A view from the front line
The Future of Pensions
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Introduction by Eversheds Sutherland

Francois Barker,
Partner and Head of Pensions, Eversheds Sutherland

Why have we published this report?

The context and background for this report on the Future of Pensions are the major changes we have seen in our industry over the last 25 years, and the material challenges that lie ahead for us all.

In terms of those changes, we see that:
- private sector defined benefit (DB) plans are largely now closed, and the Pensions Regulator (TPR) and the Government are encouraging them to work on their endgame. The future for most DB plans will be measured in decades but the journey will be an exciting one with a whole host of new challenges to deal with.
- alternatives to buy-out are emerging, allowing DB plans to continue without sponsor support.
- many DB plans may never be able to afford to buy-out. Will we see new ways (like GMP conversion) emerge for them to reshape their benefits into something more affordable?
- of course, the long term future lies with defined contribution (DC) plans, whether individual or collective.

These changes come with challenges. Most immediately, the DC landscape is a real concern. How do we get people to save more, and have access to better options in retirement? The Government and society as a whole will need to tackle this problem if we are to avoid having whole generations who simply cannot afford to retire.

The lack of adequate DC savings is likely to be a particular issue with the “forgotten” cohort aged 35-45 – too young to have DB security but too old to have enough time to save for a decent DC retirement. There are solutions to the problem - higher contributions, longer working lives, innovative, tailored retirement products and a better understanding of what a “living” DC pot would look like – but these all carry consequences.

We expect the pensions dashboard to help, giving members a better idea of what their retirement benefits may be – and what they should do if they need to save more. Changes to the auto-enrolment (AE) regime will also need to play a part here but it is not clear if these will be enough by themselves.

Key challenges

This Future of Pensions report identifies the key challenges that plans will face in the coming years and looks at what action sponsors and trustees can take to make their plans fit for the future. Everyone stands to benefit from this:
- the benefits are obvious for members
- sponsors benefit too, in the form of managing their workforce around retirement and minimising reputational damage
- trustees with well-run plans will also be less open to future challenge that they could and should have done more

The content of this report draws on two round-table client discussions, a series of in-depth interviews, and a material research exercise, all conducted with Winmark during the second half of 2019.

Four principal themes

The Future of Pensions is a huge topic so we have focussed on four key themes raised in the research exercise, and on some innovative solutions suggested for each. We comment on each of the themes and our international colleagues offer views on where the UK may have lessons to learn about the Future of Pensions from overseas jurisdictions – or vice versa.

We also include an “innovation checklist” of ideas to make the Future of Pensions a better place. These ideas – suggested by those who participated in the round-tables and in-depth interviews - are highlighted throughout the report, with an indication of how they were viewed by participants in a joint survey with Winmark.

We hope you enjoy reading the report and find the “innovations checklist” a useful way to help you think about the future of your own pension plan.

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Innovation checklist

We set out below the full set of ideas produced in the course of our research project. We have listed these in order of popularity, based on a quantitative survey of the ideas which we conducted with Winmark in late 2019.

1. Make all annual pensions statements show a consistent and realistic annual income at retirement
2. Accelerate development of the pension dashboard
3. Introduce a savings and pension planning “rite of passage” for young people
4. Extend AE to the self-employed
5. Introduce safe harbour legislation to allow trustees and employers to recommend and pay for independent financial advisers (IFAs) to advise their members
6. Establish a central independent pensions commission to direct pension strategy
7. Encourage DC investment strategies with increased appetite for diversification and risk
8. Develop interactive apps that introduce gamification to nudge engagement with lifetime savings
9. Establish new investment vehicles targeted at the life stage and aspirations of specific demographics
10. Develop artificial intelligence (AI) driven online financial advice tools that can make personalised recommendations
11. Give employers increased responsibilities to provide financial education and advice for their staff
12. Rebrand Environmental, Social and Governance (ESG) as “responsible investment”
13. Introduce consolidation legislation to permit alternative routes to settlement
14. Give management incentives for higher worker engagement with AE
15. Enable collective defined contribution (CDC) as a tool to collectivise life expectancy risk in the decumulation stage
16. Require job adverts to prioritise information about pension benefits and financial education at work
17. Remove AE opt-out
18. Consolidate DB funds into a Pension Protection Fund (PPF) sovereign fund

The Appendix contains details of the statistical analysis from our survey.
Executive summary

It is impossible to cover in a single paper everything which came out of our research exercise during 2019. We have therefore focused in this report on four of the major themes which consistently came up. We have summarised the discussion on each theme, provided some domestic and international commentary on each, and highlighted some of the innovative solutions raised during the discussion.

Theme One

The future of DB – facilitating a “safe landing”

DB is not the Future of Pensions for many outside the public sector but it will be critical to achieving what we call a safe landing - to bring legacy DB arrangements to a close over the coming decades as the Future of Pensions switches increasingly to DC. This will be via a combination of buy-out for those plans which can afford it, self-sufficiency or consolidation for others, and more radical solutions for the minority of corporates which will never be able to afford their DB plan. The safe landing needs to allow corporates a safe exit, and ensure trustees and members have security for accrued promises.

Theme Two

The future of DC – better coverage, adequacy, consolidation and decumulation

Although AE has improved coverage, current contribution levels are unlikely to deliver adequate retirement incomes for many. This is likely to be a particular issue for the “forgotten cohort” aged 35 – 45, and the self-employed. This presents risks for both Government and corporates – in terms of further calls on the state, and interference with companies’ succession planning. Better governance, economies of scale and the ability to develop innovative solutions to decumulation are likely to drive further consolidation: the future probably lies with a small number of large-scale authorised master trusts.

