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Value for money in DC workplace pensions

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Venue: Central Hall, Aldersgate Room

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We'd like to thank…

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Value for money in workplace DC pensions

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- Definition of value for money
- Factors that influence value for money
- Value for money in accumulation
- Value for money in decumulation

There are several definitions of value for money

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Office for Fair Trading (OFT) suggests taking into account:

Charges

Quality, made up of
- Design and execution of investment strategy
- Administration of the scheme
- Communication with members
- Governance, including periodic assessments of how well scheme is delivering

The Pensions Regulator (TPR) definition

A scheme offers value for money where the **costs** and **charges** deducted from members provide good value in relation to the **benefits** and **services** that they receive

National Audit Office (NAO) definition

Optimum combination of whole-life **costs** and **quality**

Does not mean always choosing the immediately cheapest option

It may not be possible to attain the best outcomes for all members

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- Value varies in line with pension membership
- Value can be subjective, with two members in identical circumstances having different definitions

It is possible to identify three outcomes likely to be seen as positive by members

- Value of the pension pot
- Security of the pension pot
- Trust in the pension scheme

Several players influence decisions around whether a workplace pension scheme offers value for money to the member

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Employers
- Select the pension scheme for their employees

IGCs and Trustees
- Analyse value for money for all funds and schemes
- Trustees must do so with regards to the demographic composition of the scheme

The pension scheme

Scheme member
- Value offered by scheme will to a large extent be judged during decumulation
- Value will depend on member's priorities
- Decisions made by the member during decumulation will affect their perceptions of value

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A feedback loop could work towards governance, administration and communication ensuring that the scheme meets members' needs

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Identify:
- Transparent charge and return structure meeting members' needs
- Appropriate contribution levels where appropriate

Interaction between member and:
- Employer
- Pension providers
- Trustees
- IGCs

- Governance
- Administration
- Communication

Fund Charges and returns

Employee behaviour Contribution rates

Feedback:
- Information around the charge and return structure, and fund performance to members via employers, trustees and IGCs
- Information around the impact of increased contribution rates where appropriate

Good governance can be the lynchpin for driving value

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- Communicate the importance of contribution rates
- Ensure transparency
- Set the right default investment strategy for the membership
- Ensure effective administration and communication
- Challenge and negotiate charges

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Contribution rate has the biggest impact on retirement income

