Recognising the different needs and circumstances of defined contribution scheme members and tailoring communications and benefit structures accordingly was a key recommendation from experts at a DC seminar last month.

Members will have a wide range of different needs and expectations of their retirement, the seminar heard, and those responsible for providing occupational pensions should take special care to ensure their offering is appropriate.

In the opening address, Aon Hewitt principal consultant Sophia Singleton stressed to the audience of around 150 trustees that members think and like to interact differently. This fact should be reflected in the way those running the scheme engage with savers.

“You can help members understand what it is they want from the scheme, what the scheme’s going to deliver, and how they can influence that. I do think that’s really, really important,” Singleton said. “As far as delivery is concerned, personalisation and segmentation are quite key, and are beginning to become best practice.”

The event, co-hosted by Pensions Age and Aon Hewitt, covered fresh thinking on DC scheme design and management.

These insights are particularly timely given the rapid growth in DC membership lately, a trend that will only increase as automatic-enrolment gets into full swing.

Figures published by The Pensions Regulator in October showed that more than 1.7 million workers had already been auto-enrolled into schemes, after more than 2,000 of the UK’s largest employers reached their staging dates from October last year.

The first wave of medium-sized employers will reach their staging dates in April next year. More than 5,000 employers will be subject to their statutory auto-enrolment duties from April, followed by more than 20,000 employers – each with fewer than 250 workers – who will reach their staging date between May and July.

Aon Hewitt’s research suggests that 80 to 90 per cent of members will join the default fund, and principal consultant Jenny Swift said DC default funds are expected to grow by a factor of 3.5 over the next 10 years. This projected growth highlights the need to ensure defaults are well designed and appropriate for the vast majority of the scheme’s membership.

Aon Hewitt senior investment consultant Calum Mackenzie said that extensive use of default options is not necessarily a problem in itself. In fact, a study of members of US 401k plans found that members who self-select without investment advice achieve annual performance 2.9 per cent per annum lower than those who get investment advice or invest in plan-managed funds.

However, traditional default options need to reflect the needs of members, and can result in members closest to retirement facing the biggest risks when they have the least time to recover from them.

“Traditional default options solve some, but far from all of the...
investment issues facing DC members,” Mackenzie said.

He outlined an approach that places the growth phase at the start of the saving experience, followed by a transition phase where the focus shifts to the downside with a mix of equities, diversified growth funds and capital preservation. The fund finishes with a ‘pre-retirement’ phase designed to suit the retirement income plans of most members.

Under a strong governance structure, the default should be tailored to the vast majority of members. Low and high risk lifestyle options, and a lifestyle option designed for members likely to utilise income drawdown can be offered to so-called ‘guided selectors’, who pick options other than the default under guidance.

A wider range of white-labelled ‘freestyle funds’ can then be offered for those members who are informed and very engaged with their saving.

Swift outlined ways to apply defined benefit thinking to DC schemes, focusing on retirement income with the impact of investment decisions on income replacement ratios taking precedence over relative investment performance.

This can be accompanied by a ‘people like me’ approach to communications, which translates the options available to members into examples of how the different funds or retirement income options will or will not work for them.

Singleton said that the level engagement of member engagement can be boosted through providing easy access to savings modellers, and tailoring the information members receive with their annual statements.

Clear ‘calls to action’ should also be in place, to make sure members actually act on the information that is provided to them.

“A lot of schemes do have model-lers or some sorts of tools available but people either aren’t using them or where they are using them they’re not taking action and making decisions,” Singleton said.

Removing jargon from communications and ensuring they are appropriately pitched at their target audience is also crucial, Singleton said. Overly complex communications may not have the impact desired by those running schemes.

The need for effective communications is particularly important in the lead up to retirement, DC proposition leader for health and benefits Debbie Falvey said, given the importance and often irreversible nature of the option taken when converting savings into retirement income.

People are often surprised at retirement when they realise they need to make a decision on how they convert their pension, Falvey said.

“At this point, unhelpfully, we introduce a whole new load of terms and words that they don’t know or understand – and why should they?”

Falvey told the audience that as well as communicating clearly with members, it is important to start the conversation early to give time to prepare and make sure they select the right option.

“As you get to two to five years before retirement, getting people to think about the different options that are available to them and the decisions they’ll need to make is really, really important,” she said. “That seems like quite a long way away, but if you think about it I might have other pensions that I’ve forgotten about. People do lose track of pensions along the way.”

Where members are going to annuitise it is important to ensure they are aware of their options, as many retirees will qualify for enhanced rates. Equally, purchasing an annuity will not be the best option for some members, which will inform the investment options taken with the fund in the lead up to retirement.

Schroders senior adviser Alan Brown made a strong case for choosing alternative retirement options to de-risking into gilts and purchasing annuities, arguing that using an income investing approach can provide better returns on terms that do not eat into capital stock or lock savers in for their entire retirement.

Modelling comparing the Schroders equity income strategy against an annuity purchase with a £250,000 pot, purchased by a 65 male with a 60 year old spouse, showed the income investing option was preferable in terms of the income generated, the level of increase, and the spousal pension income. This option also did not see the capital value eliminated upon the retiree’s death.

Brown called for the government to change the minimum income requirement to allow income from qualifying funds to be eligible, on the basis that the participant only takes the fund’s income and does not draw down on the capital.

“In those circumstances it seems to me that we would be recognising the extraordinary valuation anomaly that’s out there today, and actually helping people, most importantly with relatively small retirement pots,” he said. “And it wouldn’t cost the exchequer anything.”

Written by Pensions Age team