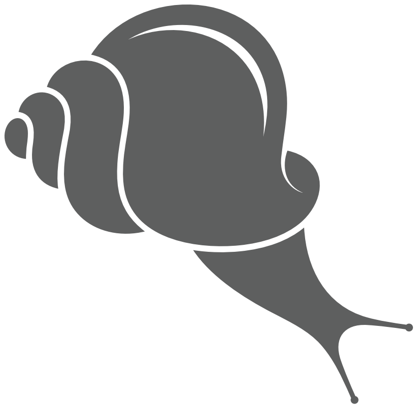


Summary
• The pensions industry has struggled to innovate fast enough – given the pace of regulation.
• At-retirement products is a key area where more innovation is needed.
• The institutional world needs to do more to keep pace with the retail market.
• Better guidance, more advice and cost controls can help bridge the gap.

Picking up the pace

Sara Benwell considers the efforts made by the pensions industry to adapt its products to the needs of today's savers, and what more needs to be done

Today's world of pensions saving is completely unrecognisable to the one we lived in just a few short decades ago.

The death of DB and decline of annuities, coupled with the rise of auto-enrolment and new freedoms, mean pensions are no longer the straightforward retirement income products they once were.

Most of these changes happened fairly rapidly, meaning that the timeframe in which anyone could innovate was relatively small. This is doubly true in the at-retirement space, where the industry had regulation thrust upon it without consultation and was expected to meet the challenges in little more than a year.

The net result of this, of course, is that innovation so far has been patchy and results have been mixed.

What do consumers want?

The big question that needs to drive innovation is: 'What do people actually want from their pensions?' After all, there's not much point in innovating just for the sake of it.

It's a question the pensions industry has been struggling to answer, in part because it is not used to treating pension scheme members like consumers at all.

When you look at the development of ISAs and other savings and investment vehicles, it quickly becomes clear that institutional pensions companies are light years behind when it comes to understanding what the everyday man (or woman) wants.

LifeSight, Willis Towers Watson, head of proposition development David Bird says: "Pensions have not evolved to meet the needs of today's members. Members are consumers – and in every other industry consumers are listened to and products designed for their needs. The industry has a very long way to go to start better addressing those needs.

"The main hope that members will get what they want and need from pension savings is the growth of the outsourced pension model. By using, for example, the master trust model, businesses can partner with providers who are consumer centric, as they are built with tomorrow's technology in mind – giving members flexibility and more personalised contact."

There have been attempts to collect evidence and design products based on what people have done so far. But because changes are relatively new and DC pots are still small, there's not enough data or genuine insight into what the future might hold, and therefore what innovation is needed.

This is exacerbated by the fact that consumers themselves don't seem to know what they want.

SSGA senior managing director, global head of DC proposition and strategy, Nigel Aston, explains: "If you ask people anywhere in the world what they really want from a pension, they say 'a wage – a steady income, guaranteed for life'. However, when you offer an annuity, they don't want it anymore. At the same time, consumers naturally wish to take advantage of the new freedoms. People desire both security and flexibility; we have to find a way to give them both."

Holistic retirement products

This dichotomy of wants suggests some sort of blended product, which combines annuity-like features with drawdown access, is needed. There are several ways

to do this, but initial attempts have been swiftly abandoned thus far.

Fidelity International head of pensions product Carolyn Jones says: "When the government removed the requirement to purchase an annuity… they expected this to lead to a 'competitive and innovative market'. Many commentators are saying that this has failed to materialise and in terms of the introduction of new products this is probably fair.

"Indeed, we have seen early adopters of 'hybrid' retirement products – i.e. products with some sort of guarantee – withdraw them. Axa, Aegon, MetLife and Partnership *[are]* all pulling products from the market."

Despite this, there is renewed interest in developing hybrid products from asset managers of late and as the market grows, it seems likely that demand will grow.