Theme Three

The future of long-term pensions planning and collaboration

Pensions are long-term issues which span many parliaments, governments, election cycles and Chancellors. So pensions, tax policy and legislation should not be left in the hands of politicians whose livelihoods inevitably require a focus on short-term gains. We need a longer-term planning approach – perhaps in the hands of a permanent pensions commission which can also ensure that the collaboration process is a fully diverse effort, reflecting the full make-up of society.

Theme Four

The future of pensions engagement and communication

Historic levels of pension plan membership through AE seem to be coupled with overwhelming lethargy at the expense of awareness and engagement in pension saving. Achieving realistic pension incomes in retirement will depend on engaging people to save more. The dashboard has a role to play here but realistically still feels a long way off. In the meantime, the simpler annual benefit statement is one of several ideas which could make a real difference.
Theme One: The future of DB – facilitating a “safe landing”

Statutory benefit enhancements, the section 75 debt “lock-in”, longer life expectancy and increased regulation have all played a part in the demise of DB plans.

Many of the DB generation will get better benefits than the sponsor ever imagined because of the impact of statutory enhancements and equalisation requirements. At the same time, legislation prevents benefits which have been accrued to date from being reduced – which can prevent efforts by sponsors to manage their DB liabilities. Sponsors must ensure these benefits are delivered – whatever it costs - unless insolvency prevents them from doing so.

Meanwhile, DB regulation is entering yet another period of significant change. TPR is increasingly delivering on its “clearer, quicker, tougher” mantra, and new legislation is likely to formalise the need for DB plans to have a formal long-term funding objective. For many plans, that will mean arriving at a point where benefits can be bought out. Preparing a plan for buy-out requires trustees not only to adopt a suitable investment and funding strategy but to address any historic problems with benefits and data. This will include dealing with any GMP inequality – presumably ultimately via conversion – and ensuring that the benefits currently being provided are the ones that the plan documentation says should be paid.

But pension plan funding is not a “one size fits all” situation. For some plans and sponsors, the long-term funding objective might legitimately not be buy-out. And some employers might never be able to break free of the regulatory burden of their DB plans – an issue which we considered in some detail several years ago.¹

The DB regulatory regime needs to be flexible enough to recognise and support this where appropriate. This is not to suggest that there should be a wholesale weakening of DB accrued benefits to help corporate sponsors. Accrued benefits represent the retirement security of members who have worked and contributed towards them. In reality, with most DB plans closed to new members and future accrual, DB will be a diminishing part of the Future of Pensions for many outside the public sector.² But it will be important for all involved to achieve a “safe landing”, bringing legacy DB arrangements to a close over the coming decades as the future switches increasingly to DC.

In this context, would it make sense to offer plans and corporates alternative routes to an acceptable DB end-game? This approach could include ideas like:

- facilitating DB members to reach properly informed and supported decisions about their DB retirement options. This may require DB trustees and sponsors to engage more fully than they do now in making quality financial advice and guidance available for their members and workers;
- accelerating the development of alternatives to buy-out such as the new DB superfunds or consolidation vehicles. There is currently no specific regulatory framework which applies to them but it seems likely that one will be introduced along the lines of the master trust framework. Many DB plans will be interested in how this market develops. Trustees will want to know if it offers a safe alternative to buy-out. Sponsors will be interested in whether it allows them to move the DB plan off the corporate balance sheet at a lower cost than buy-out – and with certainty of no come-back later on.

“All plans should go in the PPF now and create a sovereign wealth fund.”

Peter Askins
Director/Trustee,
Independent Trustee Services Ltd

“The historic options of full insurance outcomes at one end and PPF at the other drive binary outcomes, there needs to be real creativity and acceptance that in some cases promises made many decades ago are no longer affordable. There should be the flexibility to pursue other outcomes with and for members.”

Chris Martin
Executive Chairman,
Independent Trustee Services Ltd

¹ See ‘The Greatest Good for the Greatest Number’ (December 2015), published by Cass Business School and the Pensions Institute, and co-sponsored by Eversheds Sutherland.
Some of the innovations suggested by our participants...

- Enact safe harbour legislation to encourage trustees and employers to recommend (and pay for) properly qualified IFAs to advise their members on their retirement options – including transfers from DB to DC where appropriate.
- Bring forward a regulatory framework for DB consolidators as soon as possible to permit alternative routes to DB settlement.
- Consolidate all DB funds into the PPF to create a sovereign wealth fund.

"Legacy DB is not linked to current staff motivation or strategy so inevitably sponsors are less engaged, which is why buy-in/buy-out is attractive."

Senior Professional Trustee

International lessons

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Flexible DB

Any DB plan is a function of three variables – contributions, investment performance and benefits. In the UK, accrued benefits, including pension increase rights, are largely untouchable, barring an employer insolvency. This puts significant strain on the other levers, and as a consequence on the UK pension protection system.

In Ireland, benefits under DB plans can be reduced pursuant to a statutory process when other options have been exhausted. This can only be done in a controlled and limited fashion which is sanctioned by the Irish pensions regulator. This is an important safety valve which has enabled a number of Irish DB plans, and their sponsors, to continue in operation after the financial crash. It has primarily impacted on pension increases rather than core benefits.

