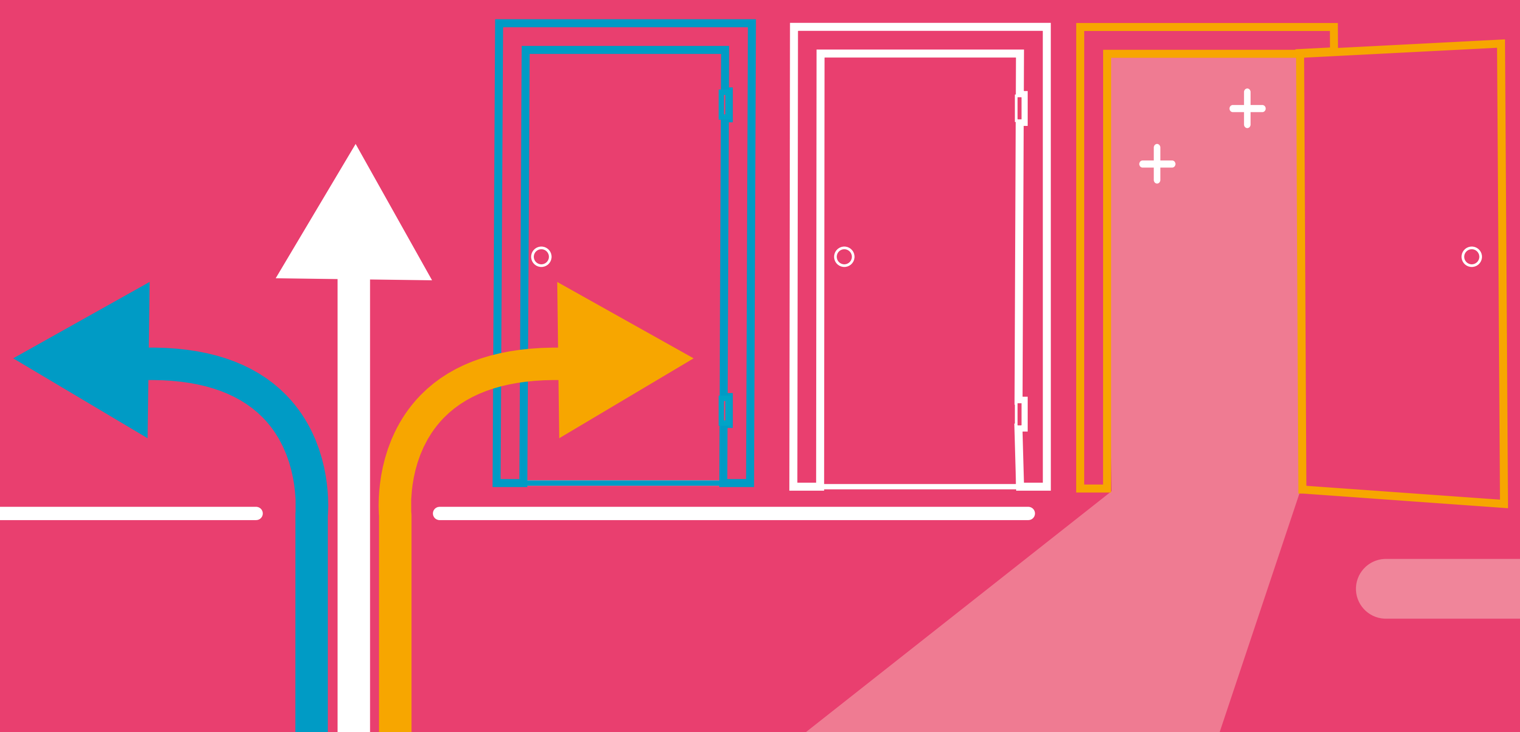
LCP INSIGHT CLARITY ADVICE

How are DC schemes adapting to freedom and choice?

