Defined Contribution Investment Forum

At Retirement solutions for the new pensions era

A study into the impact of the pension freedoms on DC schemes' retirement strategies

DCIF.co.uk

April 2015

This paper is published by the Defined Contribution Investment Forum – DCIF.

The purpose, belief, activities and membership of this group are described on the next page. Our occasional papers aim to promote investment excellence in defined contribution pension schemes by raising a wide range of new issues and by exploring a variety of existing topics in new ways. In each paper we aim to inform and encourage debate among those with an interest in this important part of the investment landscape.

The opinions expressed in this document are those of the report authors, and do not necessarily represent the views of individual DCIF members.

Furthermore the views and opinions expressed in the quotations contained within this document are solely those of the participants and do not necessarily reflect the official views or positions of their schemes.

About the authors of this report

Spence Johnson provides research-based services to asset management and insurance firms. Spence Johnson clients use its research-based advice to help them identify and retain clients within their retirement and institutional investment businesses.

SPENCE JOHNSON

Purpose

The Defined Contribution Investment Forum (DCIF) consists of investment firms and other selected industry participants and aims to exchange ideas and develop initiatives to promote investment excellence in Defined Contribution (DC) pensions in the UK.

Belief

DCIF believes that members in DC pension schemes deserve the best possible investment services to help them meet their retirement objectives. DCIF is particularly concerned to promote the widest variety of investment techniques and approaches in DC schemes. The participants in DCIF believe that at present there are many DC schemes which do not give this variety to their members. Unless DC schemes are encouraged to change the way they invest, many members will fail to meet their retirement objectives. This outcome can be avoided if action is taken now.

Activities

In order to promote investment excellence in DC pension schemes, DCIF will carry out a range of initiatives such as presenting the industry with papers, arranging seminars and debates, and in other ways acting to raise DC investment standards.

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Foreword

The Defined Contribution Investment Forum (DCIF) believes that the pensions freedoms will continue to have a significant impact on the design of DC schemes both now and in the future.

With the new freedoms in mind schemes have already begun to review and evolve their at-retirement investment designs and member support provision.

As schemes responses to the pension freedoms continue to evolve it is vital that the investment industry engages more deeply with DC pension schemes in order to support the development of high quality solutions.

In order to create suitable products it is also important to gain a greater understanding of the wider issues schemes face, including the considerable member engagement, monitoring and administrative challenges, as they attempt to facilitate their member's access to the new pension freedoms.

With this in mind the DCIF commissioned Spence Johnson to conduct a series of in-depth interviews with nine DC pension schemes. These interviews examined the effect of the pension freedoms on scheme investment design, administration and communications going forward and looked at how the schemes are shaping their responses.

In this document we present the key findings of the research combined with anonymised commentary offered by the participants in the interviews in the hope that this will help DC schemes and their advisors gain greater insight into the opportunities and challenges that are being created in the DC investment landscape by the new pension freedoms.

Madeline Forrester, MFS Asset Management
Chairman, DCIF
April 2015

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Key Findings

Summary

This report provides an overview of the effect that the pension freedoms announced in the 2014 Budget have had on the investment design, administration and communications of large DC schemes and provides insights into how these schemes are shaping their responses.

Scheme design: Impact on scheme activity more limited than expected	The impact of the 2014 Budget announcement on scheme redesign processes was more limited than expected. Despite recently completing auto-enrolment schemes have not stood still. For many, therefore, the Budget announcement simply refocused and reshaped pre-existing scheme redevelopment plans.
Scheme design: There are no one size fits all solutions	Many schemes are planning to introduce self-select options for each possible retirement option (annuities, drawdown and cash). There was a wide range of responses on which of these options (or indeed what blend of these options) to select as the 'default' option. Around half of those interviewed were sticking with an annuity target but a few are moving to default options targeting drawdown.
In-scheme drawdown: UFPLS will be offered but full drawdown will be limited	While a few schemes expressed an interest in offering full in-scheme drawdown, fiduciary concerns and the need for further development of the market will prevent many selecting this option in the near-term. Most schemes, however, are looking to offer their members access to uncrystallised funds pension lump sum (UFPLS) withdrawals.
Communications: engagement challenges are considerable	Communications was the area respondents felt that the pension freedoms had had the biggest impact, from the challenge of communicating new flexibilities to the need to bridge the emerging 'advice gap'. Above all the pension freedoms have provided fresh impetus to the long-term challenge of improving member engagement.
DB to DC transfers: schemes anticipate limited uptake	Although schemes are communicating the new flexibilities to DB members they expect DB to DC transfer volumes to be low. In addition some schemes are reluctant to allow internal transfers due to concerns over conduct and reputational risk.
Monitoring: 'good' outcomes will require new frameworks	Although schemes agree with the need to provide 'good outcomes' frameworks need to be developed to define what this means. Performance monitoring at the scheme level needs to be improved and schemes need to maintain an ongoing dialogue with retiring members and peers.
Respondent advice: administration challenges make provider selection a key issue	Offering members access to new freedoms such as UFLPS and in-scheme drawdown presents considerable administration challenges. Schemes looking to offer these options therefore require a provider flexible enough to support offering them to members.

