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WORKPLACE PENSIONS

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FINANCIAL WELLBEING

Holistic financial planning to target savings gap

Employers and pension providers are increasingly offering lifetime financial planning in a bid to engage staff in saving for retirement

TIM COOPER

Financial wellness has become a buzz phrase in the last few years. For employers, it refers to anything that supports the financial security of their employees and often involves a move from narrow benefit packages to wider and more flexible programmes of benefits and education.

A host of recent research has shown the impact of financial wellbeing issues in the workplace. For example, a recent report by the Reward and Employee Benefits Association (REBA) showed that 25 per cent of employees say that financial concerns affect their ability to do their job.

The *2017 Willis Towers Watson Global Benefits Attitude Survey* also highlights a direct correlation between employees' financial concerns and performance at work through sick days, productivity or engagement. The survey says employees are looking to their employers for support. Some are responding with programmes that support financial wellbeing, but employees are lukewarm about what they have seen so far and engagement remains low.

Meanwhile, wellness product providers talk of an explosion in the market over the last few years. A survey by workplace financial education provider Nudge Global showed a significant increase in employers providing a financial wellness programme between 2013 and 2016. In 2016, 45 per cent of companies had a financial wellness programme or were implementing one, up from 26 per cent in 2014, and 50 per were considering it, up from 20 per cent.

But some of these programmes are still narrow and there is room for progress towards holistic financial planning covering all the areas that employees need help with such as debt, pensions, saving, tax and insurance. In 2016, 96 per cent of companies wanted to provide holistic financial education, but only 42 per cent did so.

Financial wellbeing expert Jason Butler says: "I detect a much stronger awareness that financial wellbeing solutions are an important part of recruitment and productivity. But I'm less convinced that it is translating into significant tangible action."

He says many good tools and services have become available to support wellness. For example,

Yulia Grigoryeva/Shutterstock

financial advice firms provide paid-for seminars and personal advice for those who need it. Technology companies provide digital education platforms that provide individualised insights and prompt employees to action at appropriate moments. Others provide wellness content linked to products such as loans and savings accounts, perhaps at a negotiated discount for the employer.

"The challenge for employers is that they need help understanding which platforms, interventions and seminars they need, and who will pay for them," says Mr Butler. "Each firm's needs are different. For example, if you employ lots of millennials your needs will differ from companies with lots of part-timers, older workers or gig economy workers. Public sector differs from private and so on."

Minh Tran, director at benefits consultant Willis Towers Watson, says provision of holistic financial planning is increasing, but from a small base of early adopters. He agrees that employers are increasingly aware that helping address financial worries should promote a more engaged and healthy workforce, and so attract talent.

Mr Tran says providing a wider choice of flexible, alternative savings, such as workplace individual savings accounts, general investment accounts and even debt facilities, helps maximise the impact of existing benefits budgets. It also recognises the diverse needs in the workforce, which should improve employee engagement. In future, he expects tax-efficient financial advice using the recently introduced pension advice allowance will also be popular.

There may be some short-term obstacles but, in the long term, broader workplace packages will become more common as companies need them to attract the best talent, he says.

Mr Tran says Willis Towers Watson's research shows that the way to improve engagement with wellness programmes is to use new technologies together with an effective communication strategy across multiple platforms and channels, including mobile, PCs, paper based, group presentations and one-to-one sessions.

The REBA survey confirms that the role of technology in holistic planning is set to increase. It shows that 19 per cent of employers have a wellness technology platform in place, but 61 per cent have one in planning or development.

Andy Woolnough, human resources and payroll solutions director at software firm Equiniti, says: "To help win and keep the best talent, employers have become more proactive in recognising the different needs of different generations in their workforce.

"People analytics – technology that uses data to link 'people strategy' to wider business strategy – is a growing part of that. Software can also give people individualised information in the right time and context for them, and measure the value of each strategy more precisely. Plus it can make finance more user friendly with techniques such as gamification [making software work like a computer game]."

Rory Murphy, chair of the Merchant Navy Officers Pension Fund, agrees that companies will offer more holistic planning as awareness grows. However, saving for retirement is still a crucial part of financial wellness for everyone and it needs to start early. There is a danger that greater flexibility will be at the expense of pension provision, leaving employees with insufficient retirement savings later in life, he says.

Financial advice will also help support wellness and Mr Murphy says companies should offer it using the new allowance. "I expect they won't because they tend to focus on short-term profits and shaving costs," he says. "But the evidence shows that if you invest in and look after your staff, you will get a better return in productivity. Enlightened companies with wellbeing programmes that include financial education will tell you that their productivity is increasing 5 to 10 per cent."

£50k average amount accumulated in a pension by 2017, up from £36,000 the year before

25% of the UK population now expect to stay in full-time work past 65

56% do not know what level of retirement income they will receive

Aegon 2017

Finger on the DC Pulse

Changing pension options have put savers in the driving seat. When did you last think about your financial future?

It's time for a revamp around the notion of retirement. We're living longer and have more financial choice than ever before. Rather than the beginning of the end, "retirement" can be whatever we want it to be. But this freedom comes with a responsibility to save for our future selves so we can have that financial freedom.

Many of the previous certainties around retirement are changing. People used to work until 65, at which point the state pension would kick in and retirement would begin. If they had a good employer, they would be likely to receive an income equivalent to a percentage of their earnings. But longer life expectancy, rising debt levels and a less linear study-work-retirement pattern are blurring this clarity, and refashioning the traditional notion of retirement. For example, over-50s now account for nearly half those setting up their own business and pension schemes need to reflect the new landscape.

In many ways this change is liberating. The pressure to have completed studies by a certain age or stop work because of an arbitrary number no longer dominates. Our longer lives mean we will have more opportunity to reinvent ourselves and pursue new avenues. But to do so, we need to save. We need short-term savings to cover life's bumps and scrapes, and medium-term savings for life moments such as marriage, home ownership or children. We also need long-term savings for the stage in life where we no longer can or want to rely on paid income.

Only 28% of members surveyed felt they were on track

1 BlackRock *DC Pulse* survey, conducted in association with research agency Illuminas in July 2017 amongst a nationally representative sample of 500 UK residents, aged 30 to 69 years old, earning £10,000 or more and who have or are contributing to a Defined Contribution workplace scheme. Scheme findings based on interviews with trustees, independent governance committee members or investment teams of 41 FTSE 350 public sector organisations. The results of this survey are provided for information purposes.

Saving for later

Retirement savings have changed significantly in a generation. When once employers were relied upon to provide pension benefits (defined benefit), the onus is now firmly on the individual to grow and manage a nest egg for their future provisions (defined contribution or DC).

But pensions can appear dull or complex to most people and ever-moving goal posts have added layers of confusion.

Our *DC Pulse* survey[1] has shown that engagement is low and confusion high. We asked 500 members of DC schemes how they interact with their scheme and how confident they are about their futures.

There were two main areas of confusion – understanding how much income their nest egg will provide in retirement and then translating this into how much to save today.

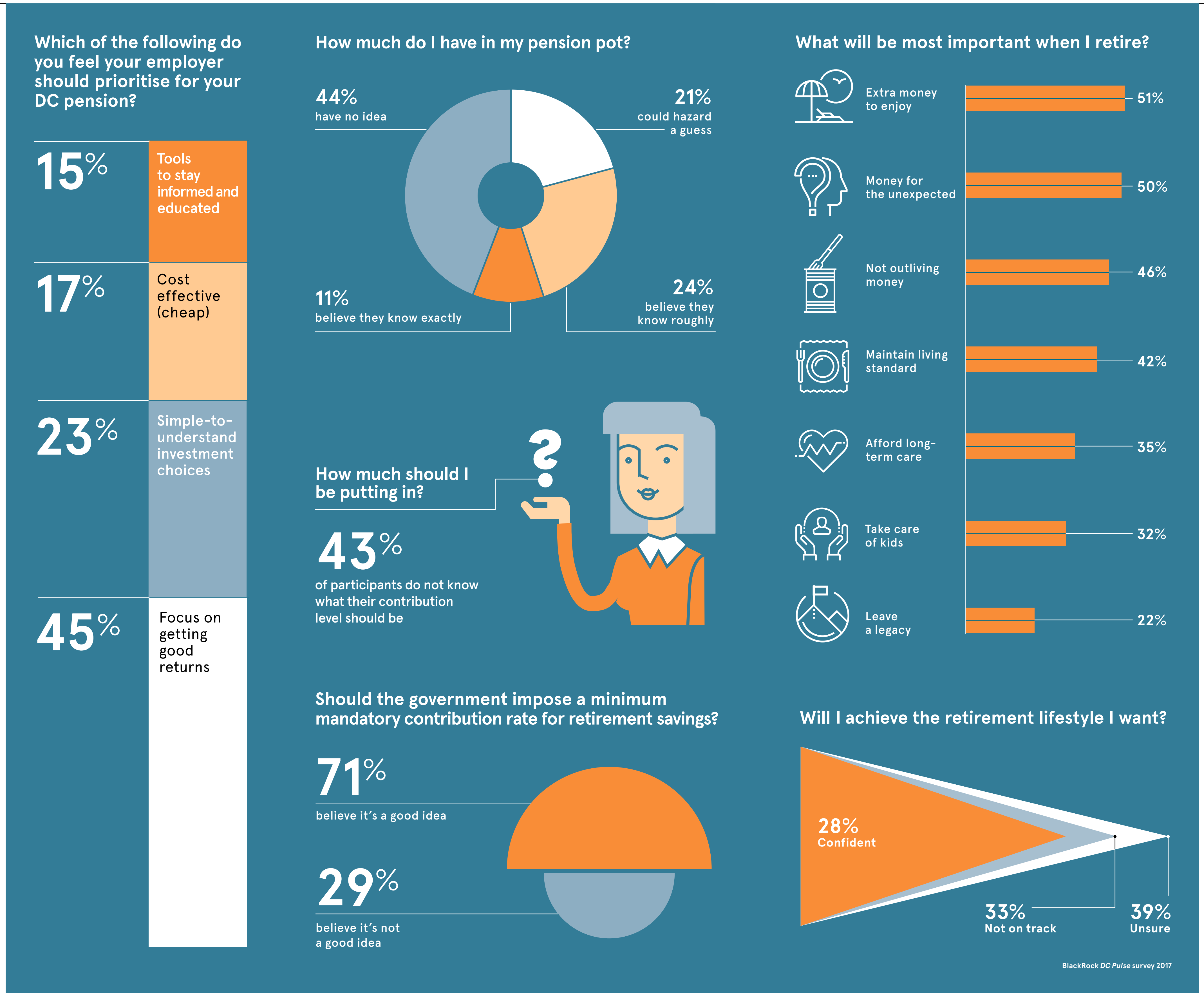
"How much income will I get?"