PTL managing director, independent trustee Richard Butcher explains: "The products in place at the moment seem okay – but I think there is one obvious weakness. While recent retirees can manage the drawdown process fairly well, as they age and their cognitive ability declines, they will be less able to do so.

"In addition, research shows that most people underestimate their life expectancy. These two together hint at the need for some sort of later life guarantee around income – perhaps a later life annuity, synthetic annuity or even collective drawdown (a sort of later life collective DC scheme).

"The other need that should be addressed is more internal for the providers. As drawdown becomes mainstream what are they going to do to their processes to reduce costs?"

The cost issue is important, and the industry is crying out for an 'institutional-style' drawdown approach. Particularly since the path to retail drawdown is fraught with danger.

Portafina managing director Jamie Smith-Thompson says: "With non-advised drawdown being pretty high risk, would you want to jump in the deep end without knowing what a safe withdrawal rate is? I know I wouldn't! Not to forget, whether the underlying investments are within your tolerance of loss."

Fortunately, the regulator is on the case and at the very least, cost controlled

products are within reach. The Work and Pensions Select Committee has called for providers of drawdown products to offer a default option for their "core customer group" with a maximum charge of 0.75 per cent, in line with the cap for DC schemes.

Creating better defaults

In the absence of holistic products, the current priority is to create better defaults and to guide people towards the right outcome.

As we don't know how or when members will take their money, traditional defaults suddenly look far from fit for purpose.

Change has therefore been – by necessity – rapid. We've seen some schemes changing their targets from annuities to drawdown or even cash and adopting new investment strategies as a result.

We've also seen a new style of 'hedge your bets' defaults emerge. This fourth way assumes that we won't be able to get members to commit to a specific end goal, so opts for an investment strategy that works for people choosing any of the available paths.

This approach has an added bonus. While it might seem pessimistic to assume that we can never engage people enough to get them to choose a specific retirement option, there are an increasing number of people looking to blend different products.

Jones adds: "We are likely to see guidance services developed… to shape how people will take their retirement income using a combination of products to suit their needs. For example, using annuity/DB and state pension to cover initial essential expenditure requirements, with additional supplementary income drawn down in the earlier years with a potential annuity purchase at a later age.

"Indeed, for those taking financial advice we are already seeing financial advisers using multiple products to provide for their clients' needs in retirement."

Better guidance and advice

This approach works well for those who choose to take advice, but also highlights the emerging gap for those who don't.

Confusion about retirement options has meant that advice and communications has been the focus for much innovation in the pensions space. Master trusts have made good progress here.

Nonetheless, we're only halfway there. And as people grapple with picking the right option, better guidance or advice will be welcomed.

ARC Pensions Law partner Vikki Masarano says: "There is also a real issue with the availability of good independent financial advice, both for members of DB schemes who are interested in transferring to DC so that they can access the value of their benefits and for DC members seeking the right product for their retirement, perhaps outside their workplace scheme."

The small pot problem

In an ideal world, sorting out the accumulation process and providing good at-retirement products should solve the problem. But that forgets that when it comes to pensions communications there are too many cooks spoiling the broth.

And the issue of multiple small pots is one that must be addressed.

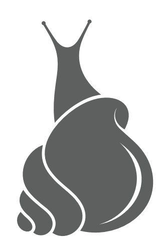
Twelve pots in a lifetime is a figure that's often bandied about, but in reality, millennials could be looking at far more workplace savings products.

Fortunately, the pensions dashboard – when it eventually comes along – will shine a light on the problem, even if it won't solve it.

Once it does, it seems likely that the pensions industry will have some serious questions to answer about how hard it is to consolidate savings – and sharpish.

Smart companies like Pension Bee are popping up in the consumer space and show what can be done to address these issues.

But if the institutional market doesn't want to see money flow into the retail market even earlier (and if we want to protect those currently saving into workplace pensions from the costs associated with some retail providers) some catching up needs to happen.



Otherwise, innovation will happen, but there will be no one left to see it.

Written by Sara Benwell, a freelance journalist