Helping DC members make better retirement decisions

Sophie Moore and Richard Cook consider what employers and trustees can do to help members make the best choices with their retirement savings

Until they reach retirement, defined contribution (DC) scheme members can effectively choose to 'default' through their entire retirement savings journey. They can join their workplace schemes through auto-enrolment, pay default contributions into the default investment strategy and target the scheme's default retirement age.

But, as soon as members want to turn their pension pots into a retirement income stream, things get much more complicated. Members have to make complex, often irreversible decisions about their pension – and the outcomes of those decisions can have life-long consequences.

The choices introduced by the April 2015 'pension freedoms' are taking an annuity, drawdown, cash or a mix of all three. Only 10 per cent of members are now expected to purchase an annuity, according to our 2022 DC Pension Scheme and Financial Wellbeing Survey, and the majority want to invest their pension pots into a drawdown arrangement. That means they will need to choose when to withdraw income, and how much, as well as considering their own longevity risk.

Unfortunately, DC members lack support and can make poor choices at this stage. Our 2021 DC member survey found that one in three are not confident in their ability to make decisions about their financial future.

Research from the Financial Conduct Authority (FCA) also found that a third of people who go into drawdown without taking advice are invested entirely in cash. According to the FCA, people who had opted for cash could have boosted their expected pension income by more than a third if they had invested in a mix of assets. And those who chose annuities or drawdown might have been able to improve their pension income by around 10 per cent if they had shopped around.

The good news is that employers, trustees, regulators and industry bodies are starting to recognise that DC members are struggling. Simply leaving members to do their own research or offering basic signposting towards services such as MoneyHelper is no longer enough. The FCA wants to improve protection for consumers, including pension savers, in the retail financial market – and the PLSA has gone further, calling for a new statutory obligation on pension schemes to provide helpful guidance and signposting.

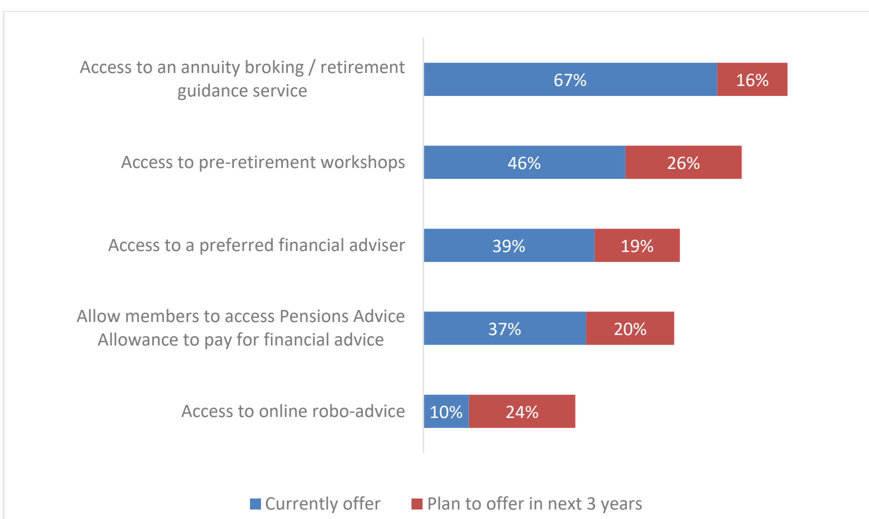
What are employers and trustees doing?
There are often simple 'quick wins' that can make a difference to members, such as improving communications that increase engagement and signposting members to help or support.

In our 2022 DC Pension Scheme and Financial Wellbeing Survey we explored how DC schemes support members approaching retirement.

The findings showed that even when schemes offer support, this might not always match members' needs. For example, most respondents provide a retirement guidance or annuity broking service (67 per cent), but some of these services have been in place for many years and have not kept up with the way people now access their pension savings.

Pre-retirement workshops are also a popular form of support, covering options from generic education through to one-to-one guidance sessions. However, our findings show that only about 20 per cent of members engage with traditional financial education programmes.

Across the market we are seeing schemes work harder to help members



[Aon 2022 DC and financial wellbeing survey]

find advice. It is not easy for individual members to find a reputable Independent Financial Adviser (IFA) at an affordable price, but companies and trustees are well placed to help them by selecting a 'preferred IFA' which they have vetted for quality.