LCP DC Scheme Survey 2018

December 2018



Introduction

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Partner

We are now three years into Freedom and Choice and we have seen many DC savers across the UK take advantage of earlier access to their pots – with most accessing cash.

At present, many DC savers also have other retirement savings, such as DB pensions, so we expect these statistics to evolve as the number of retirees relying solely on their DC pot becomes more substantial.

With so much change being thrown at members over the past few years, we wanted to find out whether schemes are truly offering flexibility, and if their investment strategies are offering appropriate levels of risk / return throughout their DC savings journey.

I would like to thank all who took part in our survey. I hope you find the results interesting.

Look out for our top tips throughout this report on how you can continue to improve your pension scheme for your DC savers.

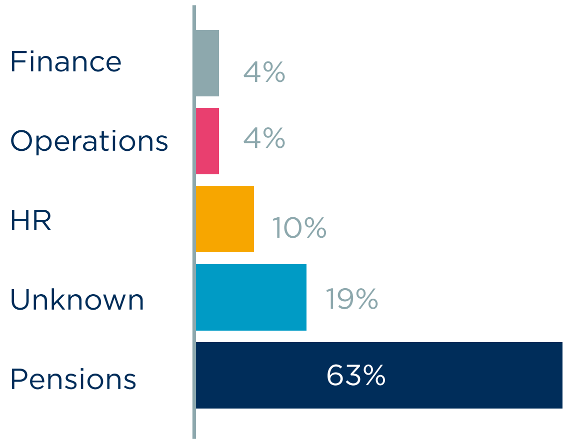
What's inside?

1. Are DC savers getting flexibility?
2. How have schemes adapted the growth phase?
3. Are we doing enough to help savers when de-risking?
4. Are managers being pushed hard enough on costs?

Who took part?

59 schemes responded to our survey, across a range of job roles and industry sectors

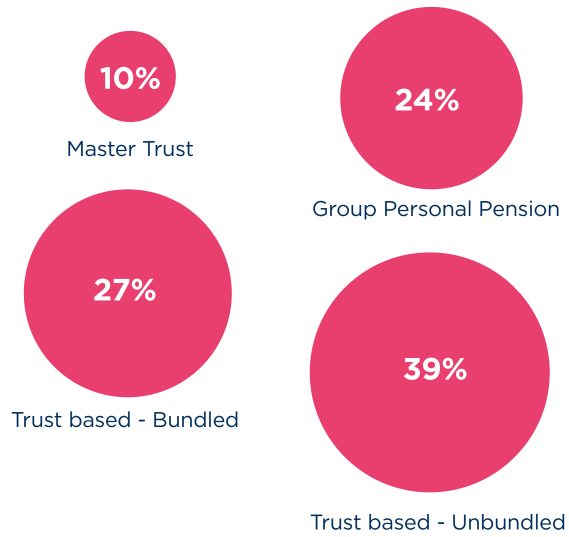
Nearly two thirds have pensions as primary responsibility in their role



Industry sectors represented

- Agriculture
- Education
- Hospitality
- Pharmaceutical
- Real Estate
- Retail
- Energy
- Utilities
- Professional Services
- Not for profit
- Banking
- Construction
- Financial Services
- IT & Telecoms
- Manufacturing

A mixture of DC pension types



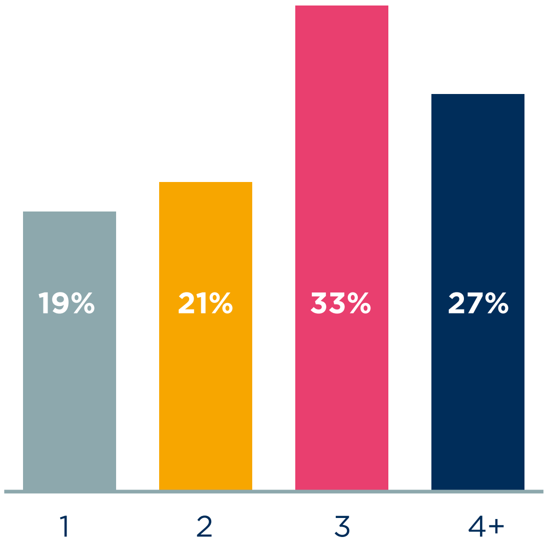
Are DC savers getting flexibility?

