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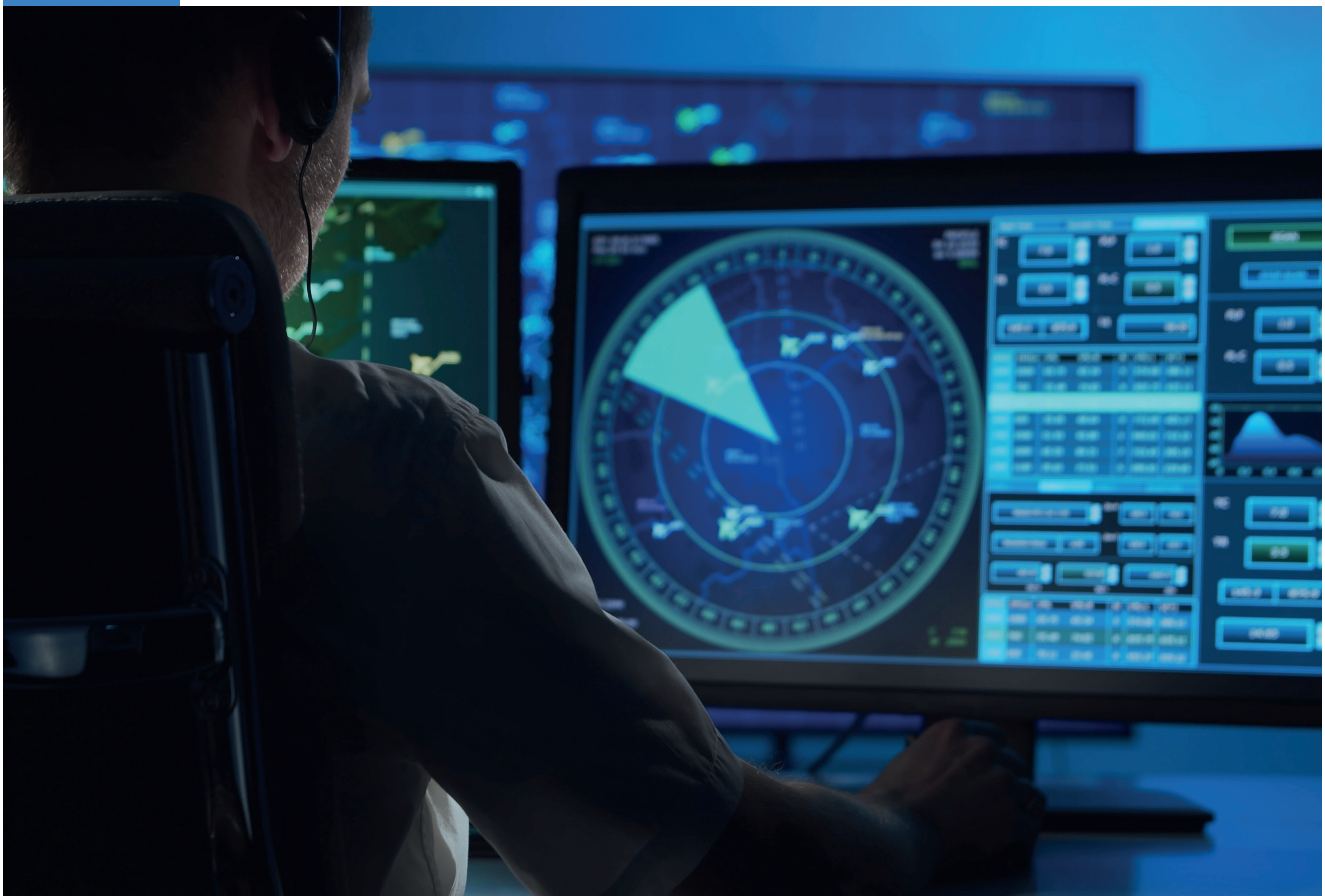
ROUNDTABLE



