The Pension Freedom debate

CHAIR:
1. Jonathan Watts-Lay (JWL)
Director, WEALTH at work, a leading provider of financial education, guidance and advice in the workplace.

PANEL:
2. Ben Piggott (BP)
DC Plan Secretary, The Royal Mail

3. Jim Churcher (JC)
Pensions Manager

4. Martin Mannion (MM)
John Lewis

5. Chris Parrott (CP)
Pensions Manager, Heathrow Airport Holdings

6. Liz Armstrong (LA)
BUPA

7. Denise Fisher (DF)
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8. John Pengelly (JP)
Thames Water

9. Mike Sullivan (MS)
The AA

10. Jane Griffiths (JG)
Head of Corporate Relationships, WEALTH at work

WEALTH at work hosted a gathering of pension experts to discuss key topics following the pension freedoms, including: investment glide paths, defined benefit (DB) transfers, and options at retirement such as the idea of a 'default' fund.

JWL: What are your schemes doing about glide path investment strategy and why?

BP: Defined contribution (DC) has gone from a homogenous world where equity or diversified growth fund (DGF) was the biggest question, to a very scheme-specific one. As a relatively new DC scheme, pots for the next few years are going to be mostly less than £10,000, and taken as cash. The evidence so far suggests that de-risking into pure cash over 10 years means you are pretty much guaranteed negative real returns, so we've put in place an end allocation of 25% cash, which kicks in for the three years before retirement.

JC: Our view is that nobody knows in advance what option they are going to pick at retirement, or when they are going to be taking it. It's difficult to say to a 30 year old 'when you reach age 60, what things do you want to pick?' They just can't know. So there has to be one size that comes as close as we can to fitting all, and we think that will be drawdown by the time they get there. If they don't make a pick, they go into a growth fund which for the last eight years phases 75% into that, and 25% into cash. A lot of people may retire early, so we don't want a short phasing period at the end.

JWL: What about those who aren't sure about drawdown?

JC: We'll point to our website and email, and write to them at the eight-year point. The reality is that most peoples' attitude to investment is, 'please just do it for me, it's too complicated'. It gives us a big responsibility to have something that will work pretty well for almost everybody.

MM: We're seeing DC going straight for cash. For a person who is at retirement age now, the new flexibilities don't mean a lot. They were going to take 25% of their fund tax-free in cash anyway. All the flexibilities do is give you some other means of doing that.

CP: This is a real generational thing. With substantial defined benefit (DB) behind them, is this any more than an individual savings account (ISA) cash fund by another name? We have had our scheme running since 2008, and have people with some sizable pots. For the vast majority of people, they see it as cash accumulation that they can either use to supplement or offset the cash sum that they would take from their DB scheme.

JWL: Are people asking to transfer out of DB schemes, or is that quite a rare thing?

JP: It is relatively rare, but there's been an increase. People have heard that things are more flexible, but they don't really understand the implications of that.

BP: We've had requests for transfers into the DC scheme from other employers' DB benefits; substantial amounts – several hundred thousand pounds in some cases. I don't know what's driving those requests, it might be that they realise their DB benefits are quite sizeable, and perhaps they are in ill health and think that accessing them through DC scheme will be beneficial.

JC: We've had quite a lot of deferred members of the DB scheme asking for transfer quotes. Delighted to see mostly via advisers, but almost nobody is taking them.

MM: I think the hurdle to get through the advisory changes is quite high, isn't it? If you get a cash equivalent transfer value (CETV) calculation and work out how much you need to earn – any adviser that can sign that off is…brave.

JC: I think it also does depend a little bit on the scheme. Our final salary scheme has a long history of being well managed and fully funded, with a strong employer behind it. So there is no security of benefits issue.

MS: That's a very important point – the fact that you may be better coming out of a poorly funded trust-based scheme, where you are relying on the PPF if you haven't got an employer, as opposed to going into an insurance product, which is backed by the Financial Services Compensation Scheme (FSCS)

CP: One thing that worries me about DB to DC transfers… and yes it is really good that people have to go through the advisory route, but will we see the creation of a new little industry, the leveraged DB bit? You get your CETV and your adviser says 'if you hang on for a couple of months we think the market is going to go in another direction and you will get another, let's say £100k, on top'. And suddenly they are picking the sweet spot to move into a DC arrangement which then gives you all the flexibilities.