It is a valuable de-risking mechanism which balances the rights of DB members against those of sponsoring employers, tax payers and other pension savers.

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We fully support the idea of trustees and sponsors engaging with IFAs to help their members make informed decisions. This isn’t about encouraging inappropriate DB to DC transfers. Rather, it is about robust governance and good member outcomes - the freedom and choice reforms offer real options to many. It is also about managing the long-term reputational and liability risks to trustees and sponsors of leaving members to access the IFA market unsupported.

For employers and trustees heading for a buy-out, they will need to expect some “bumps in the road”. A buy-out only works if you insure the correct benefits. Almost every plan will discover discrepancies between what their plan rules say and the administrative practice. Resolving these differences may incur unforeseen costs such as correcting and funding historic underpayments to members, or (in extreme cases) rectifying the position in court.

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The Eversheds Sutherland view...

If we were starting with a blank sheet of paper, we wouldn’t set up DB plans as they exist today. We would probably go for an Irish style lighter touch DB regulatory regime with fewer statutory constraints that ensures that the plan can be adapted in changing circumstances. "DB lite" may well make a reappearance in the long term future – especially if the future of DC doesn’t yield adequate income to allow current workers (and voters) to retire comfortably.

But right now, we are where we are. DB plans might be legacy arrangements for many companies but they provide core retirement benefits for many individuals and will continue to do so into the future. There may be sensible steps that would make life a little easier for corporate sponsors, but these will need to be handled with care to ensure that members’ benefits are properly protected.
FIGURES FROM TPR SHOW THAT 90% OF THOSE ACTIVELY SAVING FOR RETIREMENT ARE DOING SO IN A DC PLAN. In the current climate, the Future of Pensions clearly lies in DC. It is administratively simpler and the costs to the employer are relatively fixed.

AE – which is overwhelmingly DC in nature – has been a great success. However, there are gaps. In terms of coverage, AE does not currently cover the self-employed, and anyone automatically enrolled has the right to opt out at any time. In terms of adequacy, the amount of money currently being saved by members and their employers is likely to be too low to provide a decent income in retirement.

There are several reasons for the adequacy gap but one of the key ones is that members are not given the tools to understand the level of pension savings they need to make or what their DC account will provide in practice. New initiatives to improve member engagement are described as part of Theme Three.

However, even if members have more information, there is no guarantee that they will be able to save enough for their retirement given that real incomes are under pressure. The Pensions and Lifetime Savings Association (PLSA) estimates the minimum annual contribution required is 12% of total salary, and that 13.6 million people are not meeting their target replacement rate. To encourage higher saving, the PLSA has published retirement income targets, building on work done in other jurisdictions, including Australia.

Part of the problem may stem from current AE contribution levels which are 8% of a band of gross earnings (with 3% paid by employers). Clearly this falls some way below the PLSA’s suggested minimum, but members may be assuming (not unreasonably) that the Government has set contributions at an adequate level. Given that AE is, by definition, something which is “done to” people, the Future of Pensions could potentially include DC members arguing that they were misled and that employers and trustees have not done enough to provide an adequate retirement income.

Problems with DC adequacy are likely to be particularly acute amongst the cohort aged 35-45: these individuals will generally be too young to benefit from DB pensions, and yet have insufficient time to build up meaningful DC accounts.

All that said, the level of contributions is only one factor that feeds into income levels in retirement. There are others:

- retirement age: state pension age is already set to rise to age 68 and may well rise to age 70 and beyond in the future. This will also have implications for employers and how they accommodate ageing workforces, particularly in manual occupations
- investment: most members are in default investment funds. These should be improved to capture the illiquidity premium when members are young and won’t need to access their funds for many years. This is perfectly possible in individual DC plans with properly designed default funds, but investment in illiquids in the DC space could increase if CDC plans became a reality. Here, members do not have individual accounts and the trustees invest the whole of the fund – meaning they can make more use of long-term investments
- charges: cost is not the same as value, but it is a matter of logic that charges taken from a DC account will inevitably impact the final amount which is available to support retirement. Transparency around DC costs and charges is already improving, and one future development is likely to be a much clearer requirement to tell members about the individual pounds and pence costs they are paying
- governance: bigger is often better in terms of economies of scale and quality control, and the future probably lies with a small number of large scale authorised master trusts. These will be best placed to develop innovative solutions to decumulation which may combine drawdown, cash and annuities - as well as ongoing support for individuals throughout retirement - rather than simply defaulting to an annuity purchase or staying completely in cash.

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Some of the innovations suggested by our participants...
- encourage DC investment strategies with increased appetite for diversification and risk
- remove the ability of automatically enrolled members to opt out
- extend AE to the self-employed
- establish and publicise new investment vehicles specifically targeted at the life stage and aspirations of key cohorts
- use CDC as a tool to collectivise life expectancy/pool mortality risk in the DC decumulation phase

“I am very concerned that charge caps limit more innovative investment strategies.”
**Senior Professional Trustee**

“Size does matter. The economies of scale of larger master trusts enable better governance and increased resource for innovation”
**Neville Howe**
General Counsel and Corporate Secretary, NEST

“Pensions saving is just one of a number of competing priorities. It often doesn’t get on the priority list, debt management comes first.”
**Harry Baines, Chair of Lloyds Banking Group Pension Trustees Limited**

“Overall savings levels are nowhere near adequate. The whole approach to work and retirement is going to change. People are going to work differently and longer. We need to think about savings holistically, thinking about all sources and types of assets together and bringing long-term care into the equation.”
**Chris Martin, Executive Chairman, Independent Trustee Services Ltd**

“Don’t let people opt out! Employees need to be saving at least 8% to 10% of their salary over an entire lifetime to have any prospect of a pension worth 60% of final salary.”
**FTSE 100 Group Pensions Director**
The Eversheds Sutherland view

DC is clearly the Future of Pensions. But it only works successfully if it generates sufficient savings to allow individuals to retire with dignity when they leave the workforce. There are gaps in the current system which create risks for employers, trustees and society as a whole. Current DC retirees are likely to be propped up by some form of DB pension, but those retiring in the future - with only DC benefits - may well find that their fund is insufficient to support the retirement they anticipated.