Scheme design: impact of the Budget announcement

Key findings

- **Scheme redesigns pre-dated Budget announcement** – many of the schemes interviewed were already engaged in re-design processes prior to the Budget announcement
- **The new breadth of choice poses a significant challenge –** ultimately scheme designs are likely to be driven by their members' retirement choices
- **Engagement is a greater challenge than investment design –** most schemes agreed that the success of offering members at-retirement options would be determined by how successfully members could be engaged to interact with and select those options
- **Scheme redesign will be a long-term process –** schemes were more or less united around the idea that good quality solutions will require time to develop

Impact on design processes

Despite the shock nature of the Budget announcement our research found that many schemes were able to take it in their stride by incorporating the impact of Budget changes into pre-existing change processes:

- *"In 2014 we were already planning our triennial root and branch review of the DC offering, so the impact of the Budget was simply to alter the nature of some of the changes we were already making."*
- *"Even before the Budget announcement our due diligence review had led us to the conclusion that there was a need for us to offer more sophisticated solutions to match the range of retirement options that were open to our members."*

Designing for the new pension freedoms

Although not all the schemes interviewed were making changes to their investment design as a result of the Budget freedoms most admitted that their members actions were likely to drive design choices going forward:

- *"The pension freedoms mean the company will have to rethink its way of dealing with people as they reach retirement."*
- *"What the budget made clear is that the current default arrangement may not be appropriate going forward, especially if more and more people take non-annuity options at retirement such as drawdown or cash over a short period."*

The engagement challenge

Most of the schemes interviewed acknowledged that raising the level of member engagement at retirement was the key challenge they were facing in the near term, and indeed that the success of any investment redesign would be dependent on it:

- *"I think the investment solution to this is quite simple, the harder part is actually engagement and communications to help people to understand what they want to do."*
- *"Clearly when we do introduce these changes to our scheme we are going to have to be very careful and explicit in how we explain this to our members otherwise they will just stay where they are."*

The timeframe for change

There was a strong consensus regarding the dangers of reacting too rapidly. The respondents stressed the need for schemes to take their time to ensure solutions meet members actual needs:

- *"Our scheme is relatively immature. We only have a small number of people who are close to retirement age at the moment and so we did not feel that there was a need to rush through pension changes."*
- *"We are not feeling too pushed by the April deadline to come up with a solution, we are taking a long term approach to this and reviewing the options carefully."*
- *"I think we are in a 'jump in haste and repent at leisure' transition period where behaviour in the short-term is going to be different from behaviour in the medium term, and where the short-term behaviour is very hard to predict."*

Scheme design: default redesign post-pension freedoms

Key findings

There are three main ways schemes are considering altering the de-risking phase of their default funds as a result of the pension freedoms:

1. **No change, continue to target annuities and tax-free cash**
2. **Redesign default to target a 'mix' of options (cash/annuities/drawdown)**
3. **Move to targeting full drawdown**

Default Design: **Annuity**

Growth phase	Derisking phase	Decumulation phase
DGF	Bonds (75%)	Annuity
Passive Equities	Cash (25%)	Tax-free cash

Around half of those interviewed were sticking with pre-Budget de-risking designs targeting annuities and tax free cash. In part this reflects the admin difficulties faced by some schemes in offering access to drawdown, but by-and-large schemes are actively choosing to do this because they feel it is right for their members.

Comments

"We could not be ready to administer scheme drawdown even if philosophically we were minded to, which we were not, so for the time being we have decided to stick with a standard pre-retirement annuity mix of corporate bonds, gilts and cash."

"Our investment design has not yet been impacted because:

1) Before we pull the trigger on a new decumulation strategy we want more evidence of what retirees are actually doing.

2) We do not believe that targeting an annuity at state pension age will be the wrong strategy for most people.

3) There are significant admin challenges in offering drawdown.

4) There is already a reasonable amount of volatility control in our accumulation phase through the DGF."

Default Design: **Mixed target**

Growth phase	Derisking phase	Decumulation phase
DGF	Multi asset retirement fund	Drawdown
Passive Equities	Bonds	Annuity
	Cash	Cash

Some schemes are redesigning the derisking phase as a compromise between all the new retirement options. For some this involves adding new multi-asset retirement funds into the derisking phase. Others are considering new blends of annuity and cash 'white-label' strategies to target the two main options they believe members will choose.

Comments

"Our current plan is to offer a default option that will target a blend of annuities and cash lump sum withdrawals but designing this is incredibly difficult as we currently have no idea of what people's behaviour is going to be."

"Our first conclusion was that we needed to forget targeting an annuity. We wanted something that members could use whatever their desired outcome: it would suit for buying an annuity, it would be just as appropriate for staggered cash withdrawals, and it would be suitable for those targeting post-retirement investment."

"We are using a blended fund at retirement as we did not want to put all our eggs in one basket. We also rejected the idea of offering our members 'multiple defaults' targeting each of the three options and elected instead for a default that is a compromise between the three because nobody knows what retirees are actually going to do."

Default Design: **Drawdown**

Growth phase	Derisking phase	Decumulation phase
DGF	DGF/Multi-asset	Drawdown
Passive Equities	25% Cash	Tax-free cash

About a third are planning to change de-risking defaults to target drawdown, either by extending growth phase investments into the derisking phase, or by introducing lower volatility/'retirement' multi-asset funds into the derisking phase.

Comments

"Drawdown was chosen as the default because we feel that it is probably the most appropriate for older workers who might want to work less than before as it gives them the flexibility to draw benefits whilst still working."

"The big change from an investment perspective at the moment has been driven by our consultant who recommended we move to a glidepath targeting drawdown as opposed to annuities."

"A lot of this is still under review in our scheme, but our thought is that going forward the default should not involve de-risking, those wanting de-risking are likely to have to make an active choice."