JWL: Is it dangerous to default members into cash or drawdown at retirement if they don't make a choice?

JC: We have to do something; we almost have a default by default if you see what I mean? If the person just will not make a decision, the money remains invested then and they have no income at all.

CP: The dangerous thing to say is that there are too many choices, so just give me the cash and I will worry about it later. They will just dip in and out, keeping it at a low interest rate in a building society account because they can get instant access, as opposed to leaving it in the fund.

JC: It's a personal responsibility; I don't think I am doing the right thing by you to run your life for you. We put the information out there, go and talk to Pension Wise, go and talk to the independent financial adviser. Here are the numbers if you want quotes. You know, you decide.

BP: For some schemes, assuming that some people are going to take drawdown or stay invested, that could be risky. For example you get to retirement with £100k and say "oh that's great I'm going to go on holiday and relax". Six months later it has dropped to £80k because it's in risky assets. That's a drama waiting to happen; people don't understand investment risk, so at retirement for the next 10 years or so it's got to be risk off for the default hasn't it?

JWL: But we know members find accumulation decisions hard and the access decisions are much harder?

MM: Then duplicate the asset allocation of an annuity by a real asset of some sort. If you are going to mandate something, that'll probably be it, some income protection against inflation in their lifetime? Someone needs to give some guidance; if you look at Australia for example, people put risks on the day they retire, having de-risked they then re-risk.

LA: It's a difficult one; the default is meant to be suitable for the majority, that's the basis on which most people arrange it. You look at your population and change the default in accordance

JWL: What's the most important thing to consider following the pension freedoms, and what should you have on your agenda in the next six to 12 months?

MM: The last budget and the tax change capture low-paid, long-service people, not just the fat cats. So the person at Waitrose who's been with us for 30 years in DB who gets a £2,000 pay rise could breach their annual allowance. It's the unintended consequence of bringing lower paid people, who are not accustomed to getting tax advice, who can't afford to, into that realm.

LA: The fact that we do everything for members while they're accumulating their wealth, and then when they get there, to this place with massive decisions and nowhere to go for it, that is the challenge. And from the employer point of view, it's not an area that they are accustomed to being in.

JG: There's more that can be done when people access their pensions around providing education to give them an overview of what they could actually do, and employers can give them a lot of tools and help at that point.

JC: For those accruing DB, the tapered annual allowance; understanding how that works is hard enough for us, how are we going to communicate that to people? And we have a DB scheme for people who are existing members, a DC scheme for new hires; are we now going to allow people to choose which of the two they want be in? Some of the DB people might be better off to join the DC scheme – how do we help them make that choice?
And people now have the option to come out of DB and go into DC, and some might be better off as a result. Whilst it's an individual's responsibility to make the choice, we want to give information and tools, but it's hard to do that because it's so complicated to explain briefly.

JP: The biggest issue for me is similar to Liz. In our contract DC our current investment default puts people into annuities. We wanted to change our default – but the scheme provider said 'sorry can't do it without consent' and we've had to refer it to the Financial Conduct Authority (FCA). We've solved the issue for future contributors and new joiners, but it's a bit of a conundrum and a difficult challenge regarding existing members.

DF: I think one of the major things is just for us the shift from major DB where people accept that it's good and so they don't need to understand it, into that world where our DC scheme is new, people aren't retiring, and we've got to tackle the communication, the education piece.

MS: I have huge concerns around the new annual allowance, and I'm worried we aren't asking new entrants the right question – particularly around people who accessed some of their money in the past. We probably already have people who have got restricted lump sums allowances that we don't know about.

BP: I think one of the biggest things we're tackling at the moment is the payment and transfers policy. We don't have to have the flexibilities in the plan, but we'd like members to benefit from them. Does advice benefit the member, does it help them make better decisions, or get better value for money? Communicating our payment and transfers policy effectively can hopefully drive sensible member behaviour that the employer thinks is important as well.

CP: Annual Allowance is an issue and people don't understand tax liabilities and the tax issues they are walking into. I really hope that in five years' time we're not sitting around this table because there's been yet another change. This is the only long-term bit around people's employment that really matters, and I do worry that there are enough people out there qualified enough to give advice and design the offering.