Fewer than a third of members surveyed felt they were on track to live the lifestyle they want in retirement. This is because they don't know how much they need in their pension pot to give them enough income after they retire. Telling someone they might have half their current income in retirement is a lot easier for them to grasp than telling them they'll need to build up a £400,000 retirement nest egg.

"How much should I be putting in?"

The second area of confusion for savers was how much they should be putting in their pension pot. This is not surprising, given people struggle to estimate how big a pension pot they will need. Fewer than half the people we surveyed knew how much they should be contributing and there's a huge danger that members are overestimating how much they are saving for their retirement.

Contribution rates are the next great challenge for pensions. Both industry and government have a key role to play in helping employees to become more aware. There needs to be a push to make people understand the importance of saving today to cover tomorrow. What's more, the earlier they start, the more they will benefit from each year's growth.



> For many, it might be a case of starting with something less and then building up to a higher contribution rate

People recognise that contributions play the biggest role in growing their pension pot, which is encouraging. But we also know that people are on average contributing just 4 per cent of their salary, which is far below the recommended level.

Age of "auto"

The introduction of auto-enrolment (AE) has arguably been the boldest step in helping people to save. But minimum contributions under AE still fall far short of what is realistically needed for a comfortable retirement.

As a broad rule of thumb, pension savers should be targeting an average 15 per cent of their earnings to be put away for their future. Much of this depends on personal circumstances and how much they want to maintain their standard of living, but it can be a good place to start.

Let's also be frank, 15 per cent is probably too much for most to consider contributing initially. For many, it might be a case of starting with something less and then building up to a higher contribution rate. This is where auto-escalation can help. It allows savers to pre-select a percentage of future pay increases that will automatically be invested in their pension pot. The effect can be boosted if the employer matches any increased contributions made.

Auto-escalation, which can be tailored to a number of factors such as age, time to retirement and affordability, would see people making significantly higher contributions in an incremental and relatively painless way.

Importance of simplicity

While contribution levels are the main driver of returns, the investment returns achieved are also very important. The reality for DC funds is that the vast majority of scheme members leave this crucial part to the employer and most have little idea about the default fund in which most members' money is invested.

However, when we asked people what they wanted most from their employer or scheme, they were twice as likely (45 per cent) to want a focus on good returns as they were to want simple-to-understand investment choices (23 per cent).

This is why a scheme's default is so important. Typically, more than eight in ten scheme members will be in the default, so employers must make sure it's fit for purpose.

We believe schemes should reserve their focus on simplicity for member communications and contribution incentives. To impose a less sophisticated approach upon the default runs the risk of creating sub-optimal portfolios. In a rapidly changing world, where the concept of retirement is being remodelled, investment strategies must keep pace.

For more information please email GroupDCInvestments@blackrock.com

BlackRock®

Q&A

Member outcomes should be the priority

Increased engagement, clarity around contributions, and a focus on value can improve a scheme's success

Claire Felgate
BlackRock head of UK DC

What was the most surprising finding of the 2017 *DC Pulse* survey?

The difference in opinion between schemes and members. Schemes were very honest about how confident they are about defined contribution (DC) members' prospects. At least four in five admitted they could not guarantee positive outcomes. Driving engagement appeared to be their biggest concern, but a large proportion felt that education techniques didn't have the desired effect.

In contrast, a lot of scheme members recognised the importance of saving for the future, but were unsure of the necessary steps to take. One of the biggest surprises was that most people already in a scheme would like the government to impose a minimum mandatory contribution. This highlights a working population who know they need to save, but want to be told how much and given a helping hand to do so.

What else surprised you?

The disconnect between what members prioritise from their pensions and what schemes thought they want also came as a surprise. Schemes have focused on simplicity in the hope it would engage more people, but simple messaging shouldn't translate to simple investments. We found that nearly half the participants wanted their employer to prioritise returns and that's something we feel a number of schemes should revisit.

What is the biggest obstacle DC schemes face?

I think it's twofold. Firstly, education and engagement are huge obstacles for schemes. Secondly, more DC schemes need to look at how they can help their members, even if they don't engage.

Most scheme members cited simple, personalised communications are more likely to capture their interest. We know that if companies explain pensions in simple terms with no jargon and with their own branding, people are far more likely to engage.

What about contribution rates?

Central to engaging people is ensuring they understand the importance of contribution rates. There's a huge danger that members are overestimating their contributions, but schemes could be doing more also. Matching – "You put more in and we will match your extra contribution" – and auto-escalation – automatically increase your contributions by an agreed amount each time you get a pay rise – are both proven ways to motivate people to put more into their pot.

> Clients will ask me what value for money really means and I define it as achieving your objective in the most cost-effective way

What is the difference in employers' approach towards DB and DC schemes?

The single biggest difference between defined benefit (DB) and DC schemes is who takes the risk. DB schemes place the investment risk with the employer, while DC puts the employee firmly in the driving seat. This can sometimes translate into hesitancy to get too involved in the investment side for DC. The danger is that employers can view DC schemes as a framework, and the success of it very much comes down to the individual's personal engagement and contribution levels.

That said, we work with employers and trustees every day who are breaking new ground on investment ideas to benefit their members, such as incorporating stronger environmental, social and governance views.

What is your view on cost of ownership for investments?

Value for money has rightly become very important to DC schemes. Often, clients will ask me what value for money really means and I define it as achieving your objective in the most cost-effective way.

There are two elements. Firstly, schemes need to have the right objective. Secondly, they need transparency on charges and costs to see whether they are reaching their objective as cost efficiently as possible.

The cheapest option doesn't necessarily offer the best value for money. The focus should be delivering outcomes for members. The objective in early years may be getting the highest risk-adjusted return to grow the size of the pot. In later years it may be protecting against market losses so the pot size is more stable towards retirement. Once clear objectives are established, schemes can then look at how they get there in a cost-conscious framework.

I believe transparency around costs and fees is very important so that clients know what they are paying for and can judge if it's cost effective. Key to this is being able to distinguish between charges and costs. There are a number of charges which come from an asset manager, a platform and any advisers involved. Separate to those explicit charges are the costs to trade underlying assets in a fund – transaction costs.

This year will be about helping clients to understand fully all these costs and charges, so they can evaluate the value for money being delivered.

Workplace pension outcomes depend on shared engagement

Outcomes delivered by employer pension schemes depend more than ever on levels of engagement, so companies must create good quality schemes and successfully communicate their benefits

While auto-enrolment in workplace pensions means higher employee take-up, this does not necessarily equate to staff engagement or a true understanding of the options.

For employers, improving engagement includes putting in place the right scheme, appropriate charges, strong governance, excellent member education and communication. For employees, it is important to start early, understand key decisions and options, and regularly monitor fund values.

"Delivering desired outcomes remains a question of shared responsibility," says Martin Parish, workplace pensions proposition lead at pensions and benefits consultancy Aon.

It is increasingly important to focus on tailoring pension communications to match the life stages and financial considerations of scheme members. This is because a one-size-fits-all approach is no longer enough to motivate engagement. A recent Aon survey found that 99 per cent of human resources professionals thought it was important to increase employees' understanding of retirement savings. However, only a quarter of businesses have a related employee value proposition.

"It is crucial that employers think carefully about how they communicate their messages around workplace pensions to ensure maximum involvement from staff," says Mr Parish. "Even if employers create a great scheme and put a lot of time and effort into it, then it isn't worth much if the employees then still ignore it or only make minimum contributions."

