Rolling with the trends

Summary
- While automatic enrolment might have created an environment where many savers do not give their pensions a second thought, industry progress, catalysed by the effects of the coronavirus pandemic, is driving improved interactivity.
- ESG is only going to become more important for the industry amid increased interest from savers and beefed-up regulatory requirements.
- Both DB and DC schemes may face pressure to consolidate in the near future, but some are concerned that proposals unfairly target small schemes.

Duncan Ferris explores pension industry trends that have remained relevant throughout the unpredictability of 2020 and beyond, including the rise of ESG, the challenge of increasing member engagement and the drive for pension scheme consolidation

There is no denying that 2020 has been a rollercoaster.

It's a rollercoaster that, for most of us, has involved an awful lot of sitting inside, making awkward video calls and trying to find shops that have toilet roll in stock. In other words, it has not even come close to topping Nemesis at Alton Towers.

The pensions industry has been riding this rollercoaster, going through a number of great changes in order to protect savers and pensioners. But alongside these reflex actions taken to cushion the impact of the pandemic, the influence of several industry trends that emerged long before Covid-19 have continued to strengthen as we pelted down the track.

Engagement

Getting members engaged with their pensions, and holding their attention, can be key to them being aware of their options and receiving better retirement outcomes.

XPS Pensions Group head of client communications, Steve Powell, comments: "There is now a clear focus amongst trustees and providers to revitalise the way they communicate with members, which has been an area where the pensions industry has fallen short in the past."

A potential result of this is that it appears many members simply are not clued up on their pensions or how rules and regulations affect the money they put away for later life. Research from a report published by Nest Insight and Invesco in November 2020 showed that more than half of savers were unaware of government tax relief on pension contributions and a third did not know their employer also contributed.

LCP partner, Steve Webb, says: "The evidence is that most people are still disengaged from pensions with some people not even realising that they have been automatically enrolled and paying no attention to correspondence. The drive, led by Ruston Smith, for simpler and clearer benefit statements is a positive one, but if people are completely disengaged they may not even get as far as opening the mailing or reading the email.

"There is a growing expectation by employers and members that pension providers will have easy-to-use and appealing websites and apps, but there is still much more to be done to 'nudge' people to use these tools. There is evidence that well-written material, presented in a range of formats, can achieve high engagement rates but this is all too often still the exception."

Premier Pensions head of administration, Girish Menezes, agrees, calling the move towards simpler communication "slow" and stating that "trustee engagement with and knowledge of data quality, member web facilities and digital delivery, is low".

Of course, fighting to keep members engaged with their retirement savings is not a new battle, but it is one that has been altered by the pandemic that has gripped the world over the past 12 or so months, argues Aegon head of pensions, Kate Smith.

She comments: "It's clear that, as a result of the pandemic, the digitalisation of pensions has accelerated. This has made it easier for more people not only to see their pensions online, but also to use online tools and make transactions without the need for a wet signature.

"Further enhancements have seen improvements to digital support services, with the addition of webchat and providers personalising pensions and savings messages in more innovative ways to help promote better engagement with members. The introduction of personalised video summaries is a good example of this."

ESG

Awareness of environmental, social and governance (ESG) factors has been a hot-button issue for some time in the industry, with 2020 having seen a good deal of evidence that this trend is gathering steam. For example, May 2020 saw the release of a study from FE Fundinfo, which found that 56 per cent of financial advisers had seen an increase in the amount of client money invested in ESG funds over the past 12 months, while 82 per cent thought the number of ESG propositions would increase further over the next year.

LCP partner, Claire Jones, says: "So far, much of trustees' effort has been focused on understanding the topic, developing their policies and ensuring they are complying with regulatory requirements. ESG now features in most discussions with investment managers and views have shifted, with many trustees now regarding ESG factors as financially material and relevant to their fiduciary duties.

"Discussions have become more nuanced as trustees start to consider how to invest responsibly rather than whether to do so, and it's becoming clearer that many members – if asked – care about this topic. So far, there have been fairly limited changes in the investments actually held by pension schemes, but that's starting to change. It's becoming more common for DC trustees to include ESG or climate-aware funds in their default strategy and some schemes have set net-zero targets.

"I expect this trend to accelerate, with climate change being a big theme for pension schemes this year as the Pension Schemes Bill comes into force and world leaders step up their climate commitments ahead of the COP26 talks in Glasgow in November."