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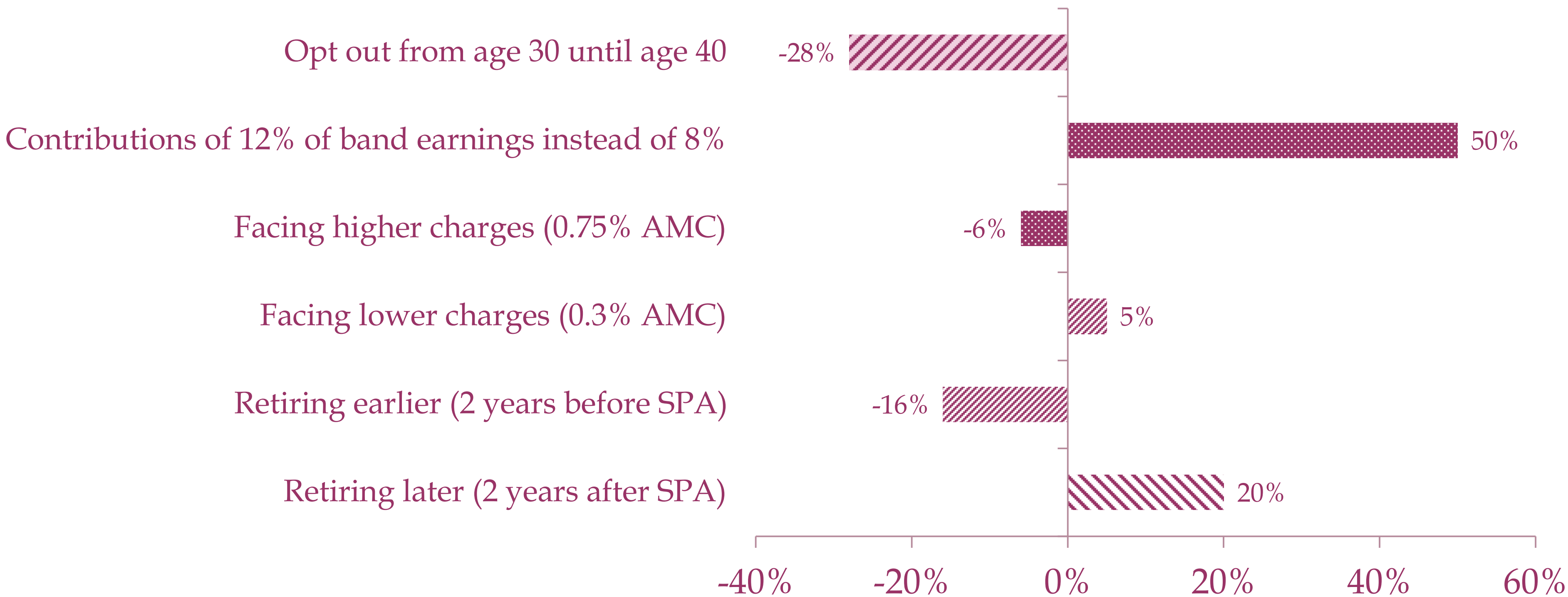
Impact on private pension income for the median earning man on reaching SPA in 2059, percentage difference from the baseline



Employer approaches based on 'nudge' and employee engagement can influence contribution levels

Overview of SMarT and 'Total reward system' approaches

Approach based on 'nudge'

- 'Save More Tomorrow (SMarT) in US increased numbers of people saving and amounts saved
- Auto-escalation is popular with employers (57% supported idea)
- Pension savers supported auto-escalation (60% supported increasing their contributions up to 15% salary)

Approach based on employee engagement

- Where pensions are presented as part of a 'Total reward system' employees are more positive
- More likely to take positive actions that result in higher saving

Employee engagement at age 22 leading to automatic escalation could make a significant increase to pension pots at retirement