TOWARDS BETTER DC RETIREMENT

– DEFAULTING TO COMPLEXITY

– OPENING THE DOOR WITH PENSIONS TECH

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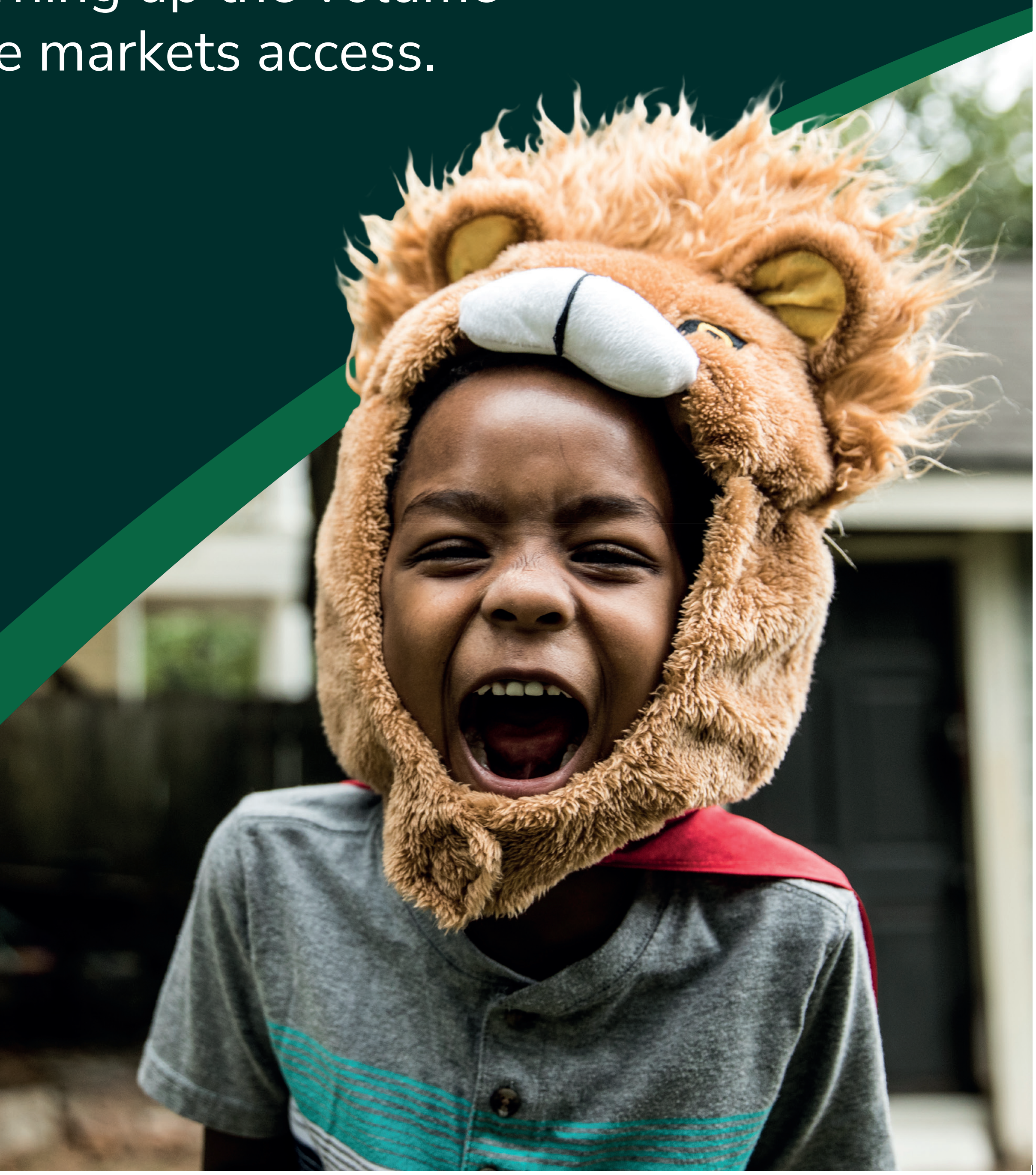

CHOICE AT ALL COSTS

Innovation in the at-retirement space is moving fast. Advisers face some big decisions on behalf of their clients in determining which models are right for their workforce

John Greenwood
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Genuine choice is emerging in the default retirement income solutions likely to be offered by providers. For employers and their advisers, the type of default retirement income solution offered by their scheme could become a genuine differentiator.

Flex-then-fix, flex-and-fix, retirement CDC and now the Nest/Rothesay Life deferred annuity model – suddenly it feels like choice of provider could be very much influenced by what it offers on the way out.

Do providers pin their hopes on a single approach, or will some offer different default options for different audiences? Will targeted support and other filtering facilitate a multiple default decumulation approach? And how big a role will the choice of decumulation solution play in advisers' overall selection process.

While advisers are understandably adopting a wait-and-see approach before deciding which retirement income strategy they think is 'best', there was one message that came through loud and clear in the round table debate covered in this supplement: whatever solution is put in place, it must retain the ability of the member to choose something else.