Companies will find it much harder to succession plan if their older workers cannot afford to retire, and they may be subject to legal or moral claims for support. The trustees of plans which provide sub-optimal outcomes for members may also find themselves challenged on whether they have properly discharged their fiduciary duties. Securing decent member outcomes, and protecting against these risks, means that corporate sponsors and trustees need to be thinking beyond the minimum in terms of DC provision.

Going forward, we believe that the DC space will consolidate at pace and continue to coalesce around authorised master trusts, providing greater economies of scale, better governance and effective decumulation options. Greater innovation in the market and regulatory support for trustees in terms of guiding and supporting their members will be key to this. The primary challenge for the future success of DC plans – already being addressed by some of the master trusts – is how to convert a fund into something which looks like a retirement income and isn’t an annuity.

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“Younger members saving for their retirement have long time horizons so there’s a real opportunity to consider competitively priced and carefully selected illiquid as well as liquid assets as part of a diversified portfolio.”

Ruston Smith, Chair, Tesco PLC Pension Scheme

“A contraction of the number of schemes will clearly help individual schemes - but it is not a panacea that will address all of the fundamental issues.”

Anthony Soothill, Chair, Telefonica UK Pension Plan Trustee

“There is a real challenge between debt, pensions and housing for young people. We tell young people that the earlier they start saving the better and then we make it hard for them to start. We need to have tax incentives for earlier engagement. Employers need to think about whether this generation of DC savers will be able to retire: they may be being short-sighted because they will be faced with the costs of an ageing workforce not able to fulfill their core employment function.”

“AE has great coverage, but input is entirely inadequate. There needs to be auto-escalation to mandate and embed the culture to save enough.”

Chris Martin, Executive Chairman, Independent Trustee Services Ltd
International lessons

In the United States, some of the innovation in DC plans has been driven by “non-discrimination” rules that limit the contributions permitted by highly compensated employees based on how much the non-highly compensated employees are contributing. This has led to significant employer interest in voluntarily adopting arrangements like AE and automatic escalation, in which participant contribution levels are automatically increased each year unless they opt out.

Looking ahead, legislation enacted at the end of 2019 made it easier for DC plans to offer distributions in the form of a commercial annuity purchased with the account balance. The legislation also paved the way for employers, particularly small employers, to band together with other unrelated employers to adopt plans that are jointly administered and invested, gaining economies of scale previously stymied by technical rules. These developments may have a meaningful impact on DC plans in the coming years.

In the Netherlands, CDC was introduced in the early 2000s, offering members targeted pensions at retirement based on salary, but with only DC funding obligations on employers. The challenges with member communication, and the need to suspend indexation in extreme circumstances, have been well-reported. But the view in the Netherlands is that these issues with CDC are outweighed by the advantages: Dutch CDC plans offer improved risk sharing between employers and employees, have achieved better investment returns than individual DC and – since they pay a pension – solve the issue of decumulation. Social partners often choose CDC as an intermediate plan between DB and individual DC, offering best of both worlds.

Compulsory superannuation has existed in Australia since 1992 and contributions are high compared to the UK AE system – currently 9.5%, increasing to 12% by 2025. This produces real scale with over AUD $2.7 trillion of assets across some 200 super funds. In December 2019, the prudential regulator released the first of its “heat maps”, identifying underperforming products within super funds. The message is not subtle: “improve, or go”.

The drive has meant that funds (leveraging the experience of their own investment management teams) invest globally, and often directly, in huge infrastructure projects - such as shopping precincts and wind farms - carefully matching the investment to the fund’s liquidity requirements. The benefit to members and the economy at large is evident. The illiquidity premium means that returns typically outstrip those seen in the UK. Meanwhile, the injection of capital and liquidity into the economy has driven growth year on year, and is generally regarded as a key reason that Australia weathered the storm during the financial crisis.

“We are trying to solve a problem for too many different groups of people with one solution. We need to look at solutions in a personalised way. More creative solutions are required with HMRC, employers and professionals all involved. Every problem in pensions requires collaboration. We should look at multiple pots, e.g. employer pensions in one pot, another with taxed relief for savings for specific expenditure and so on.”

Alison Hatcher, Global Head of Pensions, HSBC
Governments, employers, individuals, plan trustees, financiers, regulators and advisors all have an important role in addressing the pension savings gap. The constantly evolving pension environment poses complex challenges that will only be addressed if all stakeholders make a commitment to clarify responsibilities, collaborate effectively and recognise that radical solutions may be required.