It can be helpful for employers to begin by considering the various members of their pension plans and their respective needs in broad terms. As such, Aon illustrates the different needs using several fictional, typical employee characters. These characters are categorised as being millennials, generation Xers and baby boomers, showing how the key considerations around workplace pensions change as time goes by.

"Millennials might look at workplace pensions and engage with them in only a limited way because they're more concerned with their student debt or taking home as much of their salary as possible," says Sophia Singleton, head of DC (defined contribution) consulting at Aon. "So the challenge for employers is to emphasise the benefits of workplace pensions and the idea that increasing your contributions early, especially if they're being matched, can really pay off later in life."

> **"Using the right tools and providing appropriate information and guidance can make all the difference to outcomes**

Successfully helping this group includes encouraging them to register for online access and encouraging higher contributions. This can include communicating the benefit of the company contribution and the tax breaks, and educating on the benefits of compound interest through investing at an early career stage. But it also includes being realistic and providing education on how to tackle debt as they may need to do this before they can start saving.

Meanwhile, gen Xers exemplify the types of people who are mid-way through their careers, often with a family, some of whom may have trigger events, such as having recently been given a pay rise. This is a timely moment for the sponsoring employer to help them to consider their pension strategy more carefully.

"This type of person is likely to be in a workplace pension, but perhaps without really having thought about what it all means and what eventual outcomes would be good to aim for. This is where employers can step in to provide valued guidance and support," says Ms Singleton. Successful support here might consist of financial wellbeing education, including for the wider family, making the right investment strategy information available and illustrating the potential outcomes of increased contributions.

Meanwhile, baby boomers and anyone getting towards the latter stages of their full-time working lives will typically have quite different issues in mind as they look to the future and assess their pension options.

99%

of HR professionals thought it was important to increase employees' understanding of retirement savings

***Aon Benefits and Trends Survey*, 2018**

"From a contribution point of view it is pretty much too late to begin for the baby boomers, and their considerations are much more about what benefits have been built up, and when and how to retire," Ms Singleton says. "The aim for employers here should be to ensure that these decision-making processes are as straightforward and painless as possible."

To help baby boomers, good support would include pre-retirement education, good guidance around flexibility and drawdown, and advice on future investment strategies into retirement.

Although these three character groups illustrate and typify some key ideas around pension needs, it is also very clear that the diversity of concerns among individual employees needs to be considered seriously by employers of all sizes.

Improved communication by employers does not necessarily mean sending out more regular emails. "You can actually overdo this," Mr Parish says. "So you need to make your communication timely, meaningful and targeted."

Timely communication means reaching individual employees at key junctures in their working lives. These moments are when people are most likely to consider their pension situation and think seriously about their finances.

"It's in these moments when employers need to be able to reach individuals with tailored information, and be clear they can access much more detail and guidance," Mr Parish says.

Delivering resonant, timely messages and underpinning them with easy access to highly personalised information is now a fundamental part of providing high-calibre workplace pensions. Using the right tools and providing appropriate information and guidance can make all the difference to outcomes. All this is much easier when pension schemes utilise modern, engaging technology platforms such as those used in Aon's MasterTrust or in its BigBlue Touch Group personal pension offering.

POVERTY

Pensioners faced with poverty...

Failure to save enough for their retirement, coupled with an inadequate state pension, is leaving millions in pensioner poverty

VIRGINIA MATTHEWS

Millions of people will be forced to either retire in poverty or "work until they drop" unless the government goes further and quicker with its programme of pensions reform.

So says Sir Steve Webb, who as pensions minister under David Cameron was a prime mover in the introduction of the Department for Work and Pension's (DWP) flagship auto-enrolment scheme six years ago.

Now director of policy at Royal London, Sir Steve believes that unless minimum contributions to workplace pensions rise to "a more realistic level", maintaining a decent income in retirement will be beyond the reach of many.

"There are literally millions of people in their late-40s and 50s who are too young to benefit from the lucrative final salary or defined benefit (DB) pensions which are either now closed to new members or being shut down," he says.

"Yet many of these older workers may already be too old to build up a decent sum from what has replaced DB, the so-called defined contribution schemes which tend to be far less generous."

While Sir Steve says he is in favour of people working longer if they want to, being forced to stay on the treadmill purely to pay the bills is another matter.

"Going to work solely because the state pension isn't enough to live on and your personal pension is puny isn't a good state of affairs for individuals, or for business or society," he says.

Last December, the DWP's own review of auto-enrolment found that some 12 million Britons or 38 per cent of the working population overall are still failing to save enough for a comfortable retirement.

Although overall opt-out rates for the new pension savings system have been generally lower than expected, workers aged 55 and above are three times more likely to drop out than younger colleagues, even though current minimum contribution rates are just 1 per cent each for employees and employers.

With two contribution price hikes already on the horizon – they rise to 5 per cent in total in April and to 8 per cent in April 2019, sums described as "wholly inadequate" by Sir Steve – there are fears that dropout rates among the 55-plus age group may continue to rise.

"When you look at this issue in more depth and realise how many people in this country have literally never saved, let alone saved for retirement, you begin to realise how big a problem we are building up for the future," he says.

Aegon head of pensions Kate Smith believes that older workers represent a "lost generation who have been left behind" by the recent pension changes and she too urges the government to do more to help them.

"We hear a lot about millennials being short-changed by various policies, but in terms of auto-enrolment, they do at least have the luxury of several decades in which to build up a decent fund for later life," she says.

> **"Going to work solely because the state pension isn't enough to live on and your personal pension is puny isn't a good state of affairs**

"For the millions of workers who had fully expected to retire in the comparatively near future, but who can no longer afford to, the outlook is very different. When you add in the burden of expensive caring responsibilities, you begin to see that we have a perfect storm."

Although equity release lending broke through the £3-billion barrier for the first time in 2017, Ms Smith advises homeowners looking for a quick cash injection to tread cautiously.

"Selling equity in your home not only deprives your children of becoming homeowners, but may be wholly inadequate when it comes to funding 20 or more years after retirement," she says.

Although the DWP's decision to lower the minimum auto-enrolment age from 22 to 18 earns praise from Ms Smith, she believes that obliging workers to opt back in once they hit state pension age is a mistake.

"Many more people are enjoying longer working lives and they should be included in auto-enrolment just like other workers. Removing the younger age limit, but leaving the older one in place is a missed opportunity in the fight against pensioner poverty."

For Sir Steve, another major area of concern is the decision not to include the country's 4.8 million self-employed people, many of them in the older age bracket, in auto-enrolment at this stage.

According to recent data from the Office for National Statistics, as many as 45 per cent of self-employed people aged between 35 and 55 have literally zero pension wealth; a finding which Sir Steve describes as "truly shocking".

For Aviva's head of retirement solutions policy John Lawson, there is much to celebrate in the new workplace pensions landscape, however.

"It's a great shame that so many people in their 40s and 50s think they are too old for auto-enrolment because nothing could bee further from the truth," he says.

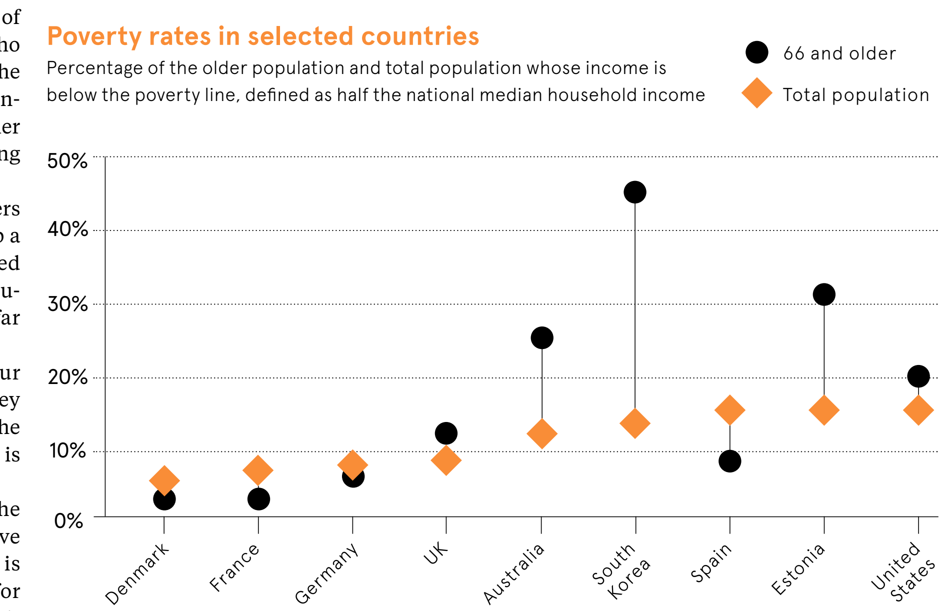
"Unless you have high-interest debts such as mortgages, which should always be paid off first, auto-enrolment is an absolute no brainer, particularly if you are fortunate enough to have an employer who will match your contributions above and beyond the minimum."

While Mr Lawson agrees that for those already close to pension age, a workplace pension may not be sufficient to fund an entire lifestyle, he believes opting out on age grounds alone may be a costly mistake.