No two people's circumstances are the same, and no single solution will be right for everyone in a workplace scheme.

While the Pension Schemes Bill's introduction of a requirement for schemes to offer retirement income solutions should make life easier for retirees wanting to use their pension in the way it was intended, it also brings in greater complexity to accumulation phase investment strategy.

Currently most providers and schemes have a glide path that targets an at-retirement landing point that tends towards drawdown, but with some element of capital protection for those wanting cash.

Going forward, schemes will have a default retirement income solution, with the emphasis on the word 'income'. In the old days of the de facto compulsory annuity purchase, schemes derisked to some form of annuity risk mirroring that effectively reduced exposure to equities and ultimately dampened the potential for stronger returns in later years.

If income becomes the new target for schemes - you could argue it should always have been – will we see a return to less cautious, more balanced asset allocation strategies in some cases? Flex-then-fix and retirement CDC both seek to keep risk on the table into retirement. But how will flex-and-fix and deferred annuity solutions fare in the absolute pot-size terms that will be important to some members? And how will this potentially suppressed pot-size performance feed into the value for money league tables.

A lot of water will flow under the bridge before hard decisions need to be made on these points. But the positive news is that genuine innovation is emerging in the decumulation space that for many should go some way towards turning pots into pensions.

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TOWARDS BETTER DC RETIREMENT OUTCOMES

DEFAULTING TO COMPLEXITY

Retirement outcome reforms are driving the agenda but the DC sector is grappling with a wide spectrum of member needs, attitudes and behaviours. As a result, the flexibility to opt out of the default remains key, hears **John Lappin**

DC pension schemes are paying increasing attention to how they help members make better retirement decisions and adopt better strategies urged on by regulators, with more legislation currently being debated.

Yet as one panellist at the Corporate Adviser round table 'DC pensions: towards better retirement outcomes' noted, while accumulation strategies are broadly similar, members' approaches, needs, attitudes and choices are often radically

different in the run-up to and across years of retirement.

The good news is that the sector is much more engaged in the decumulation conundrum than it was even two or three years ago, but it is still to converge on what might be agreed solutions.

Data demand

L&G strategic relationships director Alex Snowball emphasised how the firm is

gathering more data. This includes information about members' other DC and wider savings wealth, helping it to develop better retirement propositions. This is also helping to inform consultations with regulators, as they grapple with achieving better retirement outcomes.

One of the challenges with addressing today's retirement landscape is the breakdown in long-established retirement patterns.

Personal patterns

Hymans Robertson DC associate consultant Michael Ardill said: "We've seen the market recognising that moving into very low risk strategies and targeting a single retirement date is not necessarily the best way forward for members.

"Moving into retirement has individual personal patterns but there is also a need to manage some of the longer-term risks that are there, particularly longevity risk and maintaining the real value of the pension pot. We are starting to see an exploration of higher risk strategies moving into the retirement phase."

He also noted the need to keep an eye on sequencing risk. But he added: "We've not seen a consensus on what a retirement strategy looks like until now."

More choice

WTW director, retirement Anne Jones said that much depends on the demographics of a scheme. But she pointed out that the idea of "middle income" scheme members covered "an awful lot of different types of jobs and types of different knowledge" which in turn might need to be reflected in the level of support required.

"The level of support you get needs to reflect the level of risk and the options that you have in terms of investment. The wider

Michael Ardill

the range of options, the more support you need."

Mark Humphreys, trustee director at LawDebenture (LawDeb) added: "It's a cliché, but everyone accumulates in the same way, but then decumulates in massively different ways. We need the data to support these decisions."

He also noted just how much of a difference renting or owning could make.

He said: "You have wildly different behaviours for retirement, between homeowners and people who rent and the number of people who rent in retirement is going up steadily. The idea that we can have a single default doesn't work. We're going to need a range. We're going to need to help people get to the right place for their particular circumstances and we're quite a long way from that."

Benefit type dictates investment approach in part

XPS partner Christopher Barnes stressed the importance of the type of benefit to the investment strategy.