As we try to navigate the ever changing DC pensions landscape the focus is, and must remain, on improving member outcomes. This starts with encouraging members to save what they can into a pension scheme.

However, it is no secret that the amount currently being saved in DC pensions will result in many members having an inadequate income in retirement, even with the upcoming step up in minimum contribution rates in April 2019. This is a conclusion that has been well documented by the PLSA and led to its proposal for **Retirement Income Targets** which we fully support.

Our survey results indicate that, since Freedom and Choice, **60% of schemes offer three or more lifestyle strategies** (see chart 1), allowing members to target different retirement outcomes easily.

Chart 1: Including your default, how many investment strategies / lifestyle strategies do you offer?

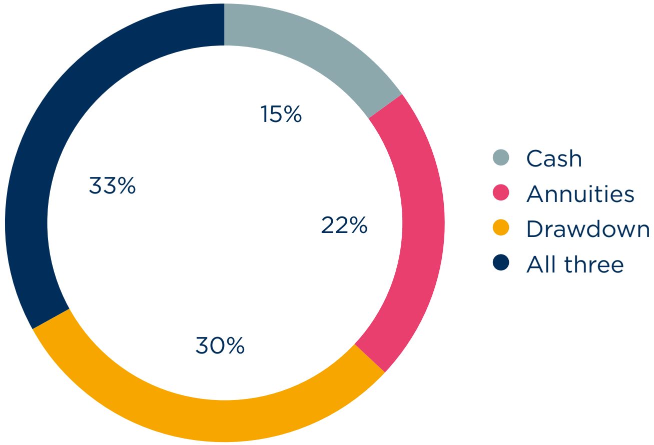


Although this is a positive step, trustees and employers need to be mindful of overwhelming DC savers by offering too much choice without clear explanations. Ensure your communications clearly state the objectives of each strategy in a language they can understand, so that members can make informed decisions.

In the last three years, **many schemes have adapted the target of their default strategy to give flexibility to members** (see chart 2).

The popularity of defaults targeting drawdown reflects that while full withdrawal is the most common way for members with small pot sizes to access their DC pension, drawdown has emerged as the most popular route for those with larger pot sizes.

Chart 2: What retirement outcome does your default investment strategy target?



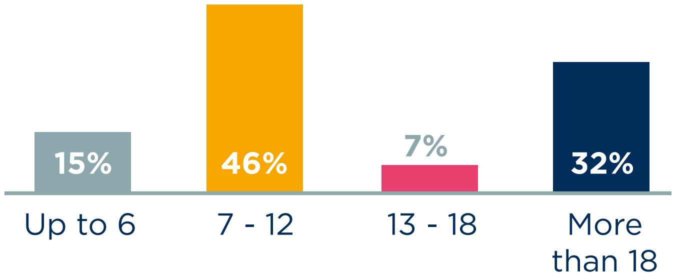
LCP Top Tip

Make sure you regularly review your investment strategy to ensure that your target retirement outcome is aligned with what your members want, and communicate this clearly.

Are DC savers getting flexibility? *Continued*

With around a third of schemes offering more than 18 self-select funds (see chart 3) we believe that clear communications are key for your DC savers who invest using your self-select range. Whilst it is well known that the majority of members are in default strategies, those that are looking at self select options will also need clear and concise information on the kinds of funds on offer. The more funds offered, the more important this becomes.

Chart 3: How many self-select funds options do you offer members?



LCP Top Tip

Make sure that your communications follow the three Ts - timely, tailored and to the point - so that your members get relevant messages which should increase engagement

Are schemes being flexible enough in their approach to communication?