"Whether it's augmenting the state pension, doing up your kitchen or having a holiday, building up cash through auto-enrolment can help retirement run more smoothly," he says. "In my view, auto-enrolment rates among the 50-pluses should already be at 100 per cent." ◆

Poverty rates in selected countries

Percentage of the older population and total population whose income is below the poverty line, defined as half the national median household income



Latest available data between 2013 and 2016

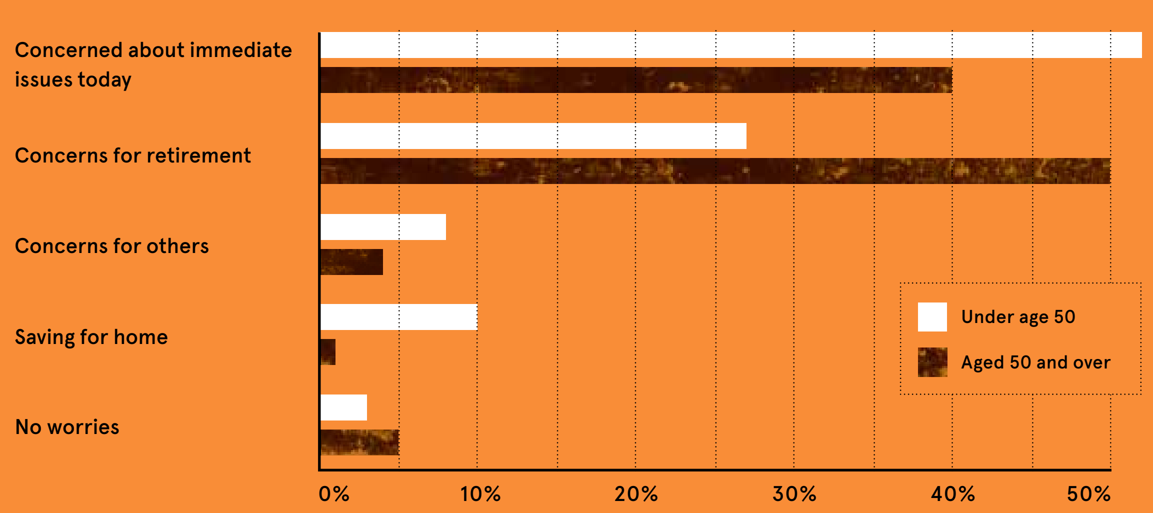
OECD 2017

AFFORDING OLD AGE

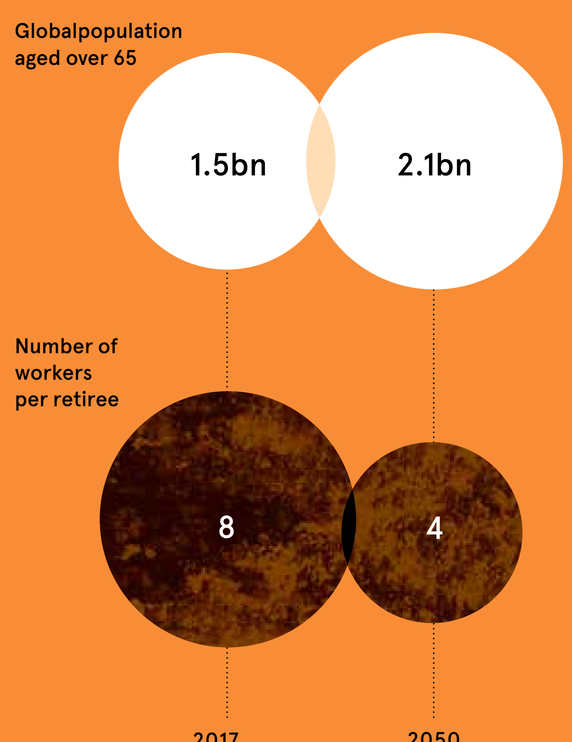
Longevity is increasing and is set to put a growing population of retirees under immense stress in the coming decades as people struggle to pay for their retirement. Life expectancies have risen by an average of three years per decade since the 1940s and, while retirement ages are gradually increasing, people are spending longer not working without the savings to justify it. This has created a $70-trillion pensions timebomb in eight of the world's largest economies, which could swell by nearly six times by 2050

RETIREMENT IS A BIGGER FINANCIAL WORRY FOR OLDER EMPLOYEES

Percentage of employees who selected the following as their biggest financial worry...