Smith agrees, noting that "pension schemes will have to do much on this front, reporting more on climate financial risk and carbon footprint" and adding that "growing interests in

investment sustainability, accelerated by the pandemic, is an opportunity for the pension industry to increase members' awareness of where their pension is invested, and drive overall pension engagement".

Summing up the situation, XPS head of DC investment, Alan Greenlees, comments: "In summary, the industry has been on a journey with ESG and that has really escalated within the past two years and led to numerous positive developments. However, we still believe that there is room for improvement and that pension schemes can invest positively and act as a real force for good, influencing change where it is needed."

Consolidation

In September 2020, the government published a DC pension scheme consolidation consultation that proposed smaller schemes wind up and consolidate if they fail to offer sufficient value to members, echoing the pushes for DB consolidation that have resulted in master trusts.

Listing the benefits of consolidation, Menezes explains: "Consolidation of pension schemes is quite attractive as it theoretically offers efficiencies and cost savings. Furthermore, there is a possibility of exit for sponsors who are not close enough for a buyout."

Webb notes that the trend towards consolidation is likely to be of key importance due to government plans to "put pressure on smaller schemes to justify their continued existence in terms of cost-effectiveness".

Smith links the issue with administration challenges and improving member engagement, pointing out that larger schemes would both be "better resourced and able to comply with the increasing amount of regulation and reporting" and "likely to have access to greater resources to continuously invest in engagement strategies to help improve members' outcomes".

Looking at how the issue has impacted the industry so far, XPS head of risk transfer, Harry Harper, states: "The Pensions Regulator's (TPR) approach to consolidation has so far been to persuade employers to contribute to the point where the scheme can eventually afford to buy out with an insurance company. This approach works well for those schemes where the liabilities are mostly in payment."

He notes that there are issues, commenting that progress with superfunds has been "painfully slow to watch" and noting that DB master trusts "provide only a consolidation of administration and governance", which keeps employers from walking away from legacy pension liabilities.

He concludes: "A key problem so far is that schemes with deficits have not wanted to truly merge together, although at least one master trust is looking to see if even this traditional taboo can be tackled. The pension industry is crying out for more affordable solutions, particularly given the traumatic events of 2020, both for cheaper insurance options and for alternatives to insurance."

Looking at consolidation for DC schemes, XPS Pensions head of DC, Sophia Singleton, agrees that "consolidation is the right solution for many DC schemes and that their members will be better off for it", but cautions that the Department for Work and Pensions (DWP) is wrong in its belief that "small schemes can't deliver but large schemes do".

Singleton states there will be "much more consolidation during 2021 and 2022" if the requirements proposed in the DWP's consultation on DC consolidation go through, but argues it "should apply to all DC schemes regardless of size" if the true objective is to improve member outcomes.

Other trends

The influence of ESG, improving engagement and consolidation are of course not the only trends that have emerged in the pensions industry. For example, Smith notes that a growing issue for the industry is "the proliferation of small, deferred pension pots", which she notes has been "accelerated by auto-enrolment and the UK job market".

This is not a problem that has slipped through the net unnoticed, with the government having launched a cross-sector working group to help address the issues caused by multiple small pension pots, but more heavy-duty solutions are likely to be required in the future.

Webb leans very much in this direction, stating: "The vast scale of stranded pots means that something more systematic is likely to be required, whether in the form of a 'pot follows member' model or some other form of mass consolidation of small pots."

Pointing out a further industry trend, Webb notes that focus on scheme funding in the DB arena has increased "as regulators and legislators have reacted to high-profile cases like BHS and Carillion".

He adds: "This is likely to continue in 2021 with the publication of government regulations flowing from the Pension Schemes Bill and a further round of consultation from TPR on its new funding code.

"A key question will be how far any or all of this will be adjusted – or perhaps delayed – in response to the economic downturn triggered by the pandemic. If we see insolvencies rise dramatically in 2021, as seems likely, the balance of government policy is likely to shift to giving greater emphasis to supporting corporate Britain and less to securing DB member benefits."

Finally, Menezes sees an issue with the industry lacking "enough administration consultants who can view the administration process strategically".

He states: "This is becoming an issue for trustees and sponsors who would like to kick off high-value programmes and have to either engage with client managers who have little understanding of administration or administrators who are unable to think outside the box."

Written by Duncan Ferris