In the initial growth stage of a member's DC pensions journey, communications and engagement should focus on contributions and understanding the benefit of saving into a DC pension scheme – tax relief, NI savings and more money through matching contributions.

We were pleased to see that nearly **50%** of respondents communicate with their members more than once a year and that nearly **20%** have a segmented communications strategy, which will help those members understand the key messages that are relevant to them.

Chart 4: How do you communicate with your members?

How have schemes adapted the growth phase?

Whilst we should continue to encourage members to save more for their retirement, it is important that the savings that they do make are working as hard as possible. When viewed as a whole, each incremental step that can be taken to improve a member's outcome will make a big difference.

In the early growth stage, where members are young and retirement is far in the future, investment growth is the key objective.

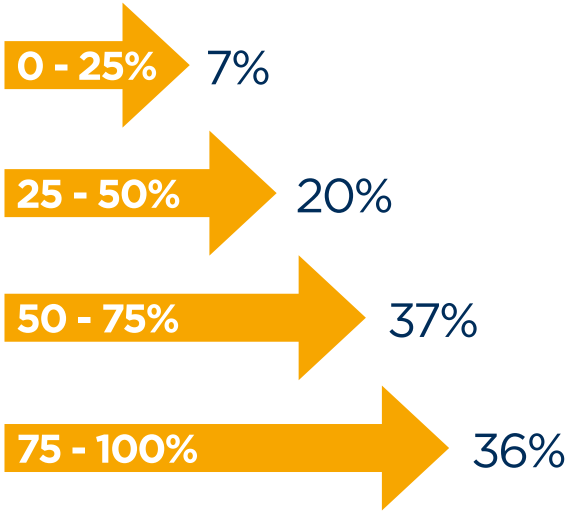
Whilst it is comforting to see that over **35% of schemes have allocated a significant proportion (over 75%) of the initial growth phase of their default strategy to equities,** there is still progress to be made in this area.

Our survey shows that around 25% of schemes have less than half of the initial growth phase allocated to equities which will be having an impact on members' outcomes in retirement.

LCP Top Tip

Make sure you understand the risk / return profile of the lifestyle strategies you offer – let members take risk at the right time

Chart 5: What proportion of your initial growth phase is allocated to equities?

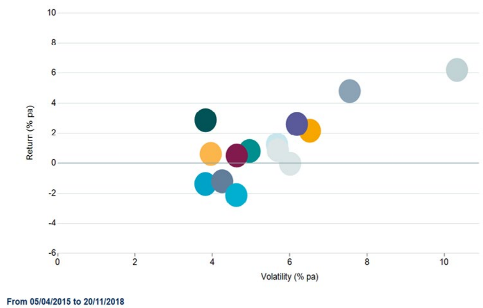


When looking at default strategies offered by Master Trusts in isolation, a similar theme is present. **The allocation to equities ranges from 38% to 100% in the growth phases.** With the average being 74.6% allocation to equities, this range will make significant difference to returns for member and outcomes.

Whilst we believe that equities represent a good long-term asset for younger DC members we are encouraging schemes to look further than just equities. With the investment landscape constantly evolving thought should also be given to other ways to access growth which could result in better risk adjusted returns for members. Private markets – areas such as Infrastructure, Private Credit and Private Equity – have been accessed by DB pension schemes for years but DC schemes have struggled to access them given the requirement for daily dealing and other DC platform restrictions. We should all be pushing investment managers and DC platforms to innovate and come up with new solutions, at reasonable costs, in this area.

In recent years there has been a spotlight on Diversified Growth Funds (DGFs) and whilst they do provide members with access to a broader spread of asset classes, they have produced significantly variable returns in the current market environment (as illustrated in the risk/return chart below). This highlights that manager diversification in this area is important. We increasingly view their strengths as being most valuable in the late growth and de-risking phase where volatility management becomes a more important consideration.