Mercer 2016



World Economic Forum 2017

48% of the global retirement-age population currently do not receive a pension

50%+ of global workers are in the informal/ unorganised sector

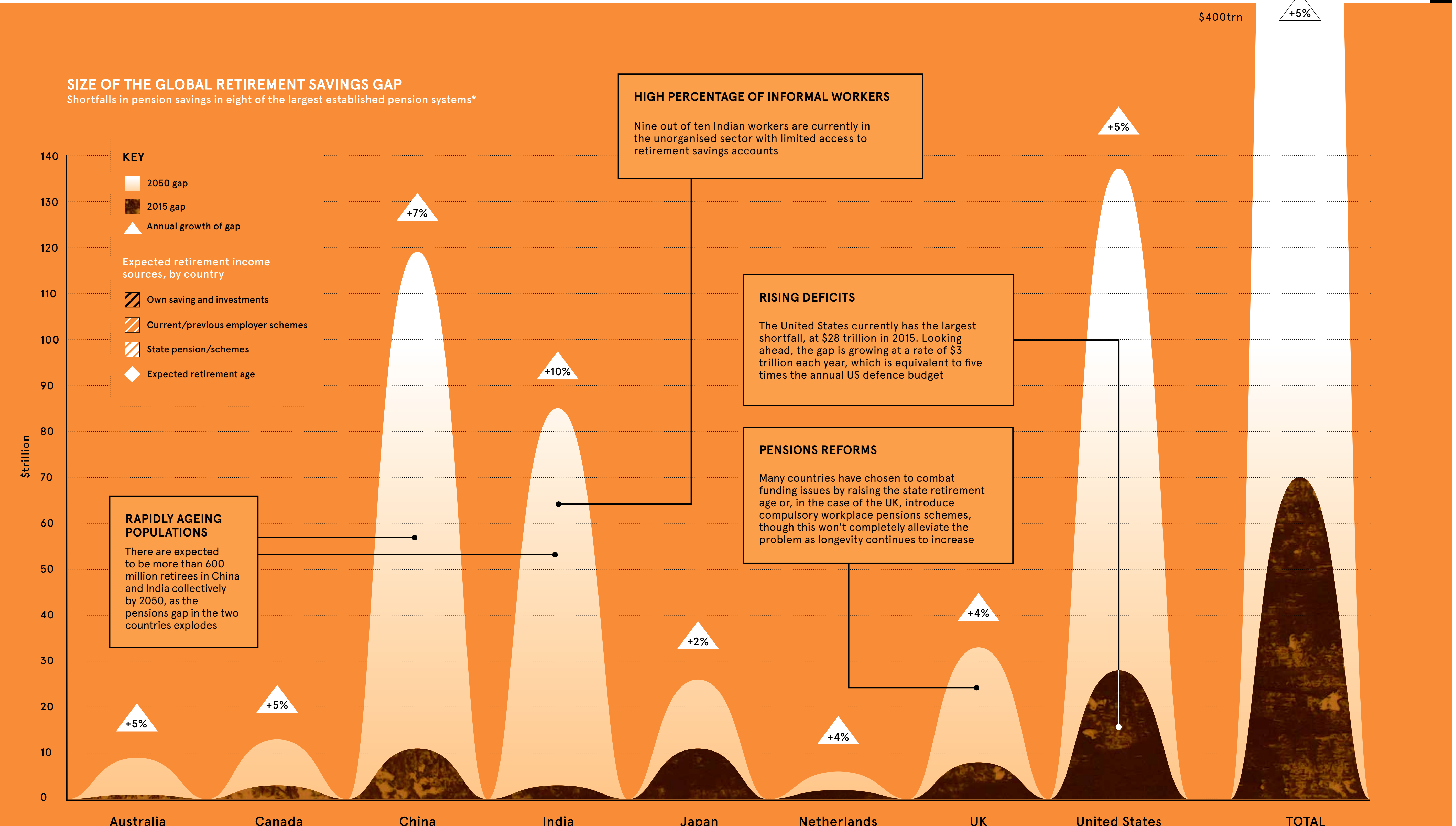
World Economic Forum 2017

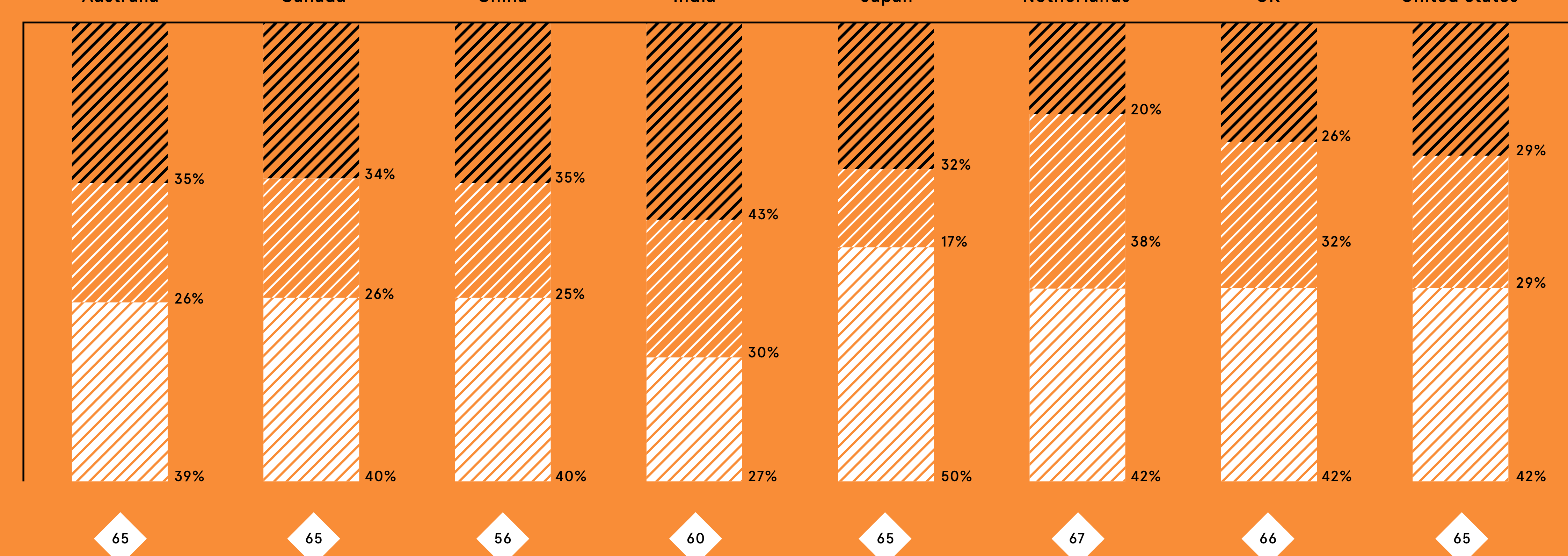
103 "best-practice" life expectancy of someone born in 2007, compared with 94 for those born in the 1970s and 85 for those born in 1940s

The 100-Year Life/ Human Mortality Database 2016

SIZE OF THE GLOBAL RETIREMENT SAVINGS GAP

Shortfalls in pension savings in eight of the largest established pension systems*





$400 TRILLION

The size of the pensions gap in these eight countries stood at $70 trillion in 2015, of which 75 per cent is attributable to deficits in government-funded state pensions and schemes for public employees. As longevity continues to rise, this pensions shortfall is expected to reach $400 trillion by 2050, equal to around five times the size of the current global economy

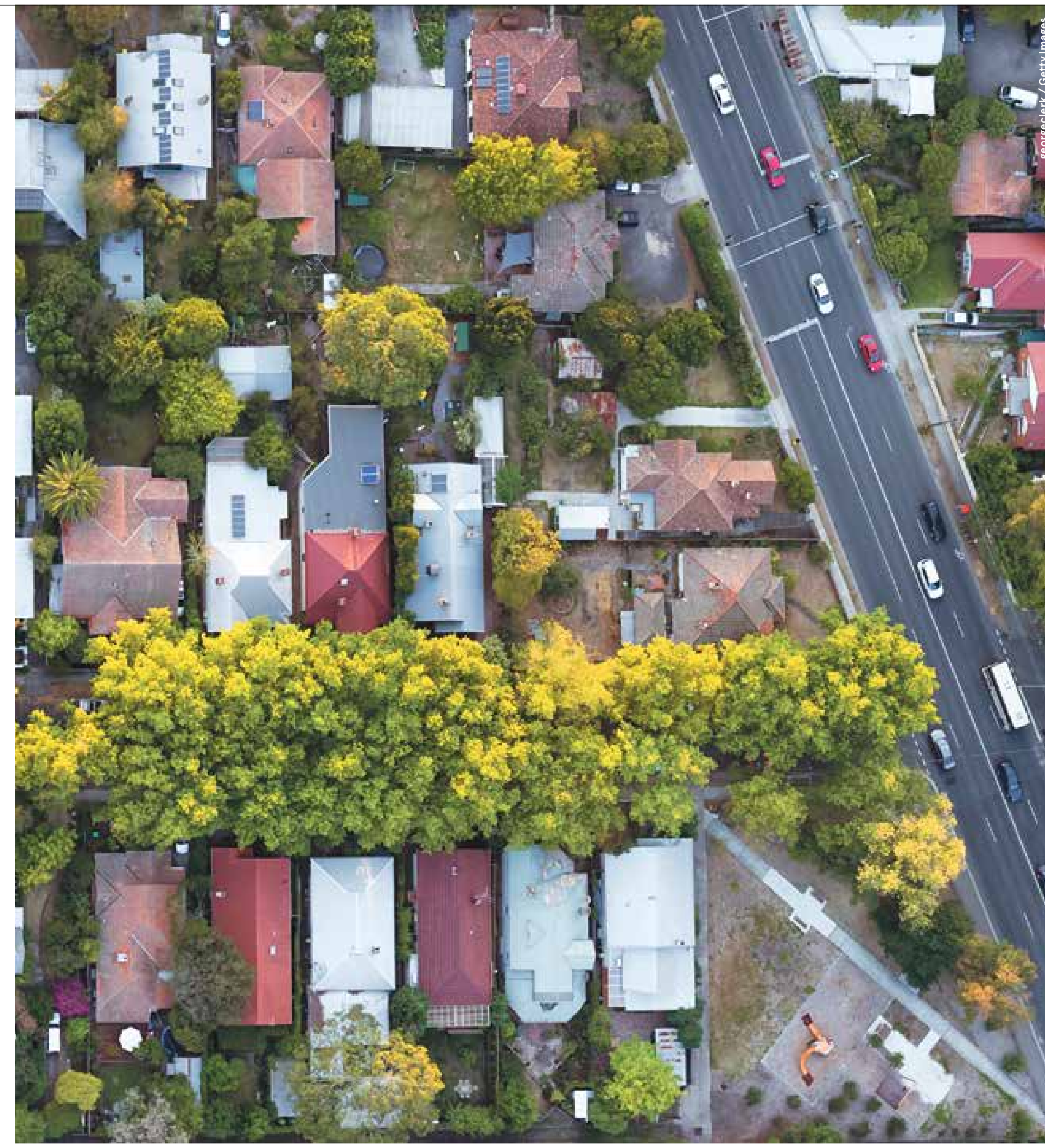
Mercer/World Economic Forum/Aegon 2017

AUSTRALIA

Is Australia the 'super' provider?

Pension provision in Australia surpasses current arrangements in the UK, so are there lessons to be learnt?

PÁDRAIG FLOYD



georgeclerk / Getty Images

The UK's final salary or defined benefit pension system was once the envy of the world. However, that "gold-plated" pension scheme, which will provide the backbone of retirement income for the baby-boomer generation, has had its day and the UK's claim to a first-class retirement system is no more.

Britain now languishes 15th out of 30 in the *Melbourne Mercer Global Pensions Index*, a league table of developed nations' pension systems, which for some years Denmark, the Netherlands and Australia have led in a class of their own.

Due to cultural similarities and the fact the pensions system was codified based on British law, comparisons are often drawn between the UK and Australia.

Just how useful these comparisons are is moot. "There are two measures to look at and they are contribution rates and coverage levels," says David Harris, managing director at Tor Financial Consulting. "Everyone earning more than A$450 a month is captured by 'super' [superannuation] in Australia, while the low paid are excluded in the UK."

Contribution rates have reached 9.5 per cent in Australia, though only paid by employers, with legislation passed to increase this to 12 per cent by 2025.

Although the UK's auto-enrolment (AE) has greatly improved coverage with more than nine million enrolled as of January 2018, contribution rates remain minimal. The UK government is aware this will not provide a meaningful income in retirement and plans are in place to increase contributions from both employers and employees.

However, because the employee has to pay into the scheme and is not compelled to remain but can opt out periodically, Mr Harris believes the pace of increases will have a detrimental effect on the AE project.

"The promise of getting up to 8 per cent contributions in the UK has to be looked at in the context of what will happen afterwards to opt-out rates and perhaps, even, the economy as earnings are reduced," he says. "Australia has done this over the past 25 years and so people have had a long time to get used to the idea."

Australian super funds have done a good job at investing their members' money. The sheer size of the market – Australian super now tops A$2.3 trillion – has enabled investment managers to innovate in areas such as infrastructure, which can generate attractive income streams over 20 or more years.

Many super funds now invest heavily in infrastructure, even in the UK, with Leeds Bradford and Manchester airports, Thames Water and Angel Trains partially or wholly owned by Australian pension fund money.

The reason it can do this is simply because of the scale of the Australian system, says Paul Leandro, a partner at Barnett Waddingham. "One characteristic of the Australian environment is size and very large-scale industry funds can effortlessly bring in huge amounts of assets through compulsory contributions," says Mr Leandro.

It's not all about size, but also a bit of luck as, unlike the rest of the world, Australia has not experienced a recession for 26 years, longer than super has been in place. This, says Mr Harris, has helped the system bed in and provided public confidence.

