

**Institute and Faculty of Actuaries
Sessional Research Event**

Outcomes and Defined Ambition

**28 April 2014
Edinburgh**

The Chairman (Mr J. R. Crispin, F.F.A.): This evening I am joined by Mr Alan Ritchie and Mr Jerry Edmondson from the Defined Ambition Working Party.

The aim of the working party is to consider what the UK might do to close the savings gap, and how the concept of defined ambition should fit into the priorities to do so. They have been looking to produce recommendations that can influence public policy in this area to benefit UK consumers. They created a working party with a core group with diverse backgrounds. They have also used external experts to apply some check and challenge.

Mr Ritchie and Mr Edmondson are going to lead in with the presentation. We will then have a discussion and time for questions.

Summary of conclusions from the paper

Retirement savings and income have come under intense political and regulatory scrutiny over the last decade, leading to a succession of policy decisions that have changed the way people save and, increasingly, the way people access those savings in retirement. Automatic enrolment (AE) has been a huge success with the small number of very large companies in the UK who passed their staging date and have now implemented AE. Its implementation continues until 2018, alongside implementation of the Budget announcements, which includes provisions in the 2014 Pensions Bill for a Defined Ambition framework. It will be important that the sheer volume of

other changes being suggested at the same time does not impact the success for the remaining (over 1 million) employers still to reach their staging date.

The working party believes a shift in the way we think about defined contribution pension savings in the UK – moving away from a focus on particular inputs (notably charges) in isolation, and moving towards an outcomes-based approach. The key point is that by focusing on outcomes – e.g. whether the individual can meet their desired living standards in their old age – competition can naturally drive good industry performance around the best mix of inputs required to achieve those outcomes. Adopting the lowest cost approach may, or may not, result in the best long term outcomes - and considering cost in isolation is not in the best interests of individuals.

An outcomes focus will also help individuals engage with their savings – bringing to life how they are progressing versus their targets (rather than a focus on fund value or projected incomes in isolation of what “enough” might be). One of the biggest challenges in the past has been helping people establish a targeted level of income to match their desired living standards. Pensions are notoriously complex and there may be value in simplifying the way we communicate desirable outcomes from them; the working party proposes a simple table to use as a ‘rule of thumb’ based on the individual’s profession (extrapolated from the DWP’s own analysis).

Two case studies are used to illustrate how this outcome focus could work in practice to the benefit of consumers, helping them understand their options and to take appropriate action in good time. Additional recommendations are made regarding the way consumers are engaged with their savings (context, not content; engagement, not education; inspiration, not information).

The working party proposes six policy actions in all. In addition to continuing the focus on automatic enrolment and in adopting much more of an outcomes focus (in regulators, providers, intermediaries and consumers) the actions proposed include:

- **Ensuring strong independent governance is in place** and enables a holistic view across all the facets of a pension scheme without decision makers getting distracted by short-term focus on inputs that may reflect immediate public opinion. The working party believes that achieving

members' retirement goals should be the focus of attention of the governance body.

- **“Pot follows member”** (for small pots), which has the potential to transform the landscape that individuals inhabit. Instead of an individual pension being a series of disconnected islands, arising from discrete periods of work, the working party proposes that “pot follows member” can bring these together into one more substantial landmass that generates member interest and more control of decision making.
- **Auto-escalation** to follow on from auto-enrolment. This may “nudge” savers gently along from the initial low entry contributions up to levels that can deliver the pension they need. It has the potential to harness those same behavioural traits that auto-enrolment has so successfully been built upon.
- Finally, **guarantees**. Once members have built up a worthwhile stock of retirement savings – the product of the previous five steps – they will have something worth protecting. Once they have better engagement with their outcomes, they may be more likely to consider paying for them at a level that makes their provision viable.

The working party proposes a timeline for completion of these six steps, designed to bring them in quickly, but also in a manageable way, so that the desired impact from each can be realised. In summary, if Defined Ambition splits into “outcomes-centric engagement with consumers” and “provision of guarantees” then the working party suggests starting the former immediately and the latter once some of the other building blocks are in place.

In recent months, some further and very substantial policy decisions have been announced in the UK. Much of this is consistent with the views of the working party – e.g. strong focus on governance, a desire to improve outcomes for customers. In particular, the greater freedom enabled to pension savers when it comes to how they take their income should strongly support better engagement and desire to save.