Scheme design: the rise of the self-select 'three options' approach

Key findings

- **Targeting different outcomes requires different 'pathways'** – although schemes differed in their 'default target' choices almost all of them are exploring self-select options that give members the ability to chose for themselves an annuity, drawdown or cash target
- **Implementation timetables have not been dictated by the April deadline** – schemes are often taking a phased approach to the introduction of new options
- **Success of this approach will be dictated by member engagement** – the pension freedoms have added more weight to the need to increase member engagement to ensure members make the choice that is right for them
- **The process has been driven by a combination of consultant and internal influences**

Reasons for development of options

Faced with the difficulty of targeting the three different outcomes with one default strategy, schemes are developing self-select options to provide members with an alternative to the default option should they want one:

- *"We chose the 'three options' route because we acknowledged that those are the three main options that people will want at retirement and we want to offer members the ability to transition smoothly into one of those options."*
- *"We felt we had to introduce a cash-targeting option because, if members are in an annuity targeting option pre-retirement but actually want to take cash, what they really need is capital protection and, given where bonds are at the moment, if you got a bit of a reversion that might look quite ugly."*
- *"We decided to offer three options because it was clear that there was not going to be a default which would meet the majority of members needs; actually options were going to be required and ultimately people are going to have to engage and make choices,"*

Implementation of options

Not all schemes are moving at the same pace, while some schemes' plans are quite far advanced others are taking their time in terms of introducing new options for members:

- *"Our new design will involve the same 'default' design during the growth phase (equity & DGF) followed by three clear options for people who have made a choice: drawdown, annuity and cash."*
- *"We are introducing a new option that will de-risk into cash that members can take as a lump sum. Although we are not yet planning to offer an option that targets drawdown we see the cash option as very much stage one."*

In part the process is being driven by consultant influence:

- *"Consultants have designed the investment underpin for our three options and recommended white labelling so in the future they and the trustees can pick and choose or change managers when the quality of what is being delivered is not in line with what we want."*

But the schemes have also had a strong hand in the new designs:

- *"In terms of influence over any post-Budget redesign: we've got quite strong resource internally including a former consultant and a very experienced pensions manager in the mix as well. So we have been very aware of the issues from the outset."*

Challenges of new options

In order for this approach to work member engagement is a key requirement:

- *"So clearly it's going to require a careful 'communications strategy'. We are going to have to be very careful in how we explain these options to people. It is a complex challenge but it is the right approach to take."*

Also by-and-large schemes were resistant to the idea of profiling members to automatically select a default option for them:

- *"Ultimately profiling is fundamentally flawed because you can have two people on the same salary with the same pot size, living in the same street but one of them has got inherited wealth, while the other has a massive mortgage. It is simply too hard to know enough about them to accurately profile their decision making. The dataset is just too limited in terms of knowing the other influences on people's decisions.."*

But even so some schemes did support going beyond three options to member-targeted default solutions:

- *"We do not want to just have a default plus two other strategies. In the long run we would actually like to use replacement income target analysis to determine what a default allocation should be for an individual member."*

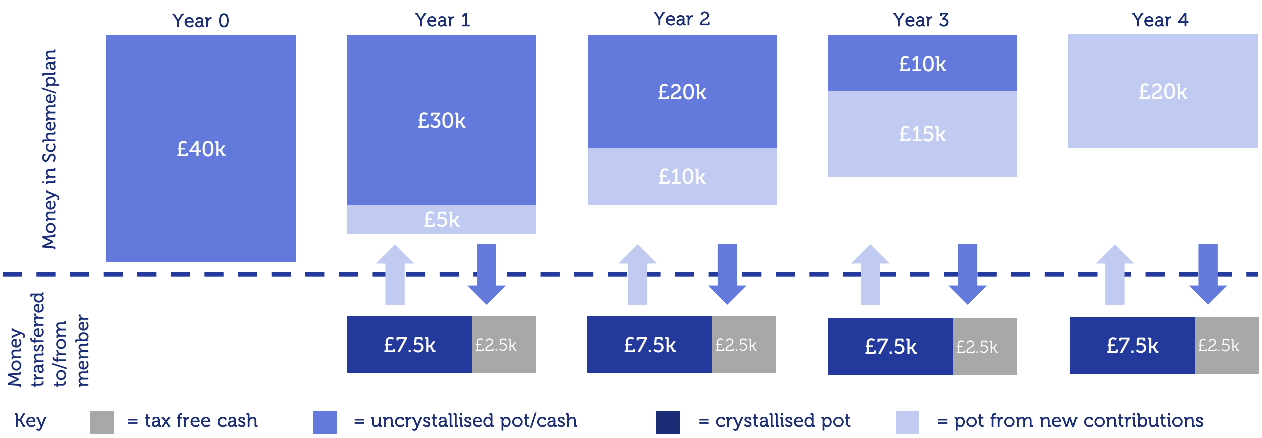
In-scheme drawdown: UFPLS vs 'Crystallised'