That confidence has influenced Australia's greatest achievement which has been engagement. Super is largely understood and supported by savers, and with good reason, says Dianne Day, who worked on super in Australia and is now client director at Independent Trustee Services in the UK.

"They are motivated by a fundamental driver that as the population ages, the likelihood of them being able to draw a state pension and rely on public health services is reducing," she says. "Australians understand that they must take personal responsibility for longevity risk, even in a country that is comparatively young."

Longevity risk, or living longer than your money lasts, has been managed for generations in the UK with annuity products, which deliver guaranteed income until death. Australians receive their pensions via products, which keeps the money invested in markets with payments limited by how much growth the fund has experienced.

As longevity has extended lifetimes, the lack of a guarantee causes many Australians to fear living too long rather than dying too young. This has resulted in many becoming excessively cautious, reducing the amount they withdraw for income.

> **Australians understand that they must take personal responsibility for longevity risk, even in a country that is comparatively young**

"The biggest mistake the Australian model made was to focus on getting people to save and put off what to do about delivering the retirement income," concedes Mr Harris. But it isn't Australia's problem alone. What to do with pension savings in retirement is a problem experienced by all ageing populations.

The trouble is no system, with the possible exception of Chile with a simple structure and state-run clearing house for annuities, has succeeded in delivering predictable retirement income where defined contribution schemes are the dominant structure, says Gregg McClymont, retirement head at Aberdeen Standard Investments.

In recent years, the UK has moved away from annuity products, which were considered to offer poor value, to income drawdown. However, this leaves the individual bearing all the investment risk in later life unless they can secure a guaranteed income.

Guarantees are difficult to provide in the current environment of low interest rates relatively low inflation, says Mr McClymont, as they rely on government bonds, which are notionally risk free among developed nations, but quantitative easing has driven down their rates and so annuities have also been low. As a result, fewer consumers are buying annuities, unless they wish to secure a guaranteed income.

The Australian government has just formed a working group to tackle the concerns of longevity risk and develop a framework response focusing on making sure Australia's superannuation system delivers more secure retirement income.

A member of this group is Jeremy Cooper, retirement income chairman at Challenger, the only annuity provider in the country, and author of the 2010 *Cooper Review*, which delivered a number of reforms to the Australian superannuation system. "People are building up pretty decent plans," says Mr Cooper, "but is difficult then for them in a default environment to make choices about their income in retirement."

One model being discussed is for a new collective approach to securing retirement income, which may require providers and super funds to enter into a risk-sharing arrangement with their members and customers.

Its early days, but without an annuity market in Australia to fall back on, the recommendations may be quite radical.

Though Australia faces the same problems in providing retirement income as every other developed nation, it has "grasped the nettle and done hard yards", according to Mr Harris.

However, just as Australia celebrates 25 years of compulsory super, the rollout of the UK's AE programme reaches its conclusion by covering all scales of employer. Most commentators see this as the perfect opportunity to push the project forward.

"The next step is to clarify the objective of the workplace and private pension system, and share that message with members," Ms Day at Independent Trustee Services concludes. "Then we will have more motivated retirement savers." ◆

9.5% current level of employer contributions to Australian superannuation funds

12% Australian minimum level by 2025

1% current minimum level of employer contributions to workplace pensions in the UK

3% UK minimum level by 2019

Commercial feature

Glide into comfortable retirement years

The glittering prize of retirement often seems too far ahead to warrant consideration

If you are to make the most of your hard-earned savings and pension, you need to start planning a long time before you crack open the bubbly.

"There are decisions often to be made up to ten years before you retire," says Jonathan Watts-Lay, director at WEALTH at work, a leading provider of financial education, guidance and advice in the workplace. "It's important to understand your options so you do not squander your hard-earned retirement savings through poor decisions."

Key to the process is understanding the pensions glide path – the investment decisions that need to be taken over time, before retirement. This process used to be automatic and aimed at an annuity outcome. Pension schemes would gradually move investments from riskier equities into safer bonds and cash as the retirement date approached, so retirees were protected from market shocks before buying an annuity.

Jonathan Watts-Lay
Director, WEALTH at work

Now the vast majority of retirees will be using some level of drawdown rather than buying an annuity. It may therefore be preferable to stay invested, at least partially, in equities. After all, retirement has a much longer time horizon than previously and the old adage that pensioners did not have the timeframe to invest in stocks and shares no longer holds good.

Today's pensions have an unprecedented level of flexibility that can work to an individual's advantage, but that flexibility can mean an unprecedented level of confusion. Mr Watts-Lay comments: "Many employees need a helping hand to work through their income options at retirement.

"By providing financial education and advice in the workplace, it can help individuals to avoid mistakes, such as paying too much tax or buying inappropriate products, and ensure pension scams are avoided. As well as providing individuals with the support needed, it can give a level of comfort to employers and pension trustees.

"What individuals need to understand is their total wealth, and that a pension pot is potentially one of several assets and income streams at retirement."

For example, many people may have built up a variety of pensions with different companies; they could also have savings in ISAs, not to mention wealth tied up in their home. It may be possible to blend the income streams from different sources to reduce or even avoid income tax altogether.

It may be worth transferring a final salary pension into a defined contribution scheme to increase flexibility, but that could be the worst decision you'll ever make; it all depends on your personal circumstances.

Our total wealth is no longer neatly divided into income and savings, earnings and annuity. Instead, we are more likely to take a mix-and-match approach. That means the decisions never stop coming, and financial guidance and advice is needed not only in the years leading up to retirement, but most certainly at retirement and beyond.

> **Consulting an adviser could help you discover matters aren't as bad as you thought**

Making these decisions often requires a long hard look at some of the less pleasant facts of life, which is why many of us prefer not to think about it. It is not easy to face up to an income shortfall or the need to keep working for longer than we thought. But problems don't get any better for being ignored and consulting an adviser could help you discover matters aren't as bad as you thought.

By looking at your options early on, you can begin to make the necessary decisions and give yourself time to glide into a comfortable retirement.

For more information please visit www.wealthatwork.co.uk

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OPINION COLUMN

'It is time for the pensions industry to catch up with the modern world'

Consider two regular people: Lynn, a 32-year-old architect in Bournemouth, and Chris, a 43-year-old claims adviser in Preston.

It's relatively safe to assume they have smartphones and use them for roughly the national average of two hours a day. In that time they shop on Amazon, read articles on *The Times* website, send a few dozen text or WhatsApp messages, scroll through 25 or so photos on Instagram, get PayPal account updates and check if they have hit 10,000 steps on their Fitbit.

Common to almost all these activities is personalisation: shaping unique experiences with content targeted at the individual. Even ads shown are based around personal profiles. And like Lynn and Chris, most of us are now used to being at the centre of our own digital universe because our data and our apps have put us there.

Contrast that to the world of Chris and Lynn's pensions. Chances are they are not lucky enough to be part of a defined benefit (DB) scheme, which provides a guaranteed monthly income for life in retirement.

However, they are more likely to be saving into a defined contribution (DC) scheme, where they choose the investments to fund their retirement, but they probably haven't looked at it recently. And they almost definitely receive an annual packet of papers from their pension provider, written in incomprehensible, snooze-inducing language.

I bet you they don't have an app calculating how much they need to live on in retirement; one that shows how close they are to achieving that goal or gives tips to reach it.

The disconnect between consumer technology and the world of pensions and savings is huge. Just think about Amazon Prime; a click of a button and Chris and Lynn are done. They don't think about the complex logistics, computer software or massive supply chain that sits behind the delivery. It simply works around their need.

The frustrating point is that the technology exists; we are just not applying it to pensions. Yes, the industry has created savings and retirement products, but these are more like components rather than the consumer-facing solutions we see elsewhere.

Chris and Lynn need access to their retirement savings in one place. The pensions dashboard, an initiative to allow people to track previous pensions online, is a positive development, but it doesn't answer key questions such as how much do I need in retirement and what's the best way to get there?

Government tried to address the lack of individuals saving for retirement by introducing auto-enrolment, whereby almost all employers provide a pensions scheme for employees. A good first step, but contribution rates are woefully inadequate. On top of this, anyone below the age of 30 will not get a state pension until they are 70. A lot can happen over 40 years. Is it prudent for Chris and Lynn to expect a state pension in later life? I fear many are sleepwalking into retirement poverty.

At least Chris and Lynn save into their pension every month, which is a good start. But imagine if, every time they spend money, an extra little bit is automatically saved into their pension. Or every time Chris goes for a run or Lynn goes to the gym, their Fitbit monitors their health, communicating with their digital pensions platform and adjusting asset allocations based on longevity projections.