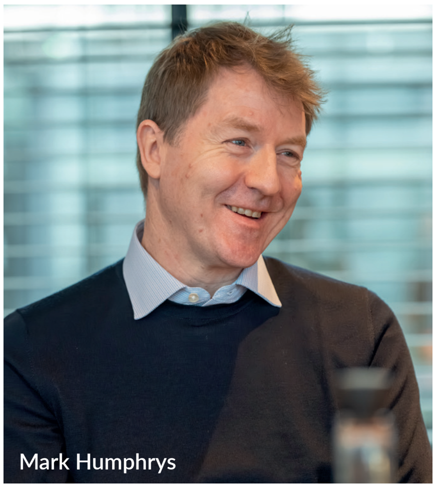
"First there's the design of that benefit - whether it's flexible or fixed and within each of those, how is that then structured from the investment point of view? Risky? Not risky? Somewhere in between?"

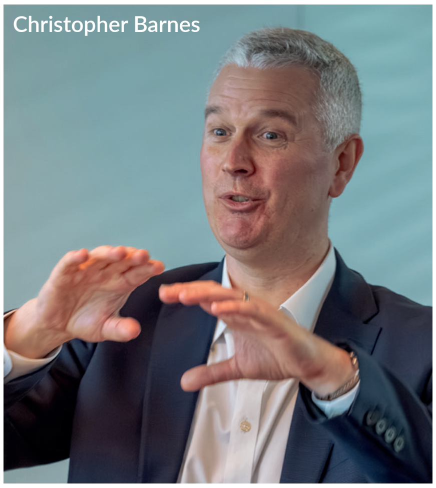
Market shocks

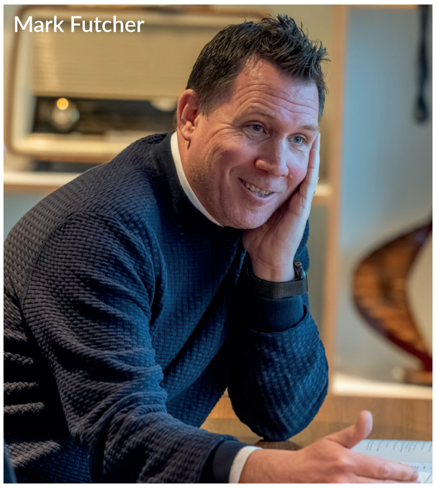
LCP partner Lydia Fearn noted that 'risk' has had a great run recently and as a result members' returns have been great. More broadly, we are also in the midst of a general policy debate about how to get more people into investing and out of cash. But this approach inevitably holds risk for scheme design.

"If we have a downturn in the market and people are in more risky situations and they feel that they've been defaulted into

Gemma Burrows


Mark Humphrys


Christopher Barnes


Mark Futcher

something, that's when the lessons may well be learnt. We have to be mindful of that modelling and where those members will end up should something happen.

"Let's not forget that members retire in very different ways. Often, depending on the sorts of jobs they've got, some have to stop and then take income, but some will continue part-time. Having an understanding of what that individual is doing is super important because then you can align a strategy with their circumstances."

Kelly Parsons, head of DC proposition at Broadstone said: "It's really important to make sure that you've got something for those people that are just apathetic, that just don't do anything and make no decisions whatsoever.

"They just leave it to somebody else to make the decisions. This is where you need to make sure that the investment strategy is good enough, but also to have the flexibility for those who do want to make decisions and make choices as they get further along. It's difficult getting that balance right. Age 65 is no longer the age you aim for. It can be all sorts."

High withdrawals

Neil Kempshall, DC consultant at First Actuarial noted some of the jaw-dropping levels of withdrawals taken by some members.

He added: "You're going to need something that caters for someone who really wants to maximise income. Perhaps you should segment an approach which says for those that really want to have high income and are willing to sacrifice capital, there's something bespoke for them. Something in terms of dynamic asset allocation is pretty important as well, just to make sure that you're constantly changing and moving as you need to."

No longer linear

Aon DC consulting partner Gemma Burrows added that the retirement path is no longer linear: "There is no one approach that's going to meet all the different ways that people might need. For some of these people, they go into retirement, but they've still got this pension as a long-term investment. It could be 30, 40 years depending on their health. So, the investment strategy has got to be suitable to cater for that and reflect the fact that you still need to have good growth if you're going to leave money invested for that period of time."

But calculations are also shifting as a result of bringing pensions into the scope of IHT.


Kelly Parsons and Lydia Fearn

IHT change means more scenarios

Barnett Waddingham partner and head of DC and workplace wealth, Mark Futcher said: "Bringing pensions into IHT completely changes the mix. The right investment strategy is going to be even more bespoke for members than it was before. Now we're going to see a lot more cohorts of members retiring and getting sucked into IHT. They need to plan for that. Where do they take those assets from? You know, a pension now isn't really a pension. It's another pool of money that you manage tax efficiently from. We just need to have a much, much broader conversation."