Definitions

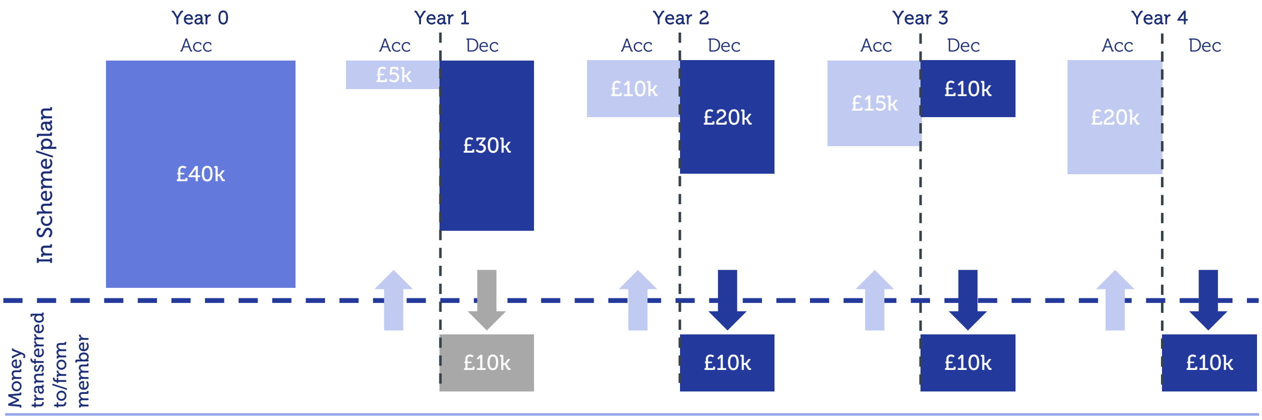
When it comes to offering their members drawdown from the schemes there are two key methods that schemes are considering:

1. **Uncrystallised funds pension lump sums (UFPLS)** – the key features of which are:
   a. Tax-free cash is deducted 'after' the money has been withdrawn from the scheme
   b. The 'pot' left in the scheme remains uncrystallised (i.e. still technically treated as in the accumulation phase) and does not enter drawdown
   c. As the pot left in the scheme is uncystallised/still in accumulation new contributions can be made to it even after withdrawals have been made (for example if the member were to continue as a part-time employee)
2. **Crystallised withdrawals from within the scheme** - the key features of which are:
   a. At the start of the drawdown period the pot enters a decumulation phase
   b. At this time the tax-free cash calculation is made (i.e. the pot is 'crystallised') and total tax-free cash is transferred out of the scheme to the member
   c. As the tax free cash has already been deducted any additional contributions made by the member cannot be added to the existing pot, and instead have to be put into a new 'accumulation' pot

Uncrystallised funds pension lump sums (UFPLS)



Crystallised withdrawals



In-scheme drawdown: Uncrystallised funds pension lump sums (UFPLS)

Key findings

- **Most schemes likely to offer UFPLS** – schemes motivations range from helping members gain access to the freedoms to ensuring smooth, tax efficient transitions into retirement
- **Provider capabilities are key to UFPLS** – generally the biggest consideration for schemes in whether or not to provide UFPLS is whether their providers can handle the administration
- **UFPLS has limited implication for investment design** – small pot sizes and limits on the number of UFPLS withdrawals mean most schemes feel offering UFPLS will have a limited impact on their investment design
- **Regulatory delays have hindered implementation** – last minute delivery of the final regulations left some schemes and their providers struggling to meet the April deadline

Reasons for offering UFPLS

The reasons for offering UFPLS spring from a desire to offer members access to as many of the new flexibilities as possible:

- *"The government has changed the pensions landscape in order to offer members access to new flexibilities. Now that they exist we owe it to our members to try to facilitate them using that flexibility."*

This includes facilitating members' ability to effectively manage a smooth transition into retirement:

- *"Thinking about the long-term, for many people the state pension will remain a key factor in determining when they want to retire from full time work. One of the reasons for making the uncrystallised fund payment available from within the scheme therefore is to increase the flexibility for those people in how they transition into retirement."*

As well as helping members take advantage of the new freedoms as tax efficiently as possible:

- *"We are offering UFPLS in a limited number of tranches because we recognised that a lot of our members may want to take cash but to do so all at once could have significant tax consequences. In order to avoid being pushed into paying higher rate tax the best strategy would be for these members to phase their withdrawals."*

Implementation of UFPLS

Implementation of UFPLS is being limited in part by what pension administrators are capable of delivering (something that is affecting both trust-based and contract-based schemes):

- *"We have been restricted in what we can offer by what the provider is able to do. They have communicated to us that they are likely to allow 2-3 UFPLS withdrawals a year on an ongoing basis."*
- *"Our administrator will be able to provide UFPLS once a year for a limited number of years."*

Delays in producing the final regulations have also been a factor:

- *"The greatest difficulties have actually been caused by the delay in getting the final regulations out, and making sure that we are sufficiently compliant with them while at the same time getting everybody comfortable with doing UFPLS through the scheme."*

Offering UFPLS is likely to have a limited impact on the investment design:

- *"UFPLS will not specifically affect the investment design. Given the relatively small pot sizes of most of our members UFPLS distributions may occur over a few years rather than all at once, but while this occurs members will still expect it to be held in very low volatility investments."*

Challenges offering UFPLS

For some schemes the challenges of providing UFPLS within their current administration set-up have proved hard to overcome within the April 2015 timeframe:

- *"In the near term the administration challenges mean that we are probably only going to be able to offer a very limited number of UFPLS withdrawals, but this is something we are working hard to improve."*

This, as well as demand for more complex drawdown solutions, will lead to ongoing reviews of administration relationships:

- *"Administration is about being able to offer what we want in the most cost-efficient manner. We have already come a long way in the last year but we expect to engage in ongoing discussions and reviews of our administrators as we look to upgrade a range of systems from improving the modelling we offer members to providing them with more app-based management tools."*

The ability to offer UFPLS to 'active' members is a big draw:

- *"We are pretty confident that we will be able to offer UFPLS to all our members who are still contributing to their pensions. This is a plus as their will be no need to create extra accounts for members wanting to draw money out of their pension while they are still contributing to it."*