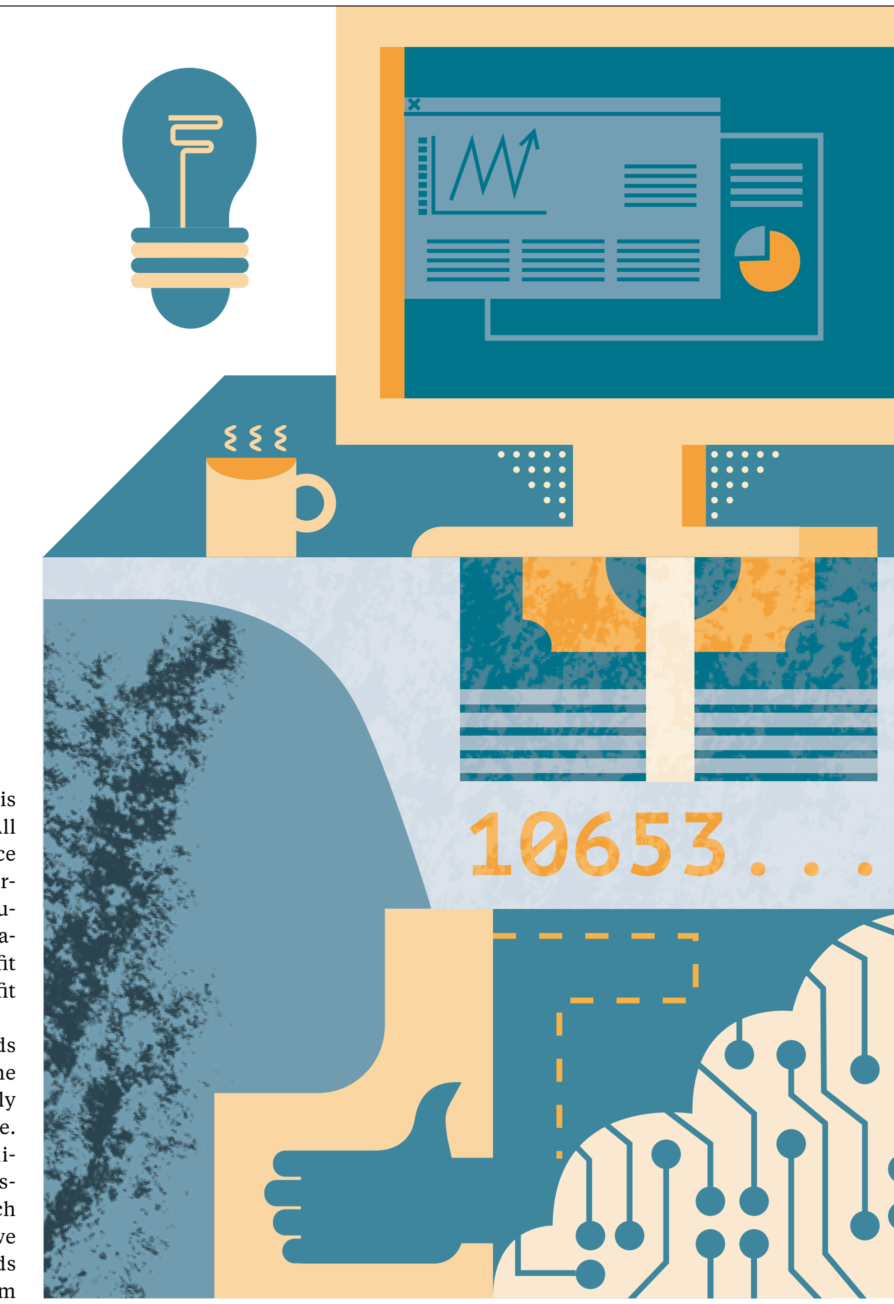
At the heart of it, how we think about and facilitate savings for retirement needs to change fundamentally. It must be easy, simple, personalised, intuitive and rewarding, more like other consumer experiences. The psychology of savings, the language used and the art of engagement all need be part of the process. It is time for the pensions industry to catch up with the modern world. It is time to get to work.

Stuart Breyer
Chief executive
mallowstreet

FINTECH

Technology can be the 'wow moment'

Despite some successful take-up, pension funds must invest more in financial technology to engage savers and help them understand their investments



TIM COOPER

Workplace pensions have been slow to join the financial technology revolution, lagging banking and insurance in areas such as data and analytics, according to research.

The *2017/18 Rewards and Employee Benefits Association (REBA) Technology Survey* says that pension schemes have focused on adopting cloud-based platforms in the run-up to auto-enrolment. But schemes say they want to start adopting more advanced technology now, including their top priority personalisation, integration with other rewards platforms and advanced analytics.

Three quarters of employers now use a cloud-based pensions platform or off-site hosted software. Some are now looking to catch up on the latest technology to improve income modelling, encourage staff to increase contributions and guide them towards retirement.

Financial wellbeing platforms, which help employers fit pensions into a wider programme of benefits and financial education, are also set to grow significantly, according to the survey.

In particular, it highlights the need for progress in analytics. "Without good joined-up data, benefits professionals struggle to meet the demands of legislation such as in real-time information reporting, gender pay reporting, auto-enrolment and re-enrolment," says REBA. "But those employers able to create data insights to match reward to performance, drive talent strategies or improve return on rewards investment will steal a march on competitors."

Despite the slow start, many innovative concepts are coming to market. They include online consolidators such as PensionBee, finance apps such as Moneyhub and a host of robo-advisers, online advisers and investments managers such as Wealth Wizards, Nutmeg and Munnypot.

> **Pension funds are not investing much in the technologies that will ultimately keep them relevant in future**

Mark Smith, pensions partner at legal firm Taylor Wessing, says one reason workplace pensions have been slow to adopt fintech is complexity. "There is so much optionality and variation with pensions," he says. "That has made it harder to use fintech effectively. One important development will be the industry-wide pensions dashboard [due next year], which should allow access to all your pension data in one place. But the UK is also a bit behind on that; other countries have had dashboards for a while."

Jeroen van Oerle, co-manager of the Robeco Fintech Equities fund, disagrees that the pension sector is late to adopt fintech in all areas. "All the developments in robo-advice and personal wealth are set up perfectly for workplace pension solutions too," he says. "Fintech companies are also well placed to benefit from the shift from defined benefit to defined contribution.

"We agree that pension funds are not investing much in the technologies that will ultimately keep them relevant in future. These include artificial intelligence, blockchain and data-transfer interfaces. But interest in such technologies is increasing and we expect several large pension funds will eventually buy into them through acquisitions."

Mr van Oerle says fintech companies have primarily served the back office to date. But customer-facing solutions are also starting to grow; for example, solutions that show the employee their savings online and whether they are enough.

"There has been much innovation in all these areas, but much more still needs to be done," he says. "The laggards, mostly in traditional asset managers, governments and regulators, need to catch up with global trends."

Peter Wilson, senior associate in the financial services regulatory group at Taylor Wessing, says that heavy regulation can stifle fintech in pensions, but can also support innovation. "For example, the Financial Advice and Markets Review is looking at the employer's role in informing employees about the financial solutions available," he says. "That is an opportunity for fintech.

"Also the pensions dashboard, the open banking standard and the second payment services directive will act together to open financial services data. These will enable providers to give a holistic view to employees of their finances, including pensions."

Brian Henderson, partner and director of consulting at Mercer, agrees. "Regulatory changes such as transaction cost disclosure and general data protection regulations can present opportunities for fintech, but they can also often act as a brake," he says.

Mr Henderson agrees that open banking architecture might be an "eye opener" that leads to a similar evolution in pensions. But he says it will be harder to achieve as pension arrangements involve multiple asset classes and funds, not just cash.

"Fintech providers probably haven't got their heads around that yet," he says. "We've also seen banks taking over pension providers and trying to bring their tech across. It will happen but not overnight."

Technology enables a broader look at an individual's financial health, of which a pension is a major component, hence the growth in financial wellness platforms. He says: "Mercer also has a solution that allows us to look at someone's financial health and nudge them to take appropriate actions. People won't recognise that they have a problem without these apps and tools.

"And we also used some smart tech to create personalised videos; a different video for each employee explaining how much they have contributed, with projected lifestyle and a call to improve contributions. It uses a lot of behavioural science.

"In the past, companies might have spent £100,000 on a big communications campaign to encourage saving and got an extra 2 per cent engagement from it. On average, two thirds of the workforce we send our personalised videos watch them within 24 hours. Of those, about half increase their contributions. That is a wow moment showing how technology can solve a difficult problem."

Mr Henderson also predicts that data will transform the workplace by, for example, helping to address financial stress and therefore improve productivity. "It can be hard to quantify, so any analytics in that space, for example the happiness data from Psychological Technologies (PSYT), will be helpful," he says. ◆

75% of global employers use a cloud-based pensions platform or licensed software hosted off-site

65% believe technology will increase staff understanding of the value of their employee benefits

Reward & Employee Benefits Association 2017

19% of global employers have a financial wellness platform in place

61% have a financial wellness platform in development or are planning one in the next three years

Reward & Employee Benefits Association 2017

DERISKING

When derisking pensio ns is the safest option

Companies are increasingly seeking to take the risk of their pension fund off the balance sheet by doing a derisking deal

Howard George / Getty Images

TIM COOPER

This year is set to be big for the lucrative defined benefit pension derisking market. The size of pension buy-in and buy-out deals, which insure schemes against future risks, has grown from £1 billion insured assets a year in 2006 to around £12 billion today, according to consultants Lane Clark & Peacock (LCP). Meanwhile, insurers report a deal pipeline worth £30 billion.