Mr A. Ritchie, F.F.A.: I am going to ask you to consider the three questions what do you like about what is in the paper?; what would you change (to what and why)? ; and what impact do you think the recent DWP announcements and budget announcements should have on what we say in this paper?

I should add that we want to use this paper; we do not want to do a purely academic piece of work. We would like, for example, to meet with the DWP with some of our ideas, so this is a chance to contribute something which we will try to progress in discussions with policymakers.

Mrs D. Walsh, F.F.A.: We tried to focus on “like”, but it was difficult not to touch on other parts as well. We like the style of the paper. It fits in well with auto-enrolment papers we have had in the past. It was also a bit more visual than papers we are used to seeing.

On the content side, we liked that because the industry is going through so many changes now that we are all quite glad that there was not something in the paper that we had not considered.

It is good that there is a mix of people involved in the paper.

Mr H Taylor: There are many good ideas in the paper which have an obvious and intuitive appeal. However, their effectiveness in driving change is something which should be confirmed as far as possible with real customer research.

Mrs Walsh: We liked the fact that there was buy-in from all of the working group and identification that we do also need the regulator to buy in to this. I also mentioned that if we are coming up with this engagement for members, if they get an annual statement which is quite bland, restrictive and confusing, does that give a confusing message to members? So do we need to lobby more to make changes there so that the information is easier for the member to understand and absorb?

I should also like to ask who is doing what next? Who is going to have the conversations and how do we make sure as Mr Alan Ritchie said in his presentation, that this does not become a paper where we all say “That was very nice.” ? How do we make sure we make the changes?

Mr Ritchie: Speaking on behalf of the working group, we are very happy for volunteers to help us take it to the next stages.

A speaker: How easy will it be to get the DWP and the regulators on board with making changes? We were thinking about the legislative requirements of what we are obliged to put into documents, and so forth.

Mr Ritchie: That could certainly bring challenges.

A Speaker: There does not appear to be a huge amount that we would want to change in the paper, because it was a good paper. In terms of the success of auto-enrolment, it is important to caveat that by saying that the contribution from employees is only 1% at the moment, so 1% may not be that noticeable, but when that goes up to 5%, the opt out rate might increase substantially. It is a success so far but not completely proven.

I do not know how much you covered the fact that a lot of the dull material is forced by regulation. Influencing regulators to allow providers to present that in a more creative way would probably be required.

In terms of the six recommendations, recommendation one, which was basically continue with auto-enrolment, might not be necessary. Auto-enrolment is going to continue. I cannot see why that would not happen. It seems a distraction from the other five recommendations, which are very strong.

I expected to see more on guarantees. That is obviously the last phase; it was not focused on in the presentation and there is not much in the paper on how we might go about achieving the aim of providing guarantees, given the cost,

and how we might persuade people without guarantees what they would be paying for.

Mr Ritchie: On guarantees, we touched a bit on it in the paper, and considered the different options. There is another working party which is going to delve more into the detail of what could be provided.

Mr M. C. Ledlie, F.F.A.: I was surprised in the paper that customers were being asked whether they wanted to invest differently in order to meet their objective. There is a risk that it might seem to the customer that by simply choosing a riskier investment option they can make a pension deficit go away. It is probably driving the consumer into a conversation that is really quite technical and complex at this stage. It might be better for this very simple communication to the end customer to focus on the hard facts of you have either got to save more or you have to accept a lower outcome. The conversation about the different investment strategies is one most people probably will not want to engage in.

Mr Ritchie: That was definitely the hardest one to put into the “what next” step - “could you change your investment strategy?”. It is the one that requires the most advice alongside it. We may have initially thought it was still an option. There is still something you could do. Maybe we could address that with a simpler statement saying something like “an alternative investment may be appropriate”.

Mr Edmondson: This is where we have the big challenge of interaction with the regulators and where we are now. How do we get away from the caveats “you must cover that” and if you say that you put this amount in you will get this pension. Do people read that as a guarantee or do they take it, as it is intended, as a guide? If we state it that way, we continue to produce up to some 60 pages that we currently produce.

A Speaker: Auto-enrolment is just for the employed population. What about the self-employed? How are we going to tackle that area?

Mr Ritchie: That is not something we have majored on in the paper.

It is certainly another one to add to the list of things to think about. Has anyone else any ideas on that about what could we do on the self-employed side?