Panellists contrasted the amount of support available from schemes with what clients could get in the higher-charging retail side of the market.

Fearn said: "Why are members taking money into expensive retail plans? Because they're getting their hands held through the whole process. We're going to have to put our hands around these individuals through the whole thing. A default is fine, but how can you have a default when you don't know what's in someone's bank account? How do you say we're going to put you in an annuity. We don't know anything about you. We don't know how much money you're going to have in totality, but we're going to buy this annuity for you."


L-R: Anne Jones, Alex Snowball , Michael Ardill

Dilemma around later annuitisation

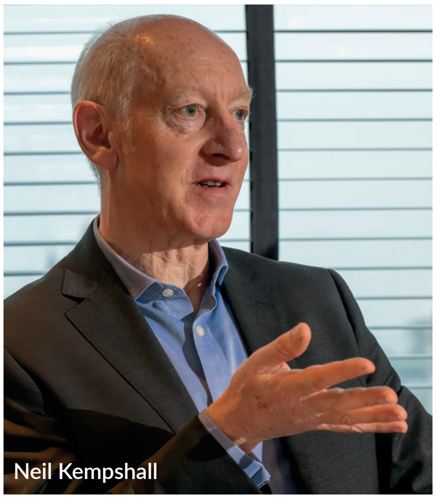
Panellists grappled with whether facilitating flex-and-fix offered a better solution.

Snowball said: "When we're thinking about solutions - and multiple solutions are needed - we don't just think flex-and-fix is this moment-in-time based thing. The annuitisation will need to have a level of data brought into the equation. We're going to have to consume the data. We have to use very clever nudges. So we're bringing behavioural science to ask questions such as 'have you visited a doctor this year?' It's gentle nudging. That's where I think providers have a really important role to play in making sure members see a full suite and have full access to all the options. So annuity broking, you've got to have that right. You can't just say you are going to hand this off to someone else."

Futcher added: "People are still going into retirement. They're going to have two or three pots, two or three providers. One's a default pathway, one might be CDC, because they're in that cohort, one a master trust. These members are going to need to understand how to pull all of that together. They're being defaulted potentially three different ways. That's not what they should be doing. They should be looking at the pot as a whole and deciding which option. We can't assume that we're going to be in a perfect world anytime soon."

Burrows added: "There are a number of positives to flex-then-fix being a solution. The biggest thing I'm hearing from trustees is a nervousness over putting someone into a situation that's irreversible. Trustees making those decisions about how to design their own default decumulation may well see flex-then-fix as an opportunity, where you're at least then giving members a longer period to engage rather than deciding at 65.

"But then you come up with a huge number of complications, like people withdrawing at rates that are unsustainable. How much of the pot are you going to then leave to purchase a guaranteed income?" ■


Neil Kempshall

TOWARDS BETTER DC RETIREMENT OUTCOMES

OPENING THE DOOR WITH PENSIONS TECH

Data holds the key to better retirement outcomes. Dashboards and pension ATM cards can help, but tech can increase scam risks. **John Lappin reports**

Better deployment of scheme data combined with open banking and commercial dashboards, when they come on stream, can power much more effective engagement in retirement planning.

Yet worries persist that scammers remain well placed to take advantage, using the open technology that many members already use day to day, even as pension providers seek closed-off, more reliable systems around AI.

Not surprisingly, opinions among panellists are mixed.

L&G strategic relationships director Alex Snowball noted that schemes and providers already had a huge amount of data but added: "We can supplement and enhance that data and utilise it to communicate better. We already have our member engagement platform that allows us to look at members' information.

"They may be approaching retirement. We then supplement that data, for example, where they have not completed retirement guidance, where they haven't created a plan. This member engagement engine crunches all that data and sends out a very targeted communication to say: 'Actually, this is really important.' So, bringing behavioural science into the communication nudge."

He said their guidance service launched in November 2024, while 'self-serve' at the moment, allowed them to see that the average client who has £30,000 with L&G may have £90,000 in pensions elsewhere and £61,000 in savings. "Now we can create a much better picture to say what is the solution that could be right for you, gleaning that information."

He said the dashboard, the commercial dashboard and Open Finance can be pulled into this too, with the member's permission.

"Bringing all of this data together is key. Yes, there will be challenges along the way, but I don't think it will be that hard to create a much better picture of a member's financial position, and then present back a solution to them in a simplistic way to help them achieve a better retirement outcome".

