# PPI Launch Event

### What can the UK learn about other countries' approaches to accessing DC savings?

## Overview


On 1st November 2023 the PPI hosted a launch event kindly sponsored by Columbia Threadneedle Investments on the topic of international experience of Defined Contribution (DC) pension decumulation.

The way we save, and access retirement income is changing as a result of the rise in DC, and the introduction of the pension flexibilities. Changes to life expectancy and working patterns have altered retirement needs. Our system for accessing savings (decumulation) is still developing in reaction to these trends; it's imperative that the system structure and products support people to best meet their needs.

This report gathers and analyses evidence from the US, Canada, Australia, New Zealand, the Netherlands, Denmark, Chile and Singapore, and offers some suggested lessons for the UK when thinking about the challenge of enabling good outcomes for those who will need to access benefits from DC pension arrangements.

This report has been sponsored by The Pensions Regulator, plus a consortium of sponsors, Columbia Threadneedle Investments, LGIM, Standard Life and Barnett Waddingham.

The event was chaired by **Sarah Luheshi, Deputy Director (PPI)** and was attended by around 70 people representing a cross section of the industry alongside a further audience online. The roundtable was held under the Chatham House Rule.

## Host's Welcome

**Mike Housden, Chief Commercial Officer – EMEA Distribution (Columbia Threadneedle Investments),** reflected on the challenge that decumulation posed and how individuals may sleepwalk into a suboptimal retirement.

This is an issue for the increasing number of people who will be relying exclusively on DC pots for their private retirement income. There is a need to take the best of what has been proven to work well elsewhere so that society as a whole can benefit.

Consequently, this is an area which is growing in significance as a policy issue.

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## Research Findings

**Nick Hurman, Research Associate (PPI)**, summarised the findings of the research to date:

### UK pensions in a world context

The UK has the second largest stock of pension assets behind the USA. In the UK only 19% of funded assets are DC savings, a lower proportion than other countries considered which are more dependent upon DC pension saving.

The UK system has been rated 'b' under the Mercer pension index, but could be improved through:

- restoring the requirement to take an income stream;
- a higher minimum level of pension.

### The nastiest problem in finance

There is a global shift towards DC pension saving (away from Defined Benefit (DB) provision) placing increasing reliance upon members. Members need to strike a balance between knowing how much income to meet spending needs and maintaining this income throughout retirement.

Retiree behaviour in USA, Australia and New Zealand shows a reluctance to spend down savings. This may suggest a need to give people the confidence to draw upon their assets in decumulation.

There is a recognition that it is necessary to segment retirees based upon their financial circumstances. Middle income individuals are the most at risk of having an inadequate income to maintain living standards as the move from working age to retirement.

### DC as part of a wider system

Each case study country has a different social policy context. This necessitates careful mapping between countries to understand the experience and how it may be applied to the UK.

The UK environment is based upon an underpin of a State Pension. This provides a stable income which acts as a longevity insurance. Pension freedoms in the UK removed the requirement for retirees to take an income stream from the majority of their private pension savings.

Internationally there is complexity from the interactions of means testing and tax complications.

There is some member choice over how they wish to manage their risks. For example in Denmark there is enforced pooling of longevity risk but individual freedom to manage inflationary risk.

Employer and industry group schemes which continue from working ages through retirement have an important role to play. Where schemes necessitate transferring at retirement this can be associated with higher member costs and therefore reduced member benefit.

There is weight placed upon an effective regulator. Regulation strategies can help improve consumer support and guidance and develop the regulation of new decumulation options in the market.

### Specific lessons can be taken from specific countries

**USA,** Where options are forced upon members, e.g. through tax penalties, they are unpopular. There is a demand failure for certain products despite the scale of the potential market.

**Australia and New Zealand**, have systems with expectations of high levels of home ownership, in a time of growing numbers of renters in retirement.

**Singapore**, the conflicts of use of retirement savings which can be spent upon other purposes such as housing or health needs, resulting in an erosion of potential retirement income.