Pensions are a long-term issue which spans many parliaments, governments, election cycles and Chancellors. Businesses develop strategies around retirement over many years based on assumptions that the legal, regulatory and tax framework will remain relatively stable. But politicians are – almost by definition – focused on the relatively short-term (their livelihoods depend on it, after all). History is littered with examples of where pensions law has been changed to address short-term issues, without realising the longer term consequences, for example:

- the indexation and revaluation of DB pensions: this changed the bargain struck between employers and members and improved benefits so they became unaffordable for some employers and commercially undesirable for others. This reinforced some of the issues around Theme One considered earlier in this report
- the freedom and choice reforms: these created much greater flexibility around DC benefits, but have led to a “dash for cash” which is often far from optimal
- the annual and lifetime allowance changes: these were designed to prevent tax abuse, but are impacting adversely on longer working lives and phased retirement plans. They are already interfering with DC retirement planning and the operation of the NHS

The collaborative approach required to take on the complex issue of meeting the pension savings gap may therefore need to be conducted outside the short-term, politically constrained interests of the Government. There is a role for a long-term, central independent commission. This would ensure that the pensions and tax framework remains stable and is not adjusted to meet short-term economic or political needs, and that the needs of all parts of society are addressed.

Both the state and employers have important roles to play in supporting long-term planning and collaboration around pensions. The primary role of the state should be to provide a safety net for those who will not have adequate pension provision of their own. Redistributive policies may be required at some point, such as limiting higher rate tax relief to increase the state pension (perhaps to the £10,000 level identified by the Rowntree Foundation as an absolute minimum basic level) or implementing a single rate of tax relief to benefit low earners.

Employers – who provide and contribute to pension arrangements – are generally trusted by employees, and occupy an excellent position to engage and communicate with their staff. This means they are likely to play a crucial role in helping to educate on pensions, and to facilitate financial advice – including helping with debt management and helping employees move from payday lenders to “Salary Finance” plans.
“61% of tax relief goes to 9% of the population. We could abolish tax relief and double state pension or have a single rate of tax relief to benefit low earners.”

“The state will have to take greater responsibility for pension provision for those on low earnings, who will never have sufficient savings to provide a meaningful outcome. We need an independent commission that is not in thrall to the pensions industry or the government of the day.”

Peter Askins, Director/Trustee, Independent Trustee Services Ltd

The Eversheds Sutherland view

There is no “one-size fits all” solution that can address the fact that different people have different needs both in relation to how to save for their retirement and what they need when they retire. Pensions policy needs to take into account both an individual’s ability to save for retirement and their attitude to saving and retirement. Career history, level of pay, variety of jobs and employers, whether they work full or part-time and whether they have periods outside paid employment have a very obvious and direct connection to an individual’s ability to save for retirement. But, class, cultural background, ethnicity, sexuality, religion and gender also impact on attitudes and behaviours when it comes to pension saving.

People are also increasingly transitioning from work to retirement in a much more fluid way than before. Any collaborative solutions – including a permanent pensions commission – should encompass all types of pension savers. A challenge for those in the pensions industry who make and influence pensions policy is to ensure that the end result is not driven by their own needs but by the needs of an increasingly diverse society. Society no longer has the same shape and values that it did in the era of DB plans, and the Future of Pensions should reflect those changes.

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Some of the innovations suggested by our participants...

- establish a permanent pensions commission to take "pensions out of politics", and direct long-term pensions strategy
- give employers increased responsibilities to provide financial education for their staff – they occupy a trusted position

“Voluntary saving is an option at some levels of income, but ... at the lowest levels the only way to materially improve retirement income is better state provision.”

Danny Wilding, Partner, Barnett Waddingham

“Some people are retiring earlier as a result of allowance changes and that is not necessarily a good thing. Is it a tax on good investments? The annual limit just turns people off. It also means HNW [high net worth] individuals have less skin in the game, meaning they are less likely to step forward as trustees and it may alienate the key management in sponsor companies.”

Anthony Soothill, Chair, Telefonica UK Pension Plan Trustee
International lessons

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The case for gradual reform

The launch of President Macron’s pension reforms in France - and the ensuing social protests - show how important it is to reform pension systems petit à petit – incrementally - to ensure they stay fit for purpose. The current system, managed on a pay-as-you-go basis and split into 40 different plans for different professions, dates back to the Second World War. The plan has fulfilled its aim but the price is very significant differences in treatment between professions, constantly rising contributions and structural inequality depending on a worker’s life expectancy.

The aim of the reforms is clear: to unify all state and public pension plans, to set up a simpler, universal points-based system; to focus the state’s role on the lowest paid (there will be no pension guarantees for remuneration above €120,000), and to give private DC pension plans a greater role.

The French are largely unaccustomed to private sector pension plans and so a large proportion of the population rejects them as a matter of principle. In-depth information and training is crucial – for example on investment (especially responsible investment), the various exit options, and the long-term solvency of the managing bodies. These are the topics that the management bodies should address and on which they will need to train, convince and reassure the French people. In France as elsewhere, communication is a key factor in the development of successful private pension systems.

Significant challenges in forward pension planning

In Asia, the pensions landscape is varied and does not naturally lend itself to a one-size fits all solution, or even forward planning outside the state system. This is supported by some of the demographic data. In India and Indonesia less than 10% of the population is over 65. In Japan, that figure is more than 45%. The state-mandated pension system in Japan covers more than 90% of the labour force, whilst in China that figure is barely above 50% (and in Malaysia, the Philippines, Thailand and Vietnam it is well under 50%).

