions, as priorities change. For example, it may be right for younger staff to focus on shorter-term savings when they are saving for a deposit for a house but this priority may change to longer-term savings such as pension as time goes by.

Jenkins: In 10 years, we will be past the 'auto-enrolment years' so we'll have a base level of pension savings starting to build. I think what we'll have is a combination of short, medium and long-term savings in the workplace and I don't think it should be any more complex than that. If we look at these three segments just briefly, long-term will probably be auto-enrolment into a pension, and short to medium term for things like house purchase and student debt, through something like a cash and stocks and shares ISA. For those who don't immediately engage in the long-term savings element (pension), at least saving for shorter-term goals





will help engender the savings habit.

Palmer: The ironic thing is that people are living longer but they are now probably more short-term focused in terms of some of their goals than ever before and I think that's one of the challenges that we need to get around. I think the employer role will be very important.

We do need to do more to try and make employers focused on saving for their employees and getting all kinds of employees much more active in terms of asking challenging questions about employment when they first take out the plan. But I think the other thing is actually around equity release and what's going to happen to the population that are now 50, 55, 60 who are now looking to retire in 10 years' time. Those individuals won't have saved up enough money. What are they going to do to provide themselves with a decent level of income?

Healey: DC will be the established norm. I would hope that the industry has moved to a position where it's won the trust of the consumer.

Employees will be better-equipped to take sensible decisions around the need for savings and more awareness and responsibility of long-term outcomes. We can help drive this as an industry through employers with a combination

of communication, engagement and technology.

Mowbray: I think in 10 years' time the DC market will be much more established. I think this holistic workplace view will start to come through because we're all agreeing that the workplace is a good place to facilitate wider financial planning, whether it's through the employer and increasingly in the form of self-service through technology. I think just the combination of those things, awareness and responsibility, will force individuals to take more ownership about managing the future. Those that fail to engage will be left in a very bad place with an increasingly limited 'baseline' state pension.

Lyne: Best case scenario, the market's split in two different sets of schemes: 50 per cent go in to Nest, a base level occupational pension, the other people are offered flexible SIPP options, ISAs etc, so a real segmentation of employers. Worst case scenario is that everyone goes to Nest and employee benefits is done purely in terms of cash and the responsibility is given to the employee.

Lefley: I think that in 10 years' time employees will be better informed, better equipped, better empowered to make sensible decisions because

platform intelligence will have caught up with communication excellence and apathy will have changed to pro-activity. The DC investor will be better engaged and far more interested.

Rowlands: It will just be a flat subsistence state pension, there will be no open DB schemes at all, including the public sector, full compulsion will be introduced, the government will have done their equivalent of a clunk click campaign to change people's behaviours. Technology will have moved on to a different level again. What industry will do as a result is employer-based solutions, technology driven, everything will be around flight path towards outcomes. Solutions will be based around target outcomes and work back from this, so members measure retirement savings against clear goals.

Watts-Lay: DC is much more likely to be part of a workplace savings offering including saving vehicles for each employee life stage. I believe regulation will insist that employees take advice at retirement to ensure after 40 years of saving they make the right choices.

Charlton: I think we're all in agreement that DC will be even more prominent eventually. We are all fairly certain that auto-enrolment has got to be a positive thing for employees, employers and for the DC industry. Nest is going to have a broadly positive influence and will serve a good purpose. We think the value chain looks complete but probably needs to deliver more innovation and that's delivery of it rather than just keeping it theoretical as it seems to be at the moment. I think we need to work hard to make DC relevant and attractive for everybody, making sure that DC in whatever shape or form can enable employers to recruit, retain and exit effectively, and for employees that we have good outcomes at all points of life for all generations as well.