A Speaker: One suggestion. People have talked about the paperwork and all the regulatory guidance that surrounds it, but technology with an app allows someone to play around with the figures. They get a sense of what risk and return means because they can play with it; it can be turned into a game. There are innovative approaches that can be used, which are taken in all sorts of other fields.

We still seem to be stuck in the view that the core mechanism is a bit of paper with letters and figures written on it. I cannot believe that will engage anyone who is under the age of 35.

Mr Ritchie: Absolutely. I guess that was implicit in what Jerry Edmondson was saying. It is something that maybe we can bring out more.

A Speaker: The paper makes it clear that there is an assumption that technology could be a delivery mechanism for engaging communication. It is more than that and I suggest that you could drop the auto-enrolment point and replace that with the use of technology. That will resonate much more widely than simply saying that we need to go ahead and do what we have already said that we are going to do.

If on your working party you had someone from Apple or Google's app development, you might have had an interesting bit in the paper. So maybe you could get someone from there to help you with the innovative content in it.

Mr Ritchie: Reverting back to saying the regulations get in the way of some of this communication. Whilst I know this is a common view in the industry, from conversations with the regulator and one of our working party members in particular (Sandra Graham of the FCA), my belief is this can be overplayed.

There is sometimes a difference between the regulator's intent and the interpretation of rules by providers. From my experience the FCA would be open to conversation around new ideas to fuel better engagement. I agree we should push the boundaries on this in a sensible, risk-controlled way, also recognising technology and recognising some of these themes around engagement.

If we were to say generally people who attended today were supportive of the paper, and are saying that this is what we as a group think, subject to the points made so far, would you all say "Yes, absolutely" or would you say "Hang on, there is just one other thing that you should change before I would be happy for you to say that"?

A Speaker: It is not a change to the core proposal. The proposed change of focus from inputs to outcomes, absolutely. I understood what you said about charges, but I suspect in order to get to the table we may need arguments stronger than that to explain why we are not evil people taking the money.

Mr Ritchie: We need to give that more thought. Moving on, what impact do you think recent announcements from the Chancellor and the DWP will have?

Graeme Bold: A few comments in terms of going through the six key steps outlined in the paper. Post-DWP and budget: first auto-enrolment is on time. Secondly, movement from inputs to outputs; the budget changes provide communication challenges as people will have more flexibility about what they can do in retirement. I would like to think that they could move from content to context and focus on the communications so that there is less detail, perhaps, in terms of the product they would have to put it in as well.

Governance: We just need to get on and do that. That is in the DWP paper. In terms of "pot follows member", I know that you had a certain timing within the paper. I would question whether that needs to push out even further. Because of what has happened with DWP in the budget, there is a whole lot more that the industry needs to do before you get near to putting into operation "pot follows member".

In terms of auto-escalation: that should definitely be part of the recommendations, potentially bringing in and accelerating industry effort on it. You can link that to a safety net of a charges cap, so people should feel a bit more confident about not being ripped off. Also you have more freedom of choice in retirement. There is less likely to be an objection that money is then locked into something that they cannot get hold of and has to be converted into an annuity. We could increase our focus on that.

We had a discussion on guarantees. It is interesting that in the discussion we have not really focused on guarantees that much in terms of true defined ambition and what that would be. Clearly volatility management is still key, and guarantees are the best example of that. Consumers want it.

The only point we might add is that the charge cap makes it more difficult now if you want to stick with default funds. You need to think more how you charge for guarantees outside of defaults.

I have not had a chance to fully read about the way defined ambition works in other countries. It is hugely different from guarantees on a DC pension. That did not come out in the paper and it has been pushed out to 2017. The way we see defined ambition in other countries, I just cannot see working in the UK.

A Speaker: We broadly agree with everything that has just been said. We wondered whether in number three, which looks at independent guidance, and also number two, outputs, whether the government are going to have to get more involved in giving us proper advice, more independent advice, rather than leaving it purely to the companies which have been seen to have been perhaps biased.

On guarantees, we wondered whether these can be offered given the charge cap. Clients definitely want more guaranteed income but also there is a need to re-educate regarding the benefits of an annuity.

Mr Ritchie: That is maybe something that we did not need to do when annuities were pretty much compulsory. Now we might have to try to engage people a bit more on that.

The Chairman: I should like you all to join with me in saying a big thank you to Mr Ritchie and Mr Edmondson for a stimulating presentation on a different style of paper.