Current pension systems range from basic government assistance to DC and (less frequently) DB plans. In Hong Kong the system is financially sustainable but pays an inadequate benefit. In South Korea, the system is neither sustainable nor adequate. Singapore’s Central Provident Fund is considered both sustainable and adequate but it is not open to non-citizens and permanent residents in the way Hong Kong’s Mandatory Provident Fund is.

The main problem in India and other Asian countries with large rural populations is coverage. Expanding pensions on a non-contributory basis to the poorest workers is a pressing need. Parts of Asia have seen significant financial growth in the past three decades and an accompanying rise of a stable middle class. There are opportunities to expand retirement savings by creating or building on existing second and third pillar systems, but governments are likely to focus on first pillar resources until poverty, rural coverage, and demographic problems have stabilised.

Plan ahead for state pension age changes

With the Irish state pension age due to increase from 66 to 67 in 2021 (and to 68 in 2028), the interaction between the state pension age and mandatory retirement ages became an unlikely campaign issue during the recent Irish general election. Parties lined up with competing proposals to offset the impact for workers. There was little focus on the role which workplace or private pension provision might play in plugging this gap. Even the introduction of AE, currently planned for 2022, barely got a mention.

The legislation increasing the state pension age was introduced as far back as 2011. However, virtually nothing was done at the time, or since, to deal with the impact this would have for workers. Unsurprisingly, workforce/private pension coverage rates did not improve significantly and, for many, retirement provision still starts and ends with the state pension. Given this, the increase to state pension age, particularly for those with mandatory retirement ages, was a ticking time bomb.

This provides something of a ‘lesson’ in the wrong way to go about significant pension reform. Adjusting state pension benefits (Pillar I) without taking any measures to encourage or enforce greater workplace/private pension coverage (Pillars II and III), won’t work. A holistic approach, which takes into action the role of the three Pillars is required.
In many ways, pensions coverage is much less problematic than it was because of AE. In the five years between 2012 and 2017, the proportion of eligible employees participating in a workplace pension rose from 55% to 84% - an increase of around 10 million workers.\footnote{DWP, “Workplace Pension Participation and Savings Trends of Official Statistics: 2007 to 2017”, 5 June 2018.}

But this has come at the cost of engagement as individuals need not take active decisions in an AE regime: 84% of people don’t know how much they need to maintain their standard of living in retirement,\footnote{PLSA, “Hitting the Target” consultation, October 2017.} and 16% have not thought about how they will manage at all.\footnote{FCA, Key findings from financial lives survey, June 2018.} Historic levels of plan membership seem to be coupled with a degree of lethargy and a lack of awareness and engagement.

To have a realistic chance of achieving pensions near the levels of the DB generation, many DC savers and their employers will need to make material additional contributions, and to decide how to use the proceeds. This means trying to engage savers to make proactive and sensible choices about what to do with their money. This is a huge challenge in a society where real earnings are under pressure, levels of financial literacy are relatively low and where there is broad agreement that the retirement savings landscape is complex and difficult for many to understand.

In this context, it will be key to make pensions communications as accessible as possible - clear, simple, relevant and helpful - and to use technology to engage at least with the younger generation. Other countries can point to examples of both which have worked well.

One of the mechanisms that the Government intends to use to tackle engagement is the introduction of pension dashboards where members can view information about all of their pension savings in one place. The idea is that members who don’t like what the dashboards are telling them about their readiness for retirement will take action.

Plans will be under a statutory obligation to provide information to the dashboards. Although it is not yet clear exactly what this will look like, the need to have data ready will be a challenge for some plans. And in reality, we are still many years away from the full implementation of an effective pensions dashboard.

So what action can be taken now to help employers and trustees engage with their current and prospective members and educate them over the value of their retirement savings? One option may be the Simpler Annual Benefit Statement, which the Government is promoting, based on a template created by the Eversheds Sutherland team and others.\footnote{DWP, “Simpler annual benefit statements for workplace pensions”, 1 November 2019.} The idea is to make annual DC statements simpler, clearer, shorter and – above all – more consistent, to engage members in their retirement savings and allow them to compare their plans.

The simpler statement could be combined with other initiatives to drive member engagement further: a “statement season” with all benefit statements delivered around the same time each year, or paper statements delivered in specially coloured envelopes to highlight their importance. The FCA is also recommending the use of “investment pathways” for contract-based members at retirement to avoid a blind move into drawdown.

Broader initiatives to help drive engagement in pensions could also include:

- using climate change to engage younger DC savers in particular. “Rebranding” ESG as responsible investment could encourage increased pension saving on the basis that contributions will be responsibly invested in ways which acknowledge the financial risks associated with environmental concerns
- requiring employers to highlight the entire benefits package – including pension – rather than just the headline salary when advertising vacancies. This could help to foster a culture which promotes the importance and financial value of pension saving
- bringing more clarity to when trustees and employers can communicate with members and employees on pension saving without fear of falling foul of providing financial advice
- building a financial “rite of passage” around the receipt of a National Insurance (NI) number at age 16 – for example, including communications about savings and pension planning. This could help to kick start financial education as young people enter into adulthood

\footnote{PLSA, “Hitting the Target” consultation, October 2017.}
\footnote{FCA, Key findings from financial lives survey, June 2018.}
\footnote{DWP, “Simpler annual benefit statements for workplace pensions”, 1 November 2019.}
Some of the innovations suggested by our participants...