Chart 6: Diversified Growth Fund Risk vs Return since Freedom and Choice



Source: LCP Spotlight

LCP Top Tip

Demand more of your managers and providers to innovate and provide access to alternative risk premium DB schemes already access

Are we doing enough to help savers when de-risking?

Whilst ensuring members are taking enough investment risk in the early years is a key consideration, it is also important to ensure de-risking is taking place at the right time.

This is a balancing act between:

- maintaining investment growth to boost member outcomes; and
- protecting the value of a member's pot (subject to their retirement outcome) so that it is less volatile when they start to access their savings which could be at very different points in time for each member.

When members are approaching retirement, the focus should shift to consider how they plan to access their savings.

As schemes offer a range of strategies to meet the retirement flexibilities, members need to make sure they are targeting the outcome that most suits their needs. This will shape the investment strategy that they follow and the DC pot they will ultimately end up with.

Our survey shows that **nearly 40% of schemes don't communicate with their members until six months before their Target Retirement Age (TRA)** as part of the standard pre-retirement pack.

Chart 7: When do your employees/members receive their first pre-retirement communication?

6 months before
Target Retirement Age as part of the pre-retirement pack
39%

From age 55
when they can access their savings
32%

Pre-age 55
14%

I don't know
15%

This could have a number of implications:

- members that don't intend to retire at their TRA may have de-risked too early and as such be invested in assets dampening their investment returns unnecessarily; and
- if members look to access their benefits ahead of receiving the standard pre-retirement pack, they may have been exposed to an investment strategy with too much volatility leading up to this point.

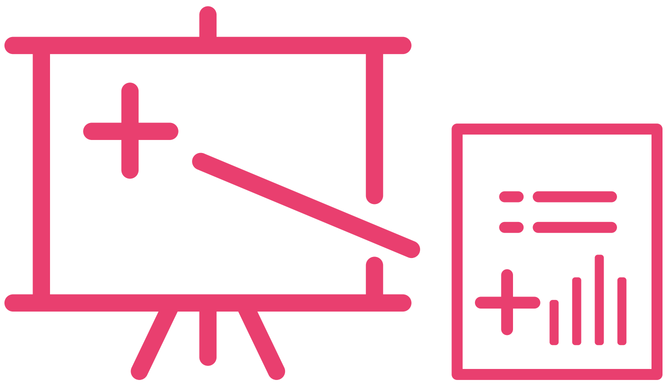
LCP Top Tip

Establish a tailored pre-retirement communication strategy in the interests of your members which is not just anchored around their TRA but has age milestones too

Are we doing enough to help savers when de-risking? Continued

Schemes should spend time tailoring a communication strategy to help members plan for retirement and get the most out of their investment strategy. Many providers are developing their propositions to allow schemes of all sizes and types to be able to do this.

A recent addition to many communications strategies has been financial education. Many employers are adding educational modules to their HR and benefits programmes, to help people to better understand their financial position, and take control of their future.



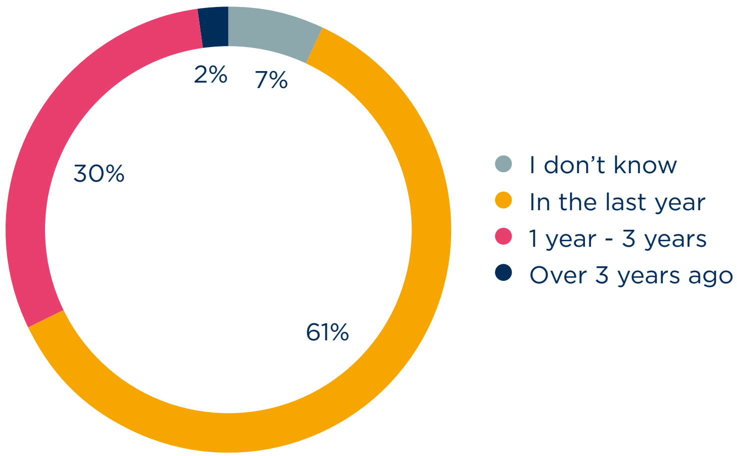
It's not just about delivering a message in a timely fashion. Schemes also need to think about how they are communicating with members, and build a multimedia strategy to engage them with their savings.

