The Future of Defined Contribution (DC)

How will regulatory change impact product design?

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UK's pension system is going through a period of transition. The last year has seen more attention on pensions regulation than we have seen since the introduction of auto-enrolment more than a decade ago.

As the UK continues its journey from DB to DC, regulatory focus has shifted to ensuring those with DC pots have an adequate retirement. Policymakers have begun introducing measures which will transform the DC landscape, including efforts to ensure members get value for money, further support with retirement income decisions, and attempts to iron out some of the kinks in the system, created by the auto-enrolment framework. Outside the DC market, SIPP regulation will also drive innovation in retail retirement products and hopefully serve as a vital area to improve access and reduce the barriers individuals face in accessing high quality retirement solutions.

While pensions have undoubtedly taken up more column inches than ever, there has been less thinking on what these changes may mean in terms of product design. What we do know is investments are firmly back on the agenda for stakeholders in the UK retirement market. This paper focuses on just that, what implications will these changes have on default design, and where we see the market going in the next decade.

3 Key Takeaways:

Value for Money

A new framework by the DWP, The Pensions Regulator, and FCA designed to enable transparency for members and reporting standardization.

Retirement Income

The DWP proposed new requirements on pensions schemes for services and products. A new focus will be defaults with a decumulation focus.

Consolidation and Retail Retirement

Moving towards new products and platforms to suit the growing SIPP market and consolidation methods for small pension pots.

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Value for Money

The Value for Monday framework, which is a joint initiative between DWP, The Pensions Regulator, and the FCA, seeks to ensure schemes deliver the best possible value and long-term outcomes for pension savers, whilst encouraging greater transparency and standardisation of reporting across the DC pension market, allowing schemes to be more readily compared. This focus on longer term value, it is hoped, will lead to a move away from the singular focus on costs, which has permeated the DC market.

Schemes and the broader DC ecosystem will benefit from greater transparency when assessing the performance of their default, especially when making important strategy reviews. We welcome this strive for greater transparency but also know that, from our experience in the Australian market, default investments should be taken in line with the objectives of the default as opposed to purely focusing on peer group positioning. Risk taking would be taken with these objectives in mind to avoid some of the consequences of herding around allocations, positions and performance can therefore be explained in the context of the default objective.

Policymakers are also hopeful that this change, taken together with changes to the charges cap and introduction of the LTAF, will accelerate DC investment into productive assets. By shifting the focus on investment outcomes as opposed to charges, schemes will be encouraged to expand the toolkit to meet their objectives and improve retirement outcomes.

Retirement income

As more and more people reach retirement with DC pots, there is a need to help people with the financial decisions that will impact the rest of their lives. To help with this challenge, DWP has proposed a new requirement on pension schemes to offer their members retirement products and services (either themselves or through a partner) to meet their needs. TPR has also put forward a number of principles for how it wants the 'at retirement' market to develop. Taken together, these initiatives will be a catalyst for major changes for how schemes view a customers' retirement journey.

In the same way that auto-enrolment used inertia to help nudge people into saving, DWP has started to think about how further support can be given to those who do not engage with, or fully understand, the financial choices they face when they come to retirement. This has included discussion of a default solution for decumulation..

Defaults will now need to be built with decumulation in mind. The new requirements will force schemes to think more, not only about their landing points or retirement pathways, but also about the data that they hold on members, who they are and what their needs might be.

From our experience in the US members place great value in securing an income in retirement over and above the pension they may receive from the government and value the combination of lifetime income with the flexibility to drawdown when needed.

For those lucky enough to have pots that can fund a retirement income, understanding the sources of retirement income and tools that can help them spend from their DC pot could are the logical next step for defaults. We also know that an assessment of investment capabilities for retirement income should be made in the context of local regulation and ability to combine traditional investments in stocks and bonds with lifetime income.

Finally, innovation in how member risks are managed in retirement is also likely to feature. Our experience in the Dutch market will help understand how features such as Longevity Pooling can be captured within our default design.

Small pot consolidation and retail retirement

The introduction of auto-enrolment in the UK has been a resounding success story, bringing millions more people into pension schemes. However, with this success has come a rapid growth in the number of deferred small pension pots, which are expected to reach 27 million by 2030. To help solve this problem, DWP now intend to legislate for a default consolidator model, with the overall aim of moving toward a pot for life framework.

Outside the workplace pension market, there are several retirement products and platforms being developed in the growing SIPP market, responding to the increased number of individual investors and regulation developed to default SIPP investments into suitable products. This segment will prove vital in providing easy to access consolidation arrangements as well as offering pension products for those either not covered by autoenrollment or individual savers looking to bolster their workplace savings. Accessing readymade, simple and cost-effective investment products that are managed to achieve retirement goals and automatically adjust the investments through time can improve access and reduce the some of the complexity associated with managing retirement savings for individual investors.

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