- accelerate development of the pensions dashboard
- develop AI driven online financial advice tools that can make personalised recommendations
- introduce a savings and pension planning “rite of passage” for young people around the receipt of their NI number at age 16
- develop interactive apps that introduce gamification to nudge engagement with lifetime savings
- make all annual pension statements show a consistent and realistic annual income at retirement
- give management incentives for higher worker engagement with AE
- require job adverts to prioritise information about pension benefits and financial education at work
- rebrand ESG as “responsible investment”

“We have grown engagement from 10% to 70% in 10 years using tools like Chatbox messaging. Also tools that show relevant and interesting interactive information such as what a £2.50 cup of coffee will compound to over time, or provide an annual statement that indicates annual income at retirement will boost engagement.”

Rose Kerlin, Group Executive, Membership, AustralianSuper

The Eversheds Sutherland view ...

AE has been a great success in terms of coverage, even if there is much more to do for some cohorts – for example, very young workers, or the self-employed. The principal challenge now is how to get those who are already enrolled to engage with their savings and contribute more. Engagement is very difficult to measure – but we could probably use the proportion of those not invested in default funds as a rough proxy.

This feels right as the starting point: more engaged savers who realise the importance of contributing higher amounts is likely to be better for the individuals themselves, for their employers and trustees, and for society as a whole.

A message about the good that pension plan assets can do could also help member engagement. The emphasis on environmental, social and governance factors when investing plan assets has come at exactly the same time that the world is waking up to the potentially material effects of climate change. Put simply, the link between assets that come with good governance and/or a limited carbon impact, and long-term financial security for the plan, is a great message for members.

Ultimately, however, if increased and better communication does not improve engagement, then the fall-back might have to be additional automation and default retirement pathways which use drawdown and tax free cash early on in retirement and an annuity later on. Members could still be given information and choice but there would then be a viable option for those unable or unwilling to engage. If people won’t “do” pensions for themselves, then pensions will have to be “done to” them to a greater extent than at present.

There is also a need to educate and increase the level of financial literacy generally within our society – both amongst the working population and for those still in education. Given that “knowledge is power”, an increased understanding of how DC pensions work is likely to make them more accessible and less daunting as a topic. In turn this will support improved engagement and decision-making by DC members.

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International lessons

**Pension 1-2-3 - the Dutch Simpler Annual Statement**

In the Netherlands, the “pension 1-2-3 tool” has been live since 1 July 2016 as a way of getting members engaged with their pension plans. This (digital) tool provides layered information to the member. The member can choose to access the level of information they want from each pension plan via the plan’s website:

- **Level 1**: high level information (“the pension plan in 5 minutes”) - all the important elements of the pension plan in straightforward language
- **Level 2**: high level information with some additional explanation (“the pension plan in 30 minutes”), still in straightforward language but with some technical information added in
- **Level 3**: all the detailed information (including relevant legal documents e.g. pension regulations, annual statement and all the information mentioned in levels 1 and 2)

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**Financial advice for DC members**

The range and complexity of accumulation and decumulation options in Australian superannuation plans can be overwhelming. Enabling members to access good financial advice is seen as crucial and is a key tool in boosting member engagement (and ultimately, better financial outcomes in retirement).

The recent Royal Commission into financial services highlighted the dangers of conflicts where a financial adviser and the trustee form part of the same corporate group. The result has been class actions against the wealth management industry over the quality of the advice and the unauthorised deduction of commissions from member accounts (including after the member’s death). The message is that financial advice is a valued and important part of the member journey, but needs to be structured carefully to ensure its independence and integrity.

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**Having a benefits “season” to increase engagement**

It is common in the United States for employers to have an annual “season”, usually lasting about a month in the fall, during which employees have the opportunity to select their employer-sponsored health plan options and other employee benefit plan choices. This period usually includes education about the employer’s retirement plan, and it provides an opportunity for employees to pause and reflect on their level of savings and choices. This has proven to be an effective way to get employees’ attention in a way that periodic communications sprinkled throughout the year might not.

Many employers have also attempted to increase engagement by implementing “financial wellness” programs. These programs are usually provided by third party vendors who offer employees the ability to speak with a financial advisor to receive information about a variety of personal finance topics, including retirement savings as well as financing college, repaying debt, budgeting, and more. The vendors also usually have websites with additional detailed information and interactive tools.

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“We can only expect members to take greater personal accountability for their retirement savings if we give them clear, simple and consistent information to help them make the right choices.”

Ruston Smith, Chair, Tesco PLC Pension Scheme

“There are some great apps available that are really engaging youngsters. Apps get over the barrier of easy accessibility and availability and enable real-time, highly personalised interaction.”

Anthony Soothill, Chair, Telefonica UK Pension Plan Trustee
Conclusions

The pensions landscape continues to be in a state of flux – as it has been for the last 25 years. What is clear is that, as part of this process of transaction, new models need to emerge to ensure that pension provision for the future is adequate and fit for purpose – for all generations of savers, and all groups in a diverse society.

The innovation ideas we highlight in this report are there to be used by policy makers – and we hope that they will be embraced fully. They offer the chance to:

- bring DB plans to a safe landing
- reshape DC arrangements (both individual or collective) so that they are better placed to provide adequate incomes in retirement
- enhance the future of long-term pensions planning and collaboration so it is less subject to short-term political whims
- develop ways to communicate and engage more fully on pensions issues, to increase the chances of a decent retirement for all

The alternative is that we run the risk of sleepwalking as a society into a future where people are required to work long beyond the age when they can productively do so - simply because they cannot afford to retire.