Almost 60 per cent of schemes currently signpost members to an IFA firm in retirement, or plan to do so in the next three years. This usually means running a selection process to choose an IFA, then making contact information part of members' retirement journey. That way, the process of accessing advice becomes simple, efficient and cost-effective for members.

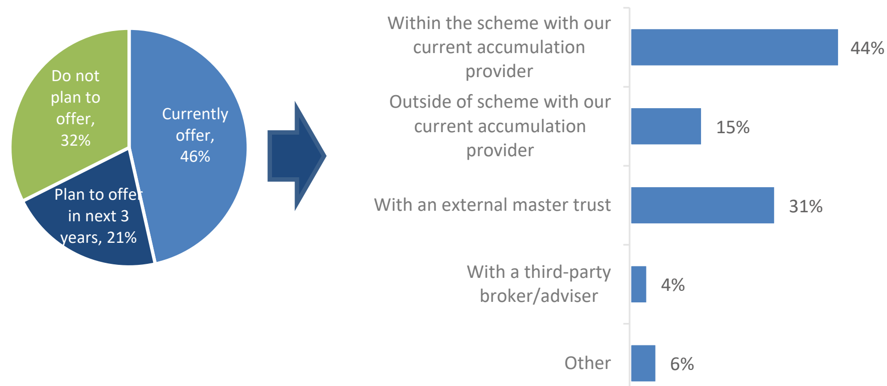
Only 10 per cent of schemes in our 2021 Member Options Survey cover the cost of member advice, but by partnering with a preferred IFA, all schemes can significantly lower fees on members' behalf. This could bring high street fees of £3,000 to £10,000 down to as little as £1,000 or less per member, which in turn encourages significantly higher take-up.

For schemes that allow members to use the Pensions Advice Allowance (PAA), this process becomes even more affordable. Members can take up to £500 from their pension pot tax-free towards the cost of advice. However, access to the PAA remains limited – our 2022 DC Survey showed that only 37 per cent of schemes currently allow access to the PAA, with 24 per cent planning to add this in the next three years.

Like financial advice, finding a suitable drawdown provider can be very difficult for members with little or no experience of high-street finance. But nearly six out of ten DC members expect to manage their retirement income in this way. The FCA found that almost everyone (94 per cent) who went into drawdown without taking advice, stayed with the DC provider that administered their pension pot during accumulation - whereas only 35 per cent of those who took advice did so.

Staying with the same provider is likely to be the 'path of least resistance' but it may not be the most appropriate choice. There are vast differences between drawdown products in terms of strategy, cost, flexibility and investment performance. Members may even assume because their current pension provider offers a drawdown solution that it has been assessed as appropriate for everyone in the scheme – but that is unlikely to be the case.

Do you currently offer or plan to offer a preferred drawdown solution for members?



[Aon 2022 DC and financial wellbeing survey]

More schemes are now exploring the option of offering access to a preferred drawdown solution. Our 2022 DC survey showed that two-thirds of schemes currently offer or are planning to offer a preferred solution, a significant jump from around one-third in our 2020 survey. Most are doing so through their current accumulation provider, but a significant minority have opted to use an external master trust solution.

What can trustees do now?

There are straightforward steps that all schemes can take to help improve retirement decision-making for members.

Carry out a 'health check' of your current DC member support to understand what your scheme currently offers and where there are gaps.

Benchmark your scheme against the market and wider best practice. This can be an effective way of prioritising your areas of focus, and open-up discussion about the range of support to offer. Areas to explore might include:

- Education: do members need better financial education? Do they have the tools they need to make informed choices?
- Support: have you considered the support your members may need at retirement? What you might be able to offer them at lower cost?
- Retirement products: do members have support to access their pension savings via drawdown, both through a high-quality service and at good value for money?

As DC pension pots become the mainstay of people's retirement income, the pressure to help members navigate complex, high-risk decisions will also increase. Members cannot have a good pensions outcome if they do not understand how best to manage their pot in retirement, so schemes and employers must help them as a priority.

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In association with AON

2022 DC Pensions and Financial Wellbeing Survey: https://aon.io/3KIfMKi