Kelly Parsons, head of DC proposition at Broadstone saw the potential for some people to have significant boosts to their retirement planning as a result of the arrival of the dashboard. She said: "People who might be on the cusp of the breadline might find a pot from 40 years ago. It's exciting to know that for some, these pots should hopefully be revealed."

The shadow side

Yet Barnett Waddingham partner and head of DC and workplace wealth, Mark Futcher was worried about the 'shadow side' of this information. "The best marketers, the best sales teams are going to find ways to use this kind of data in ways that are not in the members' interests. I really hope regulators clamp down on some of those sharp practices."

WTW director, retirement Anne Jones added: "The dashboard is the right thing to do. For people to know what they've got, all in one place. But there's a real danger of scammers going: 'I can look after all that money for you in one place' too. There's going to have to be a real ramping up by trustees, advisers, schemes and companies to help protect members."

LCP partner Lydia Fearn said: "Our expectation is that it will be advertised on consumer channels, such as those run by Martin Lewis. There'll be a massive spike in enquiries, but it will fall back again.

"With the scamming, it's going to be the providers who have to catch it, because the dashboard is not transactional, it's just information.

"We've seen the technology that scammers are using to steal from people's bank accounts, and it's quite frightening how people get sucked into these things, with scammers using different ways to try to access this money, like buying Amazon vouchers. We have to have a wall around it. But that is going to be on providers."

Other eyes on wealth

XPS partner Christopher Barnes said: "It could be transformational. But while we're sitting in this room talking about pensions, there are people in other areas of finance sitting in similar rooms and they want to dominate this space. That's as well as the Amazons, the Googles, the massive entities."

"Ultimately this is a battle for overall wealth management. And those that control the data may not actually be pensions people. There is a very big picture thing going on. The risk is the pensions world doesn't see it coming."

Neil Kempshall, DC consultant at First Actuarial added that it comes back to trusted learning sources. "The AI will only be as good as the information that's been put into. It's doing a lot of the heavy lifting and absolutely magnificently for providers.

"But there's got to be some sort of check and balance in the system in terms of security and validation. The other thing that technology does do really well is present information and data factually, but can it emotionally connect with the people that it's designed for?"

Scammers are on the same open system as members

Aon DC consulting partner Gemma Burrows again stressed the importance of having effective guardrails, but said providers can also using tech to 'compete' with the scammers.

"We'd be missing a trick if we thought that we didn't have to use technology in a way that's going to compete with the scammers that are exploiting the opportunities that come up using that technology. If you've got people exploiting it, then as trustees, providers and advisers, we need to use this technology because that is how consumers are getting information and what they're relying on to get information."

She says it is really hard to know exactly what those guardrails will be in future. The AI is as good as what goes into it. Thus, the information that open AIs use may be skewed.

"It's basically a massive search engine of what's already available. A lot of it is skewed towards males and what would be right for a male professional, because that's the information that's in there. We need to think about how we can make it applicable to females and people that aren't in that demographic," said Burrows.

Fearn added: "It means being very mindful of the hallucinations that AI has. You have to train it within your own environment. It has to be very controlled."

There was also discussion of the use of targeted messaging to prevent poor outcomes.

WTW director, retirement Anne Jones added: "The schemes I talk to are making a more concerted effort to look at what people are doing, and use targeted messaging. That probably wasn't there when the freedoms came in, because people didn't see that it was going to be quite as bad as it has been."

There was a discussion of how the industry would manage withdrawals of tax-free cash, which had been amplified by media scare stories of the government bringing in retrospective limits to reduce tax-free withdrawals already accrued, something it has never done and which would be against human rights laws. Delegates at the event felt that the government could help.

Snowball said: "People like certainty. Why don't we just take that off the table for a period of time so we can help people not make bad decisions?"

Jones added: "People are often moving to Sipps to do that. So I've got a lot of schemes where members are doing the partial transfer of their current assets to a really expensive Sipp they may not need, just to get the tax-free cash."

Contactless pension withdrawal

Panellists discussed a move to offer even easier access to pensions via an ATM-style, card something that two providers in the Corporate Adviser DC Pensions Into Retirement Report had said they were actively exploring.

Hymans Robertson DC associate consultant Michael Ardill said that if you were going to offer this "it has to fundamentally be built into the retirement solution."

He added: "The use case may be to 'bridge the gap' or be able to make decumulation feel more tangible and protect against money moving into inefficient tax environments. But the guardrails have to be so strong around it, to not undermine everything that we've discussed. We're talking about large pots of money, and most people would never see that amount of money sat in a current account."

