



Moderator:
Owen Walker,
Editor, **SchemeXpert**



Panellists:
Fiona McDonagh,
Technical Manager,
**Marks & Spencer's
Pension Fund**



Panellists:
Alan Pickering CBE,
Chairman, **BESTrustees**



Panellists:
Phelim O'Reilly,
Independent Trustee,
Trustee Principles



Panellists:
Michael Slevin,
Managing Director,
**The Open Market
Annuity Service (TOMAS)**

Reflecting on the most significant reasons for members inertia and procrastination and strategies that create engagement

Owen Walker: Thank-you everyone for joining me in this debate. It's a very interesting discussion we're looking at today: annuities and decumulation for DC members. It's an important debate because it's one of the biggest decisions people ever take in their lives. I'd like to start by asking Fiona: are trustees doing enough to encourage members to select the most appropriate annuity?

Fiona McDonagh: I started at Marks and Spencers (M&S) in 2008 and one of my first projects was to bring in new blended funds and improve communication within the M&S DC scheme. A few months later we noticed through the administration reports that we were getting some complaints from members going through the retirement process. This was an area that we never reviewed because like most schemes, we had focused on the investment side and making sure the default option was appropriate. Because of the complaints we decided to review the retirement process. What was interesting was that we were sending lots of information to members 6 months before their target retirement age and then finding out that 50% of them were not planning to retire in 6 months! This was an issue when invested through lifestyle, as they were now invested in cautious and cash funds, so you could say they may be inappropriately invested. We already had an annuity provider service, so we considered how that could link into the retirement process

more effectively, tightening up any gaps. We then tried to focus those members that were actually retiring on the types of annuities that were on offer at that 6 month point before retirement.

Owen: Moving onto Alan: just looking at the actions they've taken at Marks and Spencer's; is that typical of schemes or have trustees not been doing enough in the past to provoke the members to select the right annuity.

"it isn't disloyal to switch your money from the firm that has been helping you build up your pot, to another company that will turn that into an income stream."

Alan Pickering: What Marks & Spencer's are doing is good, but aspects are going to change in the future for the reasons that Fiona mentioned. In a defined benefit (DB) context, you know 30-40 years in advance when someone is going to retire. In a defined contribution (DC) world

members may want to draw some or all of their benefits but not immediately. We have to inform them much earlier so that even if they pursue an automated investment strategy, they're kept engaged to revisit that strategy as and when they think their circumstances will change. We also need to get them into the mindset that it isn't disloyal to switch your money from the firm that has been helping you build up your pot, to another company that will turn that into an income stream. It's a brand loyalty and it's a misplaced brand loyalty. You have to explain from the outset that someone will help them build up their pot.

Owen: Can you pick-up from that point Phelim?

Phelim O'Reilly: DC members have to make a lot of decisions when coming up to retirement. There's the issue between a tax free lump sum and annuities, and trying to find the balance between them. We find that members tend to maximise tax free lump sums. They also have to consider whether they want to buy annuities that increase in payment. A very large amount of members are buying non-increasing annuities and we are quite concerned about that. The only consolation there is that the tax free lump sum may be being invested as a hedge against inflation. We also need to make sure people get appropriate advice in regards to dependants' pensions. We need to make sure the advisors are making them consider who those dependants

might be. In Ireland, we have a further complication in that rather than pension members buying annuities; they can in fact avoid the annuity area in defined contribution pension schemes. This is quite a recent development, leaving their money in something called an 'Approved Retirement Fund'. The details are quite complicated, but essentially many members have the option of leaving their money in markets and that money would continue to enjoy a tax free build up. As they draw down income from their 'Approved Retirement Fund', it's taxed as if it were an annuity payment. This further complicates matters. DC members in Ireland have to get their heads around the annuities or "Approved Retirement Fund" choice. This has implications for the investment strategy coming up to retirement, because obviously someone who is targeting to move into the Approved Retirement Fund world won't have the same investment needs as someone who is targeting to buy an annuity. That makes this a complex development for trustees.

Owen: Michael, you're coming at this from a different perspective, in being a service provider. Have trustees done enough to encourage members to make the right annuity choices?

Michael Slevin: Some do but most don't. It's interesting that the question is about provoking fear in the minds of members, but I'm not sure that is what trustees should be doing. I believe trustees should be doing more to provide information to members and that provision of information is not something that should be a one off exercise, that gets carried out at retirement or even within a six month period, in the lead up to retirement, but is really something that needs to go beyond that. From our side of the market providing services to many different trustees, we see it as key to have consistency of process, but overlaying that with some flexibility around the timescale of delivery. Alan is right that DC is not like DB where you know six months before the retirement date what is likely to happen. Within DC you could have the lead up to retirement being a six month period. It could however be a six week or even a six day process. Whatever tools are being provided, there needs to be flexibility in providing the information they need, so that they can inform themselves of their choices.

Owen: Have you got any examples of best practice, where the processing tools have proven to be successful in provoking engagement with the open market?

Michael: There are a number of tools on the market that are available. The key to those that work well is breaking down the decision that members have to make, which is a huge financial decision, not just for who they set the annuity up with and getting the best rate, but more importantly, getting the right shape of annuity to fit their circumstances. The key need is for processes and tools to break down the decision into bite sized chunks. There are four separate areas they need to look at. One: the areas Phelim spoke about being the tax free cash option, whether they should take it and if so, how much it impacts on their remaining income if they do. Two: provision of benefit for dependants or spouse and what level that should be provided at. Three: at least some degree of inflation protection

on future income payments. And four: the provision of some form of guarantee on the income payments. The complicated aspect is then combining these options and providing tools that demonstrate the overall impact of combinations of these choices.