## Keynote Address

**Nausicaa Delfas, Chief Executive (TPR)**, addressed the session on the topic from the viewpoint of the Pension Regulator. Her speech in full is published by The Pensions regulator.[1]

All modern workplace pension schemes should offer products and services that help savers access pensions at or in retirement in the future.

The success of automatic enrolment has led to a sharp increase in saving with little direct engagement from the saver. But accessing pensions will require positive action.

We all need to work together to guide savers toward the right solutions for them. If not, we risk a lost generation of people suffering in retirement.

Without a consensus on what good looks like, positive outcomes sought for savers will not be realised. I want to start building that consensus by proposing five principles to help shape the conversation:

1. All savers deserve value for money – Schemes should help savers to maximise the value of their pension savings into and throughout retirement.
2. All savers should be helped with decision-making – Savers should be encouraged and supported to make key decisions whilst saving for their pension, and in preparation for decumulation.
3. Schemes should put the saver at the heart of decumulation – Trustees should consider the best interests of savers and proactively help DC savers to mitigate the risks they face at and in retirement.
4. The market must innovate to provide genuine choice for savers – The saver should be given a choice in how to decumulate their pension savings considering their personal circumstances.
5. Schemes should provide wrap around and personalised support in the lead up to and during decumulation and in post-retirement.

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[1] https://www.thepensionsregulator.gov.uk/en/media-hub/speeches-and-speakers/ppi-launch-november-2023

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**Nausicaa Delfas took questions and discussion from the floor on a number of topics.**

*The views reflect the discussion in the room and do not necessarily belong to Nausicaa Delfas or represent The Pensions Regulator.*

**TPR's five principles** – their scope is designed to encompass the whole industry. TPR is currently at the start of the process, with discussions through roundtables before guidance to be issued later next year.

**Flexibility** – There is breadth in the market offering distinct products, from drawdown options to fixed position under an annuity. However, there is a conflict within this as taking certain choices are irreversible. Flexibility is to be included in TPR's thinking and discussed in roundtables.

**Advice and default solutions** – new products increase complexity for individuals, this impacts the need for advice. Currently people may seek advice when there aren't many options available to them and they could be better suited by guidance and default pathways. Some people may be better served with a default product while others may require advice depending on the nature of the decisions they face. Simplification may ease the complexity through solutions that avoid needing to take an active decision and potentially work for many as a default. Across the range of potential options people may prefer to choose from a more restricted set of options that offers greater simplicity. The use of defaults needs to be worked through, considering the member pathway when no decisions are made. This default pathway is to be explored through DWP consultation.

**Innovation** – Industry innovation is expensive, but the DC system is not focussed on this spend. The commercial considerations of innovation fall under the value for money framework, and would rather talk about the value innovation may provide than the costs.

## Panel response to the findings

**Andrew Brown, Institutional Business Director (Columbia Threadneedle Investments)**, responded to the findings reflecting on the potential for a socio-economic timebomb. The comparison is to countries with higher savings and a greater State Pension underpin. Under the current demographic circumstances, DC pensions will be a poor substitute for DB funded incomes in the current UK transition.

There is also a concern about how we think about pensions. DC saving is treated as an asset, not a retirement income.

There can be a disconnect of risk across the pension life-course: Accumulation de-risks members into DGFs and bonds approaching retirement when people may then re-risk as they enter into decumulation. Typically lifestyling in accumulation is predicated on targeting an annuity purchase, but that is not how many savers may choose to use their savings.

**Graham Moles, Head of DC and Retail Solutions Strategy (LGIM)**, responded to the findings reflecting on the fact that the challenge for people becomes harder as they grow older. Longevity risk increases over retirement and the necessary decisions are made more complicated over a period of cognitive decline.

There is concern over the behaviour of people who either draw too quickly or too slowly from their pension savings. A natural reaction might be to mandate a maximum and minimum rate upon withdrawals. However, the evidence from the USA illustrates the negative consequences of reducing freedoms.

Financial advice relies on people's trust and engagement with financial institutions, and where this does not exist people will not engage. Alternatively, guidance could be extended to allow illustrations under different options and then a default approach applied where no decision is otherwise made. This would require liability to be altered in the case of guidance.

Product innovation is a slow process, and the lead times are too long. Where a solution is beneficial to members it should be made possible to roll it out more quickly.