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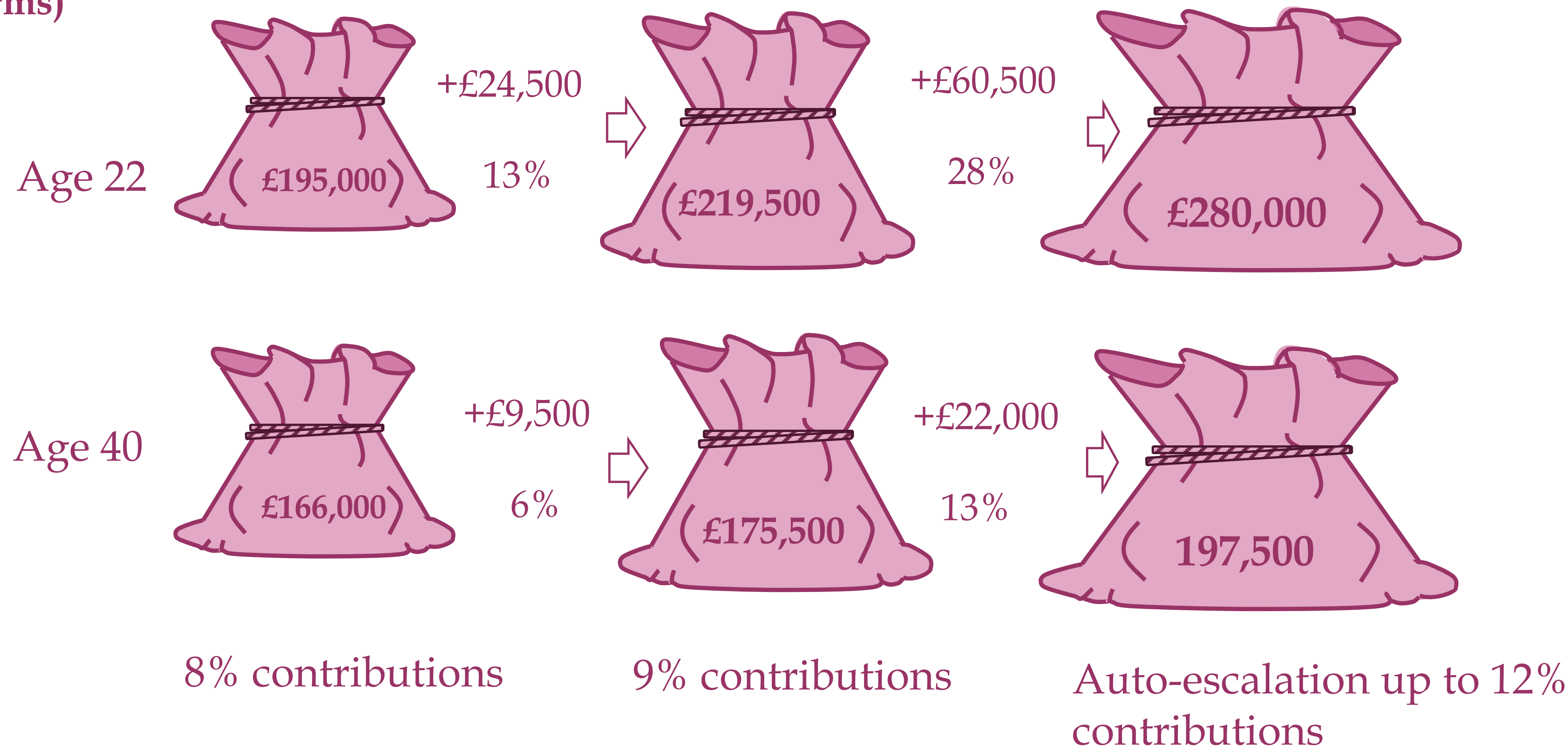
Pension pot value at retirement for a low earner aged 22 and 40 under baseline scenario (8%), 9% contribution rate and auto-escalation up to 12% (2016 earnings terms)



Charge level alone cannot be taken as an indicator of outcomes

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- Charges have decreased
- Higher charges can be justified by higher returns
- Neither higher nor lower charges automatically lead to better outcomes
- Emphasis on other ways in which these influence value for money
- Consistency and distribution of returns may be important
- It is important that charges are transparent