Alan: One of the issues that annoys me with the pensions market at the moment is this drive to provide a 'product', as if a single product can do everything for everyone! Its tools that people need, not a product and even if we break it down in the helpful way, that is being described, people are still running away from the multi-dimensional decision. Where employers

"The key need is for processes and tools to break down the decision into bite sized chunks."

are large enough to provide access to someone who can have a face to face or face to group conversation, who can give generic advice to take away the fear. We need to help them through the decisions, then to make the implementation as easy as possible, because once somebody has to sign more than one piece of paper you've lost them.

Owen: Can you give your thoughts Fiona?

Fiona: It's definitely of interest, because I do believe the four component parts are very important. We have got quite a number of low paid workers in the scheme with smallish pension pots. Most take the maximum tax free cash, no-one to my knowledge has attached a spouses pension; probably only 2% of members index link however there are a few more that want a guarantee period. At the end of the day members just want to get as much pension as they can out their pot. It's an issue and a worry, not attaching inflation to annuities, but as was said earlier, in reality, the pot sizes are not that big and taking these options can make a big difference to the amount of pension. We do have a modeller on our web-site where members consider their options and see how they look. We also have an annuity search engine attached and do encourage all members in our newsletters and annual pension estimates to have a look. Companies need to do more, but it's not always easy because of economic pressures.

Alan: Commenting on inflation protection, it can be quite rational for people to not buy an increasing pension as long as they've thought it through. This is especially the case for lower paid individuals where the state pension is going to form a significant part of their retirement income. That is going to be inflation protected in some way. For them to then use part of a small pot, to buy inflation increases in the private market, with

the private market having to adhere to the increase in solvency rules, it just won't represent value for money for people.

Michael: The reality is individuals will make rational choices on whether they do or whether they don't.

If someone chooses not to build inflation proofing that can have a dramatic effect. The market is not perfect and the cost of inflation proofing is not static. It can vary considerably over time. What is important is that members are given the relevant information. When they receive that information they can make a rational choice. It's quite possible in the market to buy inflation proofing which is extremely good value and it can be quite favourable when people do, but they can't make that decision if they're not provided with the information.

Owen: Could you comment then, Phelim, on whether processing tools improve engagement with the open market?

Phelim: From a trustee point of view, I'm not sure if we should be involved in the details of these arrangements. The trustees are not going to be advisors, but what they want to ensure is

Owen: Do you believe engagement with the members is a role trustees need to take Phelim? If so, when should that start to take place?

Phelim: It's not wise to pick a particular time; communication should be an ongoing process. The whole issue with DC is that the investment choices from quite a long way out should be influenced by whether you want to go down the annuity route or Approved Retirement Fund route. A major problem with the DC market in Ireland, as well as the UK, is the level of contributions members are making currently are unlikely to be sufficient to provide a comfortable retirement at the normal pensions age of 65. Issues like that are going to be as important as making sure you have a certain pot on a certain day. For defined contribution arrangements the 'contribution' is certain but the benefit and in fact the retirement date is not.

Owen: Is that something you would agree with, Alan?

Alan: If you use the word 'engagement', as trustees we need to make sure the employer is engaged as well as in the defined benefit world. It's quite easy to see the employer's role ending

Michael: Largely by default, what our service aims to provide is a consistency of process and treatment for all members of schemes irrespective of their fund size. Therefore it enables people, even those with small funds, to get a good level of information service and help. We also provide written materials, online tools, and a phone service, because most people actually want to talk to somebody to find out what it means for them and what the impacts are. It's really about the consistency of process as I believe it's dangerous for trustees to make decisions based on members' fund sizes; and an assumption that those with smaller funds need and deserve less help than those with larger funds.

Owen: Referring to Michael's comments about, regardless of pot sizes, the amount of engagement should be the same for all members; when do you believe that engagement should take place?

Fiona: I would agree that you relate engagement to fund sizes because you don't know what other income and benefits members have got. Picking up on Alan's point, it really does depend to what extent the employer wants to support

"It's about the consistency of process as it's dangerous for trustees to make [annuity recommendation] decisions based on members' fund sizes"

that there is an appropriate advisor in place and that they are offering sufficient opportunities, so that members are in the position to make informed decisions. For very large clients, trustees will know the advisor very well and take the time to familiarise themselves with them, to make sure things are done properly. For smaller schemes it's quite difficult to find a balance there. In respect of very small cases, what trustees can do is quite limited. There is pretty much always an advisor involved. If the advisor comes back with an annuity that is from the life office where the savings were built up and trustees should ask, 'have you investigated the open market opportunities and if not, why not?'

on finalisation of the design of the scheme. We have to make sure that the employer is willing to be engaged, they are engaged adequately and trustees who have a wide experience can prompt the employer to be engaged. Where the employer isn't engaged, we have to do the best we can within the constraints of the trustee 'law' to make sure individuals are getting the help they need within the parameters of the available DC funds. Otherwise provide them with a pension and provide them with advice because advice can be quite expensive.

Owen: Michael, I suppose your service is aimed at those who don't have access to advice, would I be right in assuming that?

member engagement. Then it depends on how much money the trustee has to spend on it. It's the trustee's job to make sure that it delivers within those confines. With regards to when it should start, it should be when they join the scheme. If members don't focus on what their target retirement age is when they join the scheme then the process is more difficult. This is easily missed when trustees have come from a DB background, as they sometimes think members are going to retire at 55. With the economy and longevity, DC members are not going to retire that early.

Owen: On that final point we can finish. Thank you very much everyone for joining me.