**Claire Altman, MD Individual Retirement Solutions (Standard Life),** responded to the findings reflecting on the difference between guidance and advice. The question of advice and guidance can be simplified to simply that people need "help" and industry should be able to provide this.

Innovation from providers would be better approached with a view being taken for value for money approach rather than a charge-based approach.

In the positioning of pension saving there is no need for an artificial line between the wealth market and the DC market as is typically presented.

## Panel discussion

The panel discussion was held under Chatham House Rule. The following topics were debated:

### Value and cost

There are learnings to be taken on how to measure and recognise value:

- Focus in the US is on transparency without a charge cap. There is more active mitigation sought that focuses on detriment where value is not delivered. We would not want to find ourselves in a more litigious environment, however greater transparency would add clarity.
- Transferability of value in accumulation to decumulation. In accumulation there may be efficiencies from scale both of employers and the scheme these improve value to members. Employer schemes can be designed to include the decumulation period and carry these benefits of scale into retirement.

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- Individual drivers by choice have needed regulator intervention to drive value.
- There is a need to not define innovation by costs. The threat of scheme closure or consolidation when benefits do not meet benchmarks which discourages innovation and risk taking.
- There is a need for transparency with a risk adjusted return measure. This will allow for greater comparison between schemes which offer different risks and returns.

## The word "pension"

How to better brand lifelong savings, as the word "pension" has connotations which act as a barrier.

- The need for simplification. For example, in New Zealand tax incentives mean there is a level playing field. It is therefore easier to see behaviours which have allowed the development of rules of thumb that are more easily applied to serve an individual's needs. This helps simplicity which is closely associated with the word "pension" in the UK where the reality may be at odds with this.
- "Annuities" need a rebrand – they are an important part of decumulation options offering longevity insurance. The name, however, carries preconceptions that impact behaviour.
- Lessons could be taken from large brands (e.g. google) about how they learn about their customers to engender trust.

## The impact of the State Pension on outcomes and the place of innovation, particularly Collective Defined Contribution (CDC) schemes

In the current market there is the rule of thumb that State Pension provides a top up to Defined Benefit (DB) to split income 70 (DB) : 30 (SP), but for Defined Contribution (DC) the split becomes 30 (DC) : 70 (SP).

- This change leads us to reflect whether innovation is able to redress this balance for future retirees or whether we simply need to increase the money into the system.
- The particular benefits of CDC are undefined as schemes have not yet come to market.
- Three CDC attitudes have been observed which colours how the benefits are perceived:
    - USA, Aus, NZ, UK – markets which empower individual choice
    - Mainland Europe – there is a societal togetherness associated with risk pooling
    - Chile & Singapore – more paternalistic market and solutions are passed down to members

There are many products innovated in the decumulation space, but there is not necessarily the connection between products developed and the customer.

- Many different drawdowns and asset / investment strategies have been made available.
- The necessary innovation now needs to be in distribution. This will connect individuals to the most suitable products for their needs.

## Guidance and Advice and defaults

- A market in which products are simple and low cost makes things easier for the consumer.

- It is important to align to what people want – which often sounds like an annuity, but with the option to take flexible amounts.
- The segmentation of retirees allows for different approaches for different groups rather than one size fits all. There can be criticism (Australia) that schemes are targeting solutions at an average member who may not exist.
- Intervention on identifying poor decisions is an important feature of guidance (e.g., flagging behaviour which increases tax liability).
    - In the Netherlands when it is believed a decision taken is not optimal, they are obliged to indicate this to a member.
- Compulsory guidance at every interaction would become familiar to people over time whenever they need to take a decision. This would build understanding and trust of guidance.
- Use of AI could be employed to recognise patterns and make prompts to people.
    - However, given the disjointed nature of the pension system (including pots with different providers) makes it hard to currently offer sufficient information for training the AI.

### Discontinuity between accumulation and decumulation

The concerns of a member change in retirement and are framed differently. Rather than focus on return, it is the ability to withdraw the money needed.

- Tools are disparate and fragmented, which makes it harder to address concerns around e.g. sustainable income.