In-scheme drawdown: 'Crystallised' drawdown

Key findings

- **Crystallised drawdown is strongly supported by a few schemes** – although not supported by the majority, some of those interviewed felt strongly that offering their members a good quality pension would only ultimately be achievable through in-scheme drawdown
- **Significant fiduciary and administration concerns will limit take-up** – those that were less supportive of in-scheme drawdown cited administration difficulties and concerns over the fiduciary implications as key considerations
- **Low levels of demand could limit take-up** – even amongst those schemes that were supportive of offering crystallised drawdown there was a feeling that in the near-term the small average pot-sizes of most of their members would limit uptake of a drawdown option

Reasons for offering crystallised drawdown

There was a strong feeling amongst some of the schemes interviewed that, as pensions provision was the key part of their mandate, they had a duty to try and offer their members drawdown from within the scheme:

- *"Our feeling is that we are still a pension scheme, not a cash savings scheme, and as such we should strive if we can to provide a pension from the pension scheme"*

In addition, especially for members of larger schemes, in-scheme drawdown to carries with it significant cost benefits:

- *"Providing drawdown from within the scheme has two key benefits for members:*

  1) It eliminates the 'friction costs' (which can be as high as 3-6% of their pot) members face in moving their retirement pots from the accumulation market into the decumulation market.

  2) In larger schemes it shields members from the shock of moving from a low-cost 'institutional' environment to a much higher cost retail environment."

Implementation of crystallised drawdown

Implementation challenges are a key barrier to those schemes willing to consider offering crystallised drawdown from within the scheme:

- *"We are not offering in-scheme crystallised drawdown because the administrative challenges are just too great. We can see that it is something that people will want but until such time as there are suitable products to enable us to deliver that we feel that all we can offer is UFPLS."*
- *"The cost of retaining members in the scheme as they enter decumulation would carry a heavy administration burden and we are not yet persuaded that there is anyone yet that really understands exactly what it would mean to do this."*

Some schemes felt that in-scheme drawdown would never be implemented through single employer schemes, and was more likely to be offered through master trust structures:

- *"I cannot see crystallised drawdown happening through single employer DC schemes. It would work through a master trust but generally master trusts are a great idea currently being done quite badly. I do think that eventually we will get the master trust sorted and when we do, especially if they include good quality drawdown options. I would not be surprised if that is the route many schemes will go down."*

Challenges offering crystallised drawdown

Apart from the implementation challenges schemes saw a number of other challenges in offering crystallised drawdown including a low level of demand in the near-term:

- *"Our first step in our post-Budget redesign was to analyse the membership and identifying the age spread, how many we have got coming up to retirement and pot size. The outcome was we don't have a big number coming through to retirement and for those that are approaching retirement the average pot-size is around £10,000."*

Managing 'Alzheimer's risk' also presents considerable fiduciary challenges:

- *"It is critical to understand it will never be possible to 'default' members into in-scheme drawdown. This goes back to the fiduciary risk discussion: as people age their ability to engage with complex decisions is likely to diminish. This 'Alzheimer's risk' needs to be managed.*

  In addition trustees are already bedevilled by members in the accumulation phase who die without a nomination form. It would be very difficult to administer in-scheme drawdown without, at the minimum, securing at least this level of engagement to ensure members intentions for the assets should they die are clear."

In-scheme drawdown: future development of drawdown solutions

Key findings

- **The lack of available products is a major block to in-scheme drawdown** – none of those interviewed have yet implemented a crystallised drawdown solution; for most of those interested in doing so considerable product development still needs to occur
- **Product development should be provider led** – by-and-large schemes interested in providing access to in-scheme drawdown solutions felt these would be best delivered as all-in-one packaged solutions
- **New product solutions are beginning to emerge** – products are beginning to emerge in the annuity and fund spaces whose design has been influenced by the pension freedoms

Development of drawdown providers

The strong view that emerged from the interviews was that there was still considerable work that needed to be done on the development of drawdown solutions, with schemes quoting 3-5 years before they felt good quality in-scheme solutions would be delivered by providers.

Provider-led in scheme solutions

- *"Crystallised drawdown just doesn't sit comfortably with a standalone DC scheme, it requires a whole industry in terms of the administration platforms that are required and that is what insurance companies were set up to do."*
- *"We expect those offering drawdown fund solutions will also have to offer a full drawdown facility attached to it so that, for us, it would be like buying an income product that sits within the trust fund."*
- *"We are looking at a 3-5 year timescale for the industry to develop full drawdown propositions. Many people are not making decisions until they see how the market goes, so it is a bit chicken and egg. Also asset managers are struggling with the question 'How can we make any money out of this?'"*

Master Trust drawdown solutions

- *"A good Plan B for a large trust-based scheme looking for a continuity of good governance and low costs for their members would be to transfer them into a third party master trust structure. This would be especially attractive if a system could be designed so that assets could be passed 'in specie' from the workplace trust to the master trust."*

Transfer to external drawdown solutions

- *"If you look at the spectrum of full in-scheme drawdown thought to telling members to take their money and go and see an IFA, there must be something in the middle that is better than that. We are waiting to see how this develops but if you ask me today where we are I would have to say we are currently much more down the latter route than the former."*

Emerging drawdown products

During the interviews respondents highlighted a number of emerging products that they had come across that were targeted at capturing emerging drawdown flows. We have listed some of these below.

Short term annuity

Designed for people who wants cash but wants to take it out over four, five or six years rather than in one or two lumps.

As an example, if you had £100,000 and wanted to take £20,000 over five years, the annuity would take the money and aim to pay out £21,000 or £22,000 over the five year period.

Essentially the product is offering a guaranteed return on your total cash pot spread over time so you keep within the tax band.

Deferred annuity

Deferred annuities are not a new idea but people are talking about repackaging them to be less toxic than regular annuities.