Volatility management throughout accumulation can lead to lower downside risk

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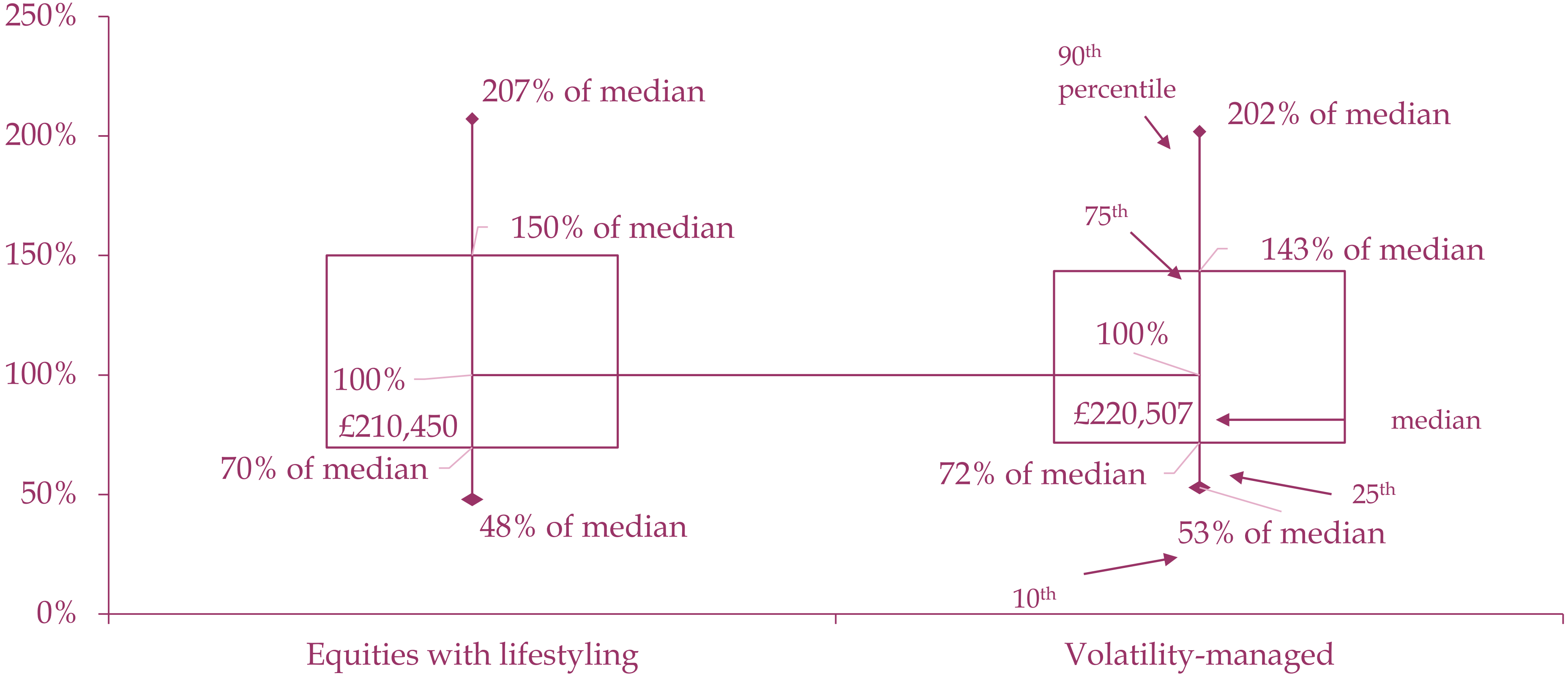
Distribution of pension pot sizes for median earners depending on the extent to which volatility is managed



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Considerations for individuals accessing retirement income

Pension factors to take into account – accessing savings

- Ways in which pension funds can be accessed, e.g. income drawdown
- Tax-free lump sum
- Types of annuity (e.g. fixed, indexed, enhanced)
- Annuity rates
- Tax rules

Decisions

- When to retire
- When to access retirement savings
- How to access retirement savings

Personal factors that will affect decisions around accessing retirement income

- Living circumstances (e.g. single or part of a couple)
- Factors related to life expectancy
- Likely retirement date

The pension regime has focused on value for money in accumulation

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- Members are aware that they need to make active decisions about decumulation but may not feel equipped to make these
- Communication and governance are becoming increasingly important but challenges remain around who will be responsible for this, and how best to present options to members
- Members may be best served where pension schemes assess the likely behavior of their own membership to adopt a suitable approach

A £100,000 pot could run out 25 years earlier than one that is retained in a pension fund