A need for friction

Burrows added: "We were talking about making things easier for people, bringing their information together. But this is one area where we don't want to make it too easy for people. There needs to be some friction, rather than making it really easy to access money that's got to last you for the rest of your life. And I'm not saying there's not a place for it, perhaps bucketing your money, having a longer-term fund and then something that you can use for immediate needs. But there needs to be some friction, even just to give people the ability to pause and think about what they're doing before they access it."

Kempshall added: "Greater access - a cash card. What could go wrong? People are already pushing the envelope when it comes to taking 8 per cent withdrawals from DC pots. You're almost taking the guardrails down. Yet it's a logical development, in terms of open finance.

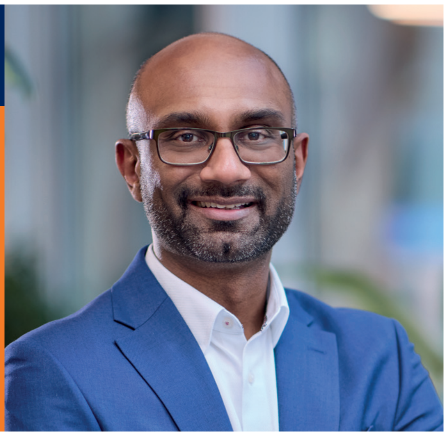
So is it a good thing? The answer is yes, if you're trying to build the perception that your pension isn't locked away and is this kind of opaque thing. But there has to be a series of checks and balances and limits in the system, as you have with a cash card at the moment, where you can't withdraw so much per day, or so much a week, with other prompts saying I didn't realise I've taken out this much this week, this month."

Parsons said: "Maybe they won't go crazy and spend it all in one go. I think it's a great idea but with the controls that we've mentioned - certain amounts, certain withdrawal limits, maybe having it in buckets or pots or it takes 3 to 5 days to get it out from the main pot before you put it in your easy access."

Jones added: "We need to make sure that it doesn't bump up charges. Because what you don't want is for people to have really expensive charges in retirement, because it's not like you can put the money back in. Once it's out, it's out." ■

OPINION

BUILDING SIMPLER RETIREMENT OPTIONS WITH CDC



» **Jayesh Patel** head of UK DC distribution, L&G

Providers will need to offer default retirement income options in future. Could new CDC schemes be a viable option?

Why are providers developing simpler retirement income solutions?

Retirement is extraordinarily complex for members. At the same time as navigating profound changes in their personal lives, they must also manage a myriad of financial decisions: where to invest, when to take income or cash, how much to withdraw, how the state pension fits in, and how to avoid unintended consequences, such as triggering higher tax rates or losing entitlement to state benefits.

It's no surprise that Nobel Prize–winning economist Professor William F. Sharpe described the challenge of turning a pot of money into retirement income as "the nastiest, hardest problem in finance". This is why there is demand for simpler income options at retirement.

In our view, a solution that offers a retirement income, albeit an income that is not protected, may be appealing from this perspective.

What advantages might Collective Defined Contribution schemes (CDC) offer for members?

One key advantage is that members don't have to make complex decisions themselves. While this may remove some flexibility, it helps to simplify decisions, making pensions easier to engage with.

CDC schemes also tend to invest more heavily in assets with higher expected returns, like equities. This may boost expected outcomes for members. It incurs greater investment return volatility, but the schemes use mechanisms to help smooth pension payments in the short term.

Another advantage of CDC is longevity pooling. Members share the risk of living longer than expected, which may improve expected outcomes. While annuities available in DC also hedge longevity risk, they don't allow individuals to pursue higher expected returns at the same time.

What are the potential risks for providers, employers and members?

As mentioned, CDC schemes invest aggressively which means higher expected returns and higher expected outcomes. However, there is no escaping that this incurs greater investment risk. CDC schemes use mechanisms to smooth pension payments in the short term but the higher investment risk doesn't disappear – rather it is effectively transferred to the longer term i.e. from older to younger members. This results from how CDC schemes adjust expected benefits when things don't go as expected. They typically change the indexation rate (the expected rate of pension increases) rather than adjusting all expected payments by the same proportion.

More generally, a concern with CDC is potential intergenerational unfairness. A key question we've researched is in what ways could younger members in CDC schemes be disadvantaged and how could this be addressed to improve fairness?