Essentially some providers are considering offering deferred annuities with tradable units to make it easier to purchase them during the accumulation phase.

In addition people are talking about deferred annuities which will offer a return of premiums if you die before the end of the deferred period.

Fund products

People are beginning to talk about the type of fund products that may be appropriate to back in-scheme drawdown solutions.

Respondents felt that having pre-packaged multi-asset products that were specifically designed to support a drawdown strategy was attractive (especially if they could be incorporated in the de-risking part of the accumulation phase to provide a smooth transition between accumulation and decumulation).

Communications: At Retirement challenges

Key findings

Communications directly prompted by pension freedoms have focused on 3 key areas:

1. **Education** – increasing member awareness of the pension freedoms
2. **Filling the guidance gap** – topping up government guidance option with additional support
3. **Signposting product options** – making members aware of scheme-supported options

In addition the lack of regulatory clarity has significantly impacted scheme's ability to develop additional at retirement support for their members

Education

One area schemes have worked hardest on since the Budget announcement has been the development of straightforward communications of the impact of pension freedoms on members:

- *"Our communications changed pretty much immediately after the freedoms were announced to say there are changes coming as a result of the budget and you should bear these in mind when making any decision about you retirement."*
- *"We are focused on producing jargon-free leaflets and newsletters that include simple case studies that quickly summarise the new pension flexibilities open to them and which direct them to our employee benefits platform, where they can explore each case study example in more detail."*
- *We think people need help and our job is to make these changes simple and easy for them, as well as facilitating informed choice.*

Filling the guidance gap

While schemes were generally positive about the guidance Pension Wise is offering, most acknowledge that the members would need additional support:

- *""We were pleasantly surprised by what Pension Wise have come up with. It may not be great, but based on the remit they were given and the timeframe they had to deliver it in they have done the best they can."*
- *"We are primarily pointing people to Pension Wise but our provider is seeking partnerships with financial advisors to provide advice at discounted fees."*
- *"We are offering a meeting with our pensions department as part of retirement process. They will essentially be giving guidance on the Pension Wise's free guidance."*

Signposting product options

While schemes are keen to avoid offering members advice they are working hard to make it clear to members what options they can gain access to through the scheme :

- *"Our member communications have focused primarily on outlining all the options that have been opened up to them and which options are available within the scheme and which options they will have to leave to do."*
- *"Once we have educated members on what their options are we are directing them to our website to show them which options are available to them 'in-scheme' and which they will need to transfer out to get access to."*
- *" We felt we would only get one opportunity to communicate the impact of the pension freedoms on the scheme so we have focused on communicating the options we are offering now rather than the options we hope to offer in the future."*

Regulatory challenges

The lack of regulatory clarity on both the nature of the freedoms and on the nature of 'guidance' has been a key challenge for schemes:

- *"The question of what is guidance and what is advice still does not have a clear answer. If anything recent indications from the FCA suggest they intend to severely limit the guidance end of the guidance to advice spectrum."*
- *"The limits being placed on guidance could severely limit the help we are able to offer our members as trustees do not want to end up on the hook for advice"*

At Retirement support

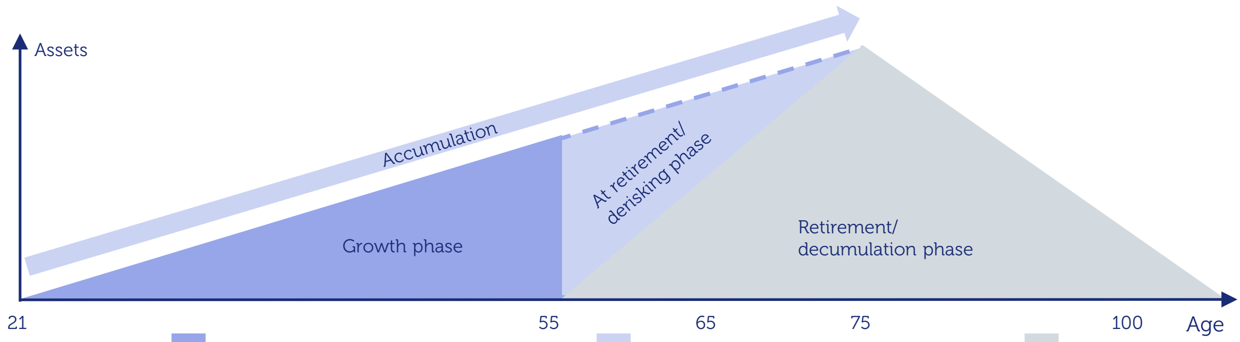
Beyond improved communications a number of schemes are working to expand members access to some form of additional support:

- *"We partner with Hargreaves Lansdown's retirement service so that at any time an employee can contact their helpline to understand what the options are."*
- *" We have put in place a service for everyone to have free access to additional guidance through TOMAS (The Open Market Annuity Service)"*

Communications: a call to action on long-term member engagement

Key findings

- **Pension freedoms are a 'call to action' on member engagement** – the pension freedoms have provided fresh impetus to the long-term challenge of improving member engagement
- **Early stage engagement needs a 'value' focus –** the value of pension saving need to be stressed at an early stage if members ultimately want access to the full range of flexibilities
- **At retirement communications will focus on options –** engagement on the decumulation options available to members needs to start a long time before retirement
- **Later stage engagement required to assess outcomes** – engagement with members as they retire will be important to assess the quality of the outcomes achieved