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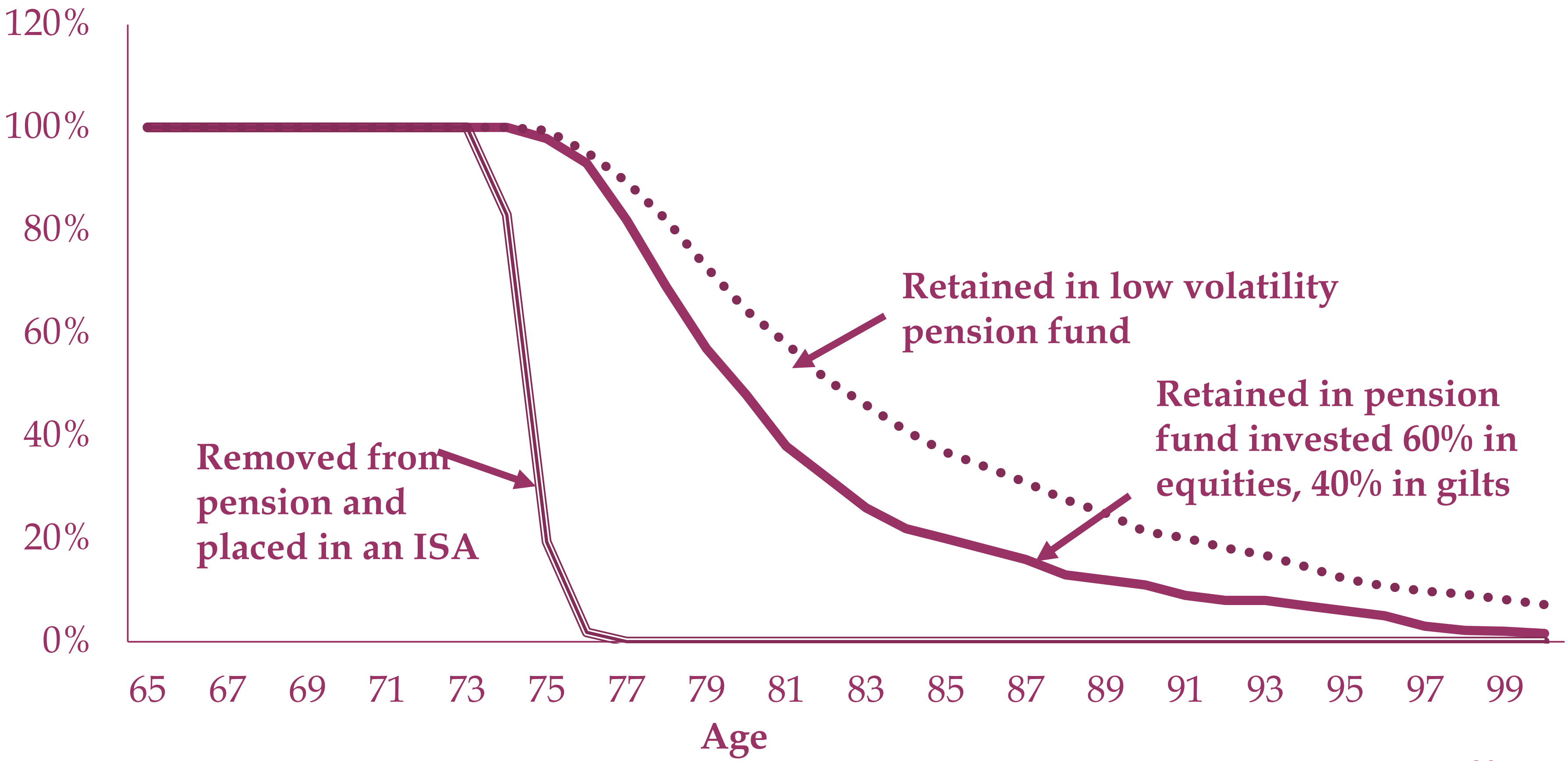
Median duration of pension savings of £100,000 where this is removed from or retained in the pension fund