There are different notions of fairness, so we need to be clear by what we mean in this context. In our view, a scheme is fair if the present value of benefits awarded to a member – calculated with an appropriate risk-adjusted discount rate – equals the size of the contribution made at that time. Similar ideas apply to other exchanges, such as transfers in or out.

In theory, any unfairness (as so defined) can be addressed by adjusting the terms of exchange of money for expected benefits. If priced correctly, the exchange should be fair.

Some aspects are easier to price than others. A very important aspect to capture to avoid unfairness is the time value of money – the fact that money today is worth more than the same expected amount in the future, because of its expected return. So, in theory, the accrual should be cheaper for younger members than older ones — flat accruals work against this and risk creating unfair outcomes.

The investment risk transfer mentioned above adds another layer. Younger members are exposed to more uncertainty, so accrual ideally should reflect that through appropriate, risk-adjusted assumptions. This adds some complication, but is manageable using standard techniques, providing the scheme continues to attract new members over time.

That brings us to another risk - new entrants to the scheme may slow or stop. If that happens then younger members lose the ability to pass risk on as they age. This risk is harder to gauge.

'Assumption uncertainty' is yet another risk to consider. If longevity is underestimated, for example, then younger members may end up bearing the cost.

This all said, we're keen to stress that 'fairness' (as we define it) is not the only consideration in scheme design. Simplicity matters too, especially from a member perspective.

Other things to bear in mind include that longevity pooling reduces death benefits, and that CDC does not offer members flexibility. CDC schemes also face practical challenges. They require strong governance, careful actuarial oversight and sufficient scale. While CDC schemes may feel simpler for members, they are generally more complex and costly to run than DC schemes.

How might a retirement-only CDC work?

Retirement-only CDC (RCDC) is similar to whole-of-life but starts from retirement. In exchange for a lump sum an expected (not guaranteed) pension is awarded.

As the duration of RCDC schemes is shorter than whole-of-life, the method of adjusting benefits through the indexation rate is less effective at stabilising short-term moves. This means that the scheme is unlikely to be able to invest as aggressively as a whole-of-life scheme, so expected uplifts may be more modest than whole-of-life. Like whole-of-life CDC, stabilisation of the short term potentially comes at the expense of greater long-run uncertainty in pension levels.

The ability to pool longevity risk while investing in growth assets remains a key advantage. Challenges include scale and costs, as mentioned above, and the extent to which different members are offered different terms based on indications of their longevity, for example postcode, biological sex or medical history.

Is L&G looking to develop a CDC solution?

We are exploring the potential development of an RCDC solution. Our priority is to help secure better retirement outcomes for our DC members. CDC schemes pose a powerful opportunity to seek key benefits for certain cohorts. By managing investments collectively and sharing longevity risk, CDC schemes have the potential to provide members with a higher expected retirement income, with simpler decision making.

There are of course multiple factors to carefully consider before launching a solution. This includes how regulations evolve and meeting Consumer Duty requirements, client demand, and commercial factors. We're committed to working with clients, regulators, and industry stakeholders to shape solutions that can enhance retirement options and outcomes for members, driving innovation in pensions.

Ultimately, it depends on whether it's the best option for our DC members - we're continuing to monitor and evaluate and will wait for the final regulatory framework for RCDC.

What other solutions might be seen when it comes to delivering default retirement options. How does CDC differ from longevity risk solutions, for example?

A CDC scheme is a type of pension plan structure that includes longevity pooling but only as one of its features. In contrast, longevity risk solutions are risk management instruments rather than plan designs. They can be used to manage the risk that people live longer than expected. This can include annuities that can hedge at the individual level, but also reinsurance and longevity swaps, which can hedge the experience of a group. CDC schemes could use longevity swaps to help manage systemic longevity risk.

We're developing a DC decumulation solution that involves spending from a drawdown fund followed by later-life annuitisation. We've developed important intellectual property concerning the investment strategy and an innovative way to guide spending that aims to avoid cliff edges in consumption. The 'L&G Guided Income' solution is likely to appeal to members that value flexibility, but appreciate a degree of guidance on investment and spending decisions.

When might we see these new retirement options in the workplace market?

The timing of new options will be influenced by the government's proposed roadmap for introducing RCDC and guided retirement solutions. While innovation can happen now outside of RCDC, the regulations on guided retirement will define the parameters, opportunities and potential constraints that such solutions will need to operate under, if they are to be used as defaults.

Consultation on the regulations for RCDC and guided retirement are expected to be published during the first half of this year, while applications for RCDC authorisations are tabled to start early in 2028. ■

L&G