Demand for these arrangements is increasing as more employers look to remove the risk of future pension liabilities from their balance sheets. The biggest risk is stock market volatility, as large swings in the value of pension scheme investments can play havoc with companies' finances, sometimes even causing or contributing to their collapse. Another is longevity as people living longer than expected can cost companies millions more in meeting their pension promises.

LCP says buy-out affordability has risen to its highest level since the 2008 financial crisis, due to three factors. Increasing competition among insurers has brought prices down and promoted innovation. A deceleration in longevity rates has meant insurers can charge companies less to take on the risk of people living longer. Thirdly, improving stock markets have boosted scheme funding positions – how much money they have compared to their liabilities – thus reducing the risk to insurers of taking them on.

In a buy-out, a pension scheme pays an insurer to take responsibility for paying the pensions of the scheme's insured members. A buy-in is similar except the insurer makes payments to the scheme, which then pays the members. It is usually a step towards full buy-out and winding down of the scheme. Another derisking tool is a longevity swap, which transfers the risk of pensioners living longer than expected to an investment bank or insurer.

Schemes also do much to derisk themselves through, for example, careful matching of their investments to liabilities and adjusting benefit levels where possible. Doing this will also make them more attractive to an insurer should they choose to a buy-out later.

Buying is expensive, but can potentially save companies millions topping up funding levels in the long run. It usually also has advantages for scheme members. All deals come with the safeguards of the UK insurance sector regime, including the strong capital reserves required by regulators, and the back-up of the Financial Services Compensation Scheme if the insurer still fails. These typically compare favourably with the safeguards members get from staying in an employer scheme.

Insurance contracts will also typically include protections for members, for example, if the insurer is not able to pay the pensions on time or if unforeseen data issues arise. Some large deals also feature collateral structures to ensure schemes can recover their assets in the event of an insurer default.

▲10%

increase in average buy-out funding levels for FTSE 100 UK pension plans since August 2016

1 in 5

FTSE 100 companies had pension plans over 80 per cent funded relative to the full buy-out cost in 2017, up from one in eight the previous year

Lane Clark & Peacock 2018

Charlie Finch, a partner at LCP, says buy-ins are the biggest growth area as going straight to full buy-out is more expensive and beyond the means of most schemes. "Also buying out in chunks can get you better pricing by targeting a set of liabilities," he says. "For example, some insurers might prefer younger members, older members or those with larger pensions, so you could sell them to different insurers."

Jeremy May, head of pensions at PwC, says more innovative buy-in solutions are also becoming popular, for example those that unbundle and customise the benefits without all the traditional costs.

"There is a whole suite of innovation," he says. "You can mix some of the parts of a buy-in, such as longevity protection, inflation and interest rate protection, and specialist asset management, to suit your scheme's needs. Also, there are cheaper buy-in solutions with more limited levels of cover and specialist firms that take over running the scheme to prepare it for buy-out."

The biggest obstacle is cost, so schemes should beware any hard sell by insurers and advisers. They should also take care with any partial deals where the insurer gets the cheaper liabilities, such as pensioners with defined benefits, leaving the scheme with the more expensive ones such as deferred pensioners. The latter cost more to derisk because the benefits are less well known due to the timescales involved and unknown future variables.

Stephen Dicker, pensions strategy leader at PwC, says: "A partial buy-in or buy-out may still be the best option as a step towards full buy-out. But be sure that, if you are left with the more expensive liabilities, it won't make a final buy-out deal look less attractive in future.

"You might be better off retaining control of those assets and investing them to generate a slightly higher return. This could enable you to settle more of the liabilities with a buy-out sooner. The challenge is deciding where in that risk spectrum you want to be."

Mr May adds: "Also a buy-in leaves more risk with the employer as the asset is still on its balance sheet. So it's questionable whether the company's investors will give you much credit for doing that."

Most UK schemes are a long way from being able to make a full buy-out; the current £12 billion of insurance transactions a year is a tiny fraction of the £2 trillion of liabilities in defined benefit schemes. Most schemes need to get near to a state of full funding before they can afford a buy-out. But if they achieve this, they can invest in low-risk assets that match their liabilities and there is arguably then less need to insure. The cheaper option might be to keep the assets until the scheme is close to winding up, as administration gets proportionately more expensive at that point.

"Deals done earlier than that are often driven by additional factors, such as large corporate transactions where tidying the pension scheme makes sense," says Mr May. "For example, Cable & Wireless derisked its pension scheme in 2008 prior to a demerger. ICI has done a series of derisking deals following takeover by Dutch firm Akzo Nobel. Also Philips completed a buy-out after splitting the business into two."

> "Buy-ins are the biggest growth area as going straight to full buy-out is more expensive and beyond the means of most schemes

Independent trustee George Taylor has worked at the coal face of derisking activities at several schemes. "In all cases, it started by moving steadily towards a lower-risk investment policy," he says. "The downside of that is lower returns. But the regulator requires insurers to hold lower-risk assets, so you have to do that to make it insurable."

Mr Taylor says two significant obstacles to a buy-out are often issues related to administration or data. "Pension schemes are complex and often have unresolved issues in their data," he says. "The insurer won't take them on with those issues because trustees can interpret them and exercise discretion, but insurers cannot. They have a more automated payment system. So it requires much work to tidy your data, administration and other issues, such as equality of benefits between members."

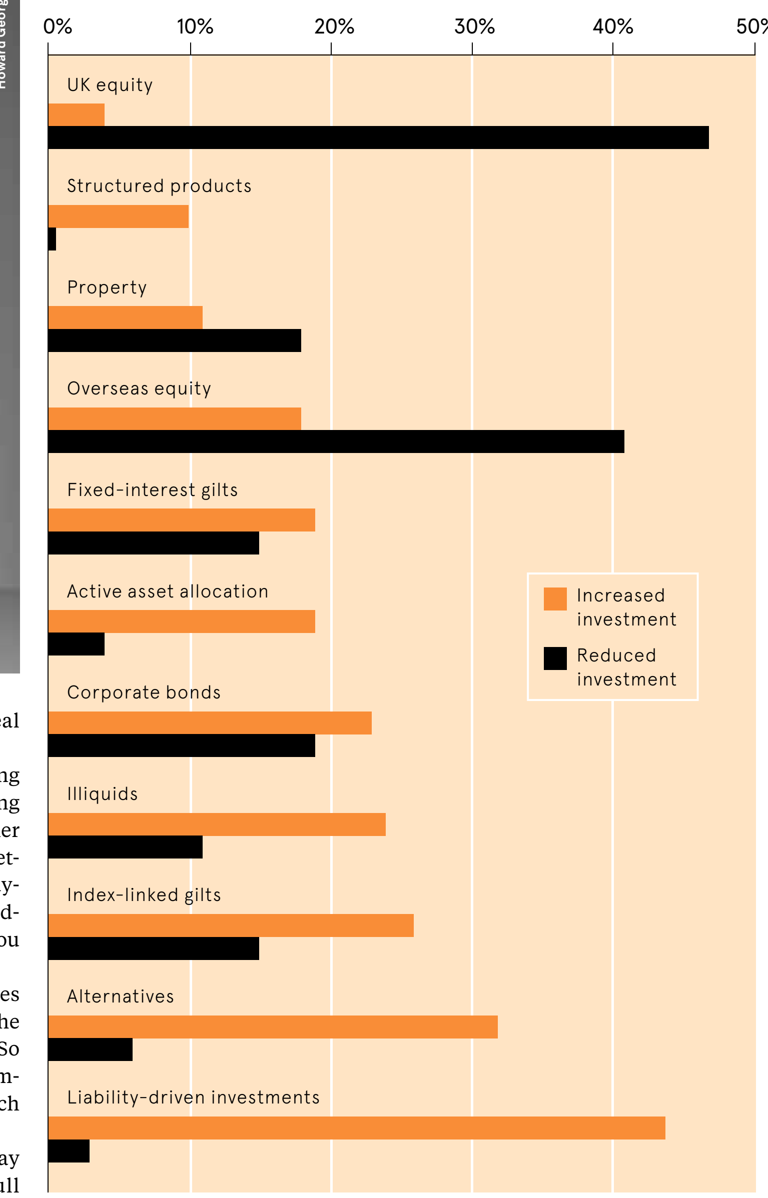
The £3-billion Merchant Navy Officers Pension Fund (MNOPF) has been a derisking pioneer. The scheme has made several buy-ins since 2009, plus one buy-out and an innovative hedge of £1.5 billion of longevity risk in 2015.

Andy Waring, chief executive at MNOPF, says: "A significant improvement in funding enabled these moves, aided by the appointment of consultant Willis Towers Watson as delegated chief investment officer. This led to a plan to improve funding, which grew from 69 per cent in 2012 to 88 per cent in 2017 and is on target to achieve over 100 per cent by 2025.

"The success of this strategy, at a time when many other schemes' funding levels deteriorated, enabled the fund to further secure its members' benefits and saved over £300 million in deficit contributions for its employers." ◆

How UK schemes are changing their investment strategies

Percentage of trustees and pensions managers or sponsors who made the following changes to defined benefit scheme investments in the past year



Aon Hewitt 2017