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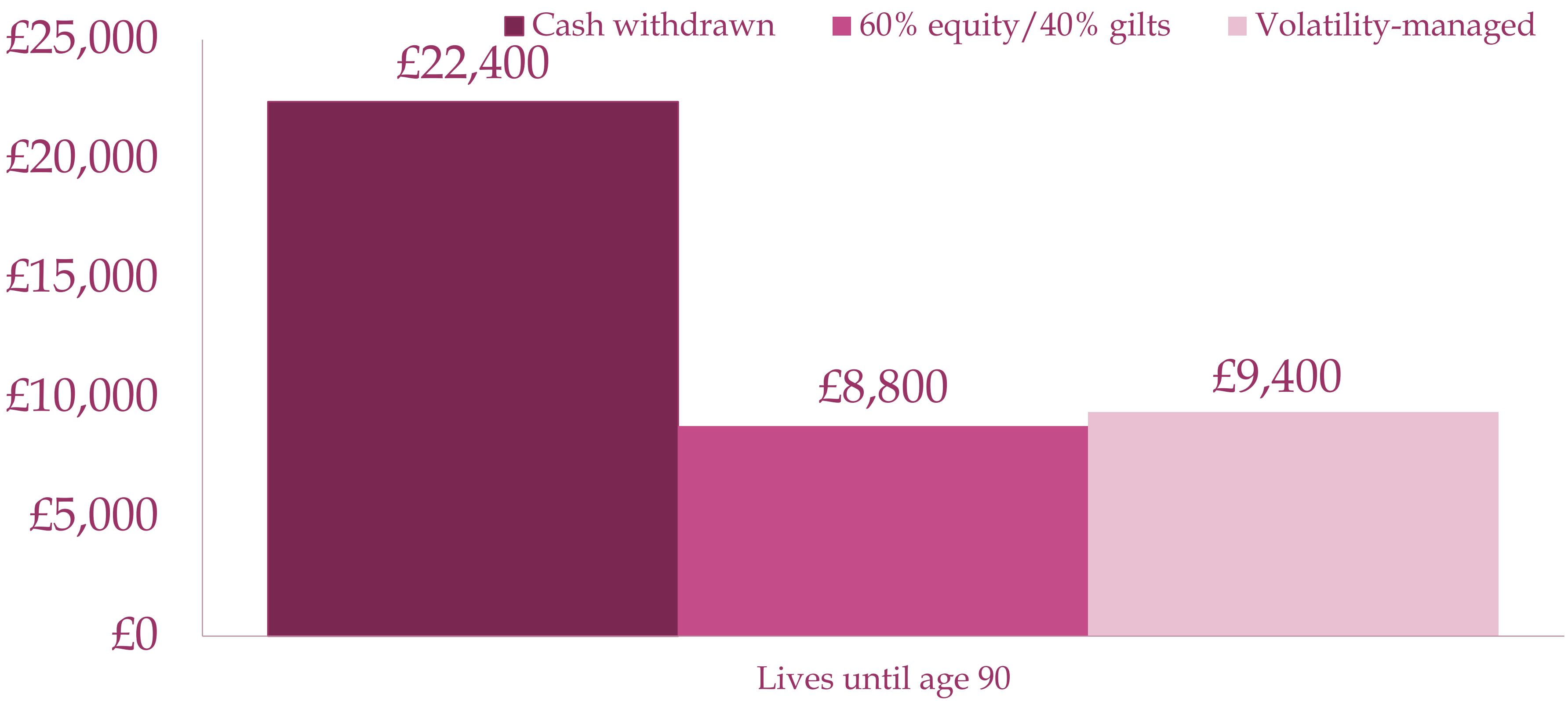
For an individual with a £100,000 pension pot, withdrawing the entire pension pot at retirement could lead to a significantly higher tax liability

Tax payable on pension fund for an individual with a £100,000 pension pot who lives until 90 where cash is withdrawn at age 65 and where this is retained in a pension fund



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Conclusions

- It may not be possible for those responsible for scheme governance to attain the best outcomes for all members
- IGCs, trustees, employers and providers may have to make decisions that are broadly in members' best interest
- It is important to consider all determinants of value for money rather than narrowly focusing on charges
- Extending the role of trustees and IGCs may be needed to help individuals who are making decumulation decisions
- Elements such as charge structures should be transparent to ensure value for money for members

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Q&A