Earlier this year, we hit Europe's busiest high street to find out how people like to learn. Click **here** to watch the video to see what they said:

Are managers being pushed hard enough on costs?

Our survey shows that over **60% of schemes have reviewed ongoing charges that their members pay in the last year** (chart 8). We would urge all Schemes to keep up the momentum on this and undertake an annual fee benchmarking exercise to ensure members are getting good value.

Chart 8: When did you last benchmark review the ongoing charges that your members pay?



Taking this one step further, transaction costs have recently come under the spotlight given new requirements for disclosure in the Annual Chair's Statement.

Asset managers and pension providers are still coming to terms with the changes, as we revealed in the **LCP DC Investment Survey 2018** which was released in August.

Key findings

Over 50%

of respondents expect to be able to provide members with a whole year of transaction costs, in the "slippage cost" format, in time for chair's statements to be signed off for the Report and Accounts for 30 June 2018.

Nearly 50%

envisage some problems with providing data for some asset classes in self-select ranges, meaning the information might not be there for all members

80%

of providers have internal checks for reasonableness of transaction costs

Click **here** to find out more -

LCP Top Tip

Push managers on ongoing charges and transaction costs to ensure members are receiving value for money

Related resources

Make a difference to your employees' financial futures

Early registrations are now open for our 2019 DC and financial wellbeing conference.

In its sixth year, we will be delving into the complete financial outlook for your employees, from pensions to alternative savings ideas, and how we can help them to feel more in control.

We'd love you to join us on Tuesday 19 March at the St Pancras Renaissance Hotel to hear the latest ideas to really make a difference to your DC savers' futures.

Save your seat by registering here – **www.lcp.uk.com/dcconference**

Understanding the Future Pensioner

Education, Savings, Technology and Future Landscape are fundamental themes that will continue to play a hugely significant role in shaping pensions that are fit for the future.

Read LCP's latest thoughts on how we can improve workplace savings for our future pensioners.

Take me to the blogs - **www.lcp.uk.com/future-pensioner/**

Have you seen what's new in LCP Horizon?

We haven't just been re-imagining lifetime savings, but also how our technology can help make your life easier.

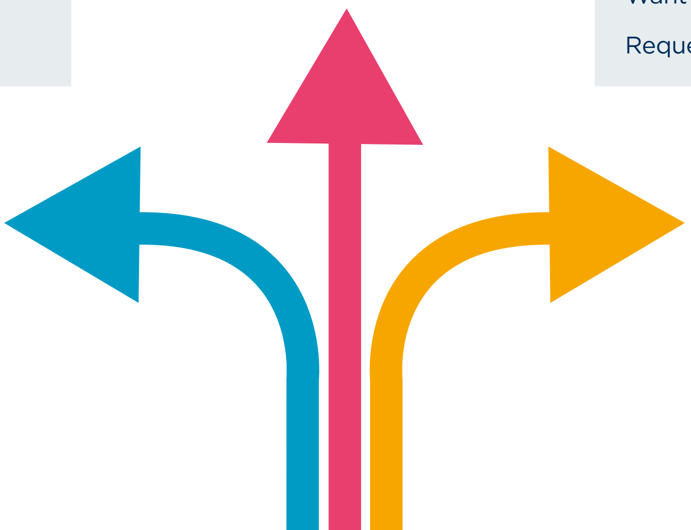
With that in mind, we have new features in LCP Horizon to help you understand your members choices.

With a completely bespoke dashboard, you can now have answers to questions such as:

- Are member's outcomes improving over time?
- Are members actively changing their elected contributions?
- How are members taking advantage of flexibility at retirement?

Want to see these new features in action?

Request a demo at **www.lcphorizon.com**



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