Early stage comms focus on value of pensions	Pre-retirement focus on decumulation choices	Late stage comms focus on quality of outcomes
"Finding investment solutions is relatively simple, the much harder part is actually the engagement and communications part of getting people to understand what they want."	*"Even before the age of 55 we are planning to engage with members at various trigger points to alert them to the need to make a choice about their decumulation target."*	*"We need to think about preparing members to ask the right questions to ensure their guidance experience is personal to them and we need to make sure they go with the information about what is available within the scheme."*
"The more we tell people to build up sensible sums of money, the more likely it is that they will have flexibility when they get to the ages where they start thinking about retiring."	*"Communication needs to start 10 years before retirement and continue on a drip-feed basis so our members are never faced with just one big annuity/ cash/drawdown decision"*	*""Post-April we need to follow-up with people when they make their decisions to make sure they are happy with what they have done."*
"We are paying a lot into the scheme and if people are really going to appreciate it then we need to do more to help them understand how it is going to make their lives better."	*"The government information is going to be too little too late, people will need to be engaging in the 10 years before they expect to retire so they can start to make suitable investment choices."*	*""Once people are familiar with the new freedoms we need to start to think about surveying older members periodically in order to gain insight into issues as they emerge."*

Improving engagement will require the development of new tools

"Questions we are asking ourselves are: how do we target our communications better and how do we deliver that? Is it via email, webinars, face-to-face? How do we improve the tools that we currently have?"	*"Our engagement strategy is really about giving our members the tools to help them gauge and improve their financial health, in particular pensions, so they can start to establish goals and then work towards achieving those goals."*	*"We need to help people develop targets that put them into annuity or cash or drawdown depending on the pattern, reliability and level of income they are looking for."*

DB to DC transfers: schemes anticipate limited uptake

Key findings

- **Most schemes plan to facilitate some form of DB to DC transfers** – this will mostly take the form of allowing partial transfers out of the DB scheme either internally or to a third party
- **Uptake of DB to DC transfers is expected to be low** – although willing to offer members access to transfers, most schemes felt the value members placed on their DB benefits would mean transfer values will be low
- **Conduct and reputational risks are making schemes cautious** – a few schemes reacted strongly against facilitating internal DB to DC transfers on the grounds of potentially high conduct and reputational risk

Reasons for offering DB to DC transfers

Although shying away from promotion of DB to DC transfers schemes felt it was important that DB members were aware of the full range of options available to them:

- *"We are working hard to communicate the full range of options that are now available to DB members as a result of the pension freedoms. In some ways the reforms have been more revolutionary for DB members than for DC members and we want to ensure members are fully aware of the flexibilities they now have access to."*

Schemes were most open to facilitating DB to DC transfers in circumstances (such as serious ill-health) where there was a clear benefit to the member:

- *"It makes most sense to facilitate the commuting DB into the DC plan in serious ill-health cases where doing so would be clearly in the members benefit, but even then it would have to be IFA-ed very carefully."*

Implementation of DB to DC transfers

The majority of schemes have not seen a large increase in transfer requests:

- *"We have had a few requests for transfer values but it has not been a huge weight. This is largely in line with our expectations, especially until there is a greater awareness of the new flexibilities."*
- *"We have seen a bit of an uptake in requests for transfer values but nothing material."*
- *"The perception in the market is that volumes will be high but we think that people will understand the security of DB and not want to transfer out."*

While schemes are keen to communicate the new flexibilities to members they are keen not to be seen to be promoting DB to DC transfers:

- *"Are we going to raise the profile of DB to DC transfers. Possibly, but only on a light touch basis, probably more through newsletters and information telling member that this is available to them and directing them to go to our website to look at the pros and cons."*

Challenges offering DB to DC transfers

The majority of schemes are cautious about promoting DB to DC transfers due to the potential conduct and reputational risks:

- *"If anyone wants to transfer out to access the new flexibilities they have every right to do so but we are not going to allow internal DB to DC transfers as the potential mis-selling risk is too high."*
- *"We have just got no appetite for conduct or reputational risk, so while we are concerned to ensure DB members are appropriately informed we will not be promoting this option in any way."*

In addition, the quality of IFA advice is being questioned:

- *"Financially for the majority of members we do not see how it can make sense for them to be transferring and so we have some serious questions over the quality of the financial advice which is being provided."*
- *"We will not put any obstacles in people's way, but we would want to make sure that they are fully aware of the consequences of transferring out of DB."*

Monitoring: the challenges of measuring outcomes

Key findings

- **A framework of definitions is the primary requirement –** before achievement of a 'good outcome' can be assessed a framework to define that concept is required
- **Assessment of outcome quality needs to be broadly drawn –** any definition should take into account governance, member options and scheme support of member decision making
- **Outcomes need to be measured at a blended, overall level –** metrics need to be developed to monitor the overall performance of the scheme
- **Dialogue with retirees and industry peers –** monitoring the quality of outcomes needs to involve feedback from recent retirees and industry peers

Lack of a definitions framework

A large portion of schemes interviewed highlighted the pressing need to develop a framework for defining what constitutes a 'good' outcome:

- *"We have a big challenge in defining what is a good outcome, what are we targeting?"*
- *"We think that the focus will shift to defining the 'typical' outcome for different cohorts of members. It is likely we will see segmentation of members to develop targeted outcomes for each different group, but the information set will always be partial."*
- *"So what would constitute a good outcome? So let me give you an example of somebody in a DC scheme for 40 years that earns £20,000 a year and are also going to get a state pension. Given their current contribution rate and default option what will they get and what replacement ratio should they be targeting?"*

Definitions need to be broadly drawn

Any framework for measuring outcomes that emerges needs to be broadly drawn to include governance structures and the appropriateness of the range of options offered to members:

- *"Our starting point in terms of a good member outcome is that we offer a DC scheme which has got an appropriate range of options around contributions and around investments, it's got appropriate well thought through defaults and we support informed decision making."*
- *"Processes are very important and so we have a whole series of metrics around delivery of the pension scheme but going forward trustees will increasingly need to focus on the role they play and to ask themselves 'What are we trying achieve? What do we have to do to achieve this?' and 'What is our role versus that of the employer, and how do those roles work together?"*

Scheme level metrics

Scheme-level metrics need to be developed. At present most monitoring occurs at an individual fund level but respondents felt that more could be done to develop metrics to measure the scheme's overall performance:

- *"The danger is to just monitor the scheme against what you asked the investment manager to do. As trustees of a white-labelled fund it is our responsibility to look at the total return of the fund, especially as our experience in DB means we know in any year what's a good outcome for investment return on risk."*
- *"I think as we go forward with white label style funds the trustees will have to engage in a secondary level of oversight which is not, "what does XYZ manager do?", but rather "how is the blend performing?" and "what is the relative value of the various options offered to members?"*

The importance of an ongoing dialogue

Schemes interviewed stressed the importance of continued dialogue both amongst peers in the industry and with retiring members in order to socialise good practice and test actual member's assessment of outcomes achieved:

- "We are *monitoring what our members are doing in practice, also looking at what's happening across the industry. I am a great believer in monitoring NEST, if we can not do better than them then it raises the question of whether we should simply wind the scheme up and put everybody into NEST."*
- *"We are planning to seek feedback from people who have just retired or taken their benefits. If, for example, those who have taken UFPLS are willing to share with us why they have done so, we could understand what people are typically using those funds for."*

Respondent advice: plan for the long-term

Key Advice

- **Act in haste and repent at leisure –** this was a major theme of the interviewed schemes' advice as the market and its components are still in a development phase
- **Discern and plan carefully –** develop plans that focus on benefitting members in the long-term and on conserving their funds in the short-term
- **Partner with a provider –** a low-cost provider coupled with a flexible administration platform are key to ensuring a good outcome especially for smaller schemes
- **Importance of sponsor support –** schemes stressed the importance of ensuring employer buy-in to the redesign process

Take your time

The overarching advice from the schemes interviewed was not to rush into new scheme designs. With the current lack of products and the speed with which the market is moving. schemes stressed the benefit in taking time to ensure the solutions that were developed were suitable:

- *"Do not rush. The market is moving so much in terms of what is and what is not advice and in terms of how products are developing. The danger is you tie yourself into something too early. So do what you need to do but do not close too many things down."*
- *"Do it in stages, do not be pulled on to this timeline. Do what you need to do to be compliant but give yourself the time to build up a proper solution in a sensible timescale because the timescales that have been set are not sensible."*

Plan carefully

In addition to taking time to review options advice was also focused on the need for careful planning and development of a clear set of objectives to ensure members demands are met as cost effectively as possible:

- *"Schemes should start this process with the question of what it is they can do to benefit their members. The answer is likely to be around administration, around fees and around a flexible method for taking their benefits."*
- *"Every time we do something it costs our members money, so we need to take a long-term view and plan carefully because we are spending members' money."*
- *"Step back and think about what you are trying to achieve with employees. Think about this in the wider context of your reward programme and where the pension sits within that."*

Partner with the right provider

The majority of schemes interviewed stressed the importance choosing a provider capable of delivering the flexibility of the new freedoms. This is especially the case for smaller schemes who can leverage off the providers' scale and experience:

- *"Identify a provider who can demonstrate low cost, flexibility in taking benefits, an investment range that allows a member the ability to manage their funds effectively and who provides a mechanism that does not shut defaulters out of drawdown."*
- *"The first thing is to make sure you have got an administrator and a platform provider that is actually flexible enough to support this stuff, and it's only once you have got that that you actually can even consider doing any of the other stuff."*
- *"Engagement with the provider early in the process is key in order to prevent them enacting a 'one-size-fits-all' strategy."*

Ensure sponsor support

Schemes felt that, now more than ever, it is important that sponsors are fully engaged in the changes that are being made to their pension schemes:

- *"Employers who do not engage with their pension scheme at this stage may find themselves struggling to effectively manage resources in the future. That future holds significant populations of people who may want to retire but, without an effective pension, may be forced to continue working significantly longer than in the past."*
- *"Especially for those looking to make radical changes to the pension scheme, such as introducing in-scheme drawdown, it is very important to ensure the sponsor is fully on-board at an early stage in the process."*

This document consisted of a summary of interviews carried out by Spence Johnson with trustees and pension managers from 9 DC schemes (including both trust-based and contract-based schemes). Interviews were carried out in March 2015 just prior to the introduction of the pension freedoms in April 2015.

The participants in the research were as follows:

- Carol Young, Head of Group Pensions, RBS
- Ian Barrett, Pensions Manager, Santander UK
- Ian MacRae, Finance Pensions Investment Manager, JaguarLandRover
- Ian Richards, Independent Chairman, Next Pension Trustees Limited
- Jerry Ghandi, Pensions Manager UK and Ireland, Schneider Electric
- Karen Jones, Director of Staff Pensions, Aviva
- Mark Thompson, Chief Investment Officer, HSBC Pension Scheme
- Rene Poisson, Chairman, JP Morgan UK Pension Plan
- Yvonne Pearce, Group Pensions Manager, DMGT

Report details

Report compiled by Spence Johnson

Spence Johnson provides research-based services to asset management and insurance firms. Spence Johnson clients use its research-based advice to help them identify and retain clients within their retirement and institutional investment businesses.

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