Government, regulators, sponsors, providers and trustees should all consider new benefit models, mitigate developing risks and embrace new technologies as part of considering what current and prospective savers need for the future.

If the industry embraces change and innovation in this way, the future of pensions promises to be a long and exciting one. 
Observations from Winmark

John Madden,
Research Director at Winmark

The challenges society faces in providing adequate retirement income for its citizens are wide-ranging and complex, and finding a path through the maze of demographic, political, social and financial factors influencing the future direction of the pensions landscape can be daunting.

Winmark has been pleased to support Eversheds Sutherland’s Future of Pensions initiative as a start to tackling the issues. The initiative involved a series of in-depth interviews and round-table discussions with senior experts (including plan and fund managers, pension chairs, consultants and analysts). These helped to define the challenges, and explore how they can be addressed, so that future generations can enjoy financial security in their retirement.

We looked through all the short-term “noise” – for example on Brexit, elections and politics. This is because pensions are, by definition, much longer-term than this. We also encouraged our participants to share some more unorthodox ideas to help encourage new, innovative perspectives and to generate discussion. We hope the report will stimulate debate and reflection about the roles and responsibilities of all stakeholders in the pensions arena, and help contribute to future pension provision in the UK that is better equipped to meet the many challenges ahead.

We would like to thank all of the senior professionals from corporate plans, investment funds, trustee boards and advisory firms who generously gave their time to help in the production of this report. Their perspective shared in personal interviews and at our round-table sessions is greatly appreciated.

Winmark has been pleased to support Eversheds Sutherland’s Future of Pensions initiative as a start to tackling the issues.
About Eversheds Sutherland and Winmark

Eversheds Sutherland is a global legal practice with a multi-award winning pensions practice. Our global team of over 100 advisers provides pragmatic and solutions-oriented pensions and benefits legal advice across multiple jurisdictions.

The Future of Pensions report is testament to the fact that we go beyond simply advising on the law. We are actively involved with some of the most influential industry and governmental organisations in this area, and seek out opportunities to drive thought leadership based on our experience. This keeps us actively involved in shaping pensions and benefits law and policy across the globe, rather than simply reacting to it.

Our collective legal experience, our global project management and our influence at national and international policy levels all mean that we are able to offer advice that anticipates industry trends. This helps our clients better prepare for, and manage, their evolving risks.

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Winmark enables leaders to improve the governance, performance and sustainability of their organisations.

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– our academies update, develop, and empower executives across industries and functions
– our widely acclaimed research provides leaders with intelligence and perspective through expert thought leadership, competitor intelligence and client insight

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Appendix

Respondent role

- Independent/professional trustee: 18%
- Pension manager: 15%
- Finance: 14%
- Member/company appointed trustee: 13%
- HR/personnel: 9%
- Consultant/advisor: 8%
- Actuary: 7%
- Legal/compliance: 6%
- Non-executive director (NED): 5%
- Independent/professional trustee: 1%
- Other: 15%

Agreement with statements

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<tr>
<th>Statement</th>
<th>Net agreement</th>
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<tr>
<td>Make all annual pensions statements show annual income at retirement, not</td>
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<td>just projected fund value</td>
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<td>Accelerate development of the pension dashboard</td>
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<td>Introduce a savings and pension planning 'rite of passage' for young</td>
<td>36%</td>
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<td>people</td>
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<td>Extend AE to the self-employed</td>
<td>34%</td>
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<td>Introduce safe harbour legislation to allow trustees and employers</td>
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<td>to recommend and pay for IFAs to advise their members</td>
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<td>Establish a central independent pensions commission to direct pension</td>
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<td>strategy</td>
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<td>Encourage DC investment strategies with increased appetite for</td>
<td>30%</td>
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<tr>
<td>diversification and risk</td>
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<tr>
<td>Develop interactive apps that introduce gamification to nudge</td>
<td>26%</td>
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<td>engagement with lifetime savings</td>
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<td>Establish new investment vehicles targeted at the life stage and</td>
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<td>aspirations of specific demographics</td>
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<td>Develop AI driven online financial advice tools</td>
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<td>that can make Personalised recommendations</td>
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<td>Give employers increased responsibilities to provide financial</td>
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<td>education and advice for their staff</td>
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<tr>
<td>Rebrand Environmental, Social and Governance (ESG) as 'responsible</td>
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<td>investment'</td>
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<tr>
<td>Introduce consolidation legislation to permit alternative routes to</td>
<td>13%</td>
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<td>settlement</td>
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<td>Give management incentives for higher worker engagement with AE</td>
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<td>Enable CDC as a tool to collectivise life expectancy risk in the</td>
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<td>decumulation stage</td>
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<td>Mandate job adverts to prioritise information about pension benefits and</td>
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<td>financial education at work</td>
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<tr>
<td>Remove AE opt-out</td>
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<tr>
<td>Consolidate DB funds into a Pension Protection Fund (PPF) sovereign fund</td>
<td>-25%</td>
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- Strongly disagree
- Completely disagree
- Strongly agree
- Completely agree
12 top further ideas

We asked our survey respondents for their own suggestions to improve the pensions landscape - twelve of the most popular ideas are outlined below.

- Introduce drawdown facility to DB schemes by allowing partial transfer values of up to say 50% of entitlement pension commencement lump sum (PCLS) to in-house DC arrangements with attaching flexi-access legislation.
- Move away from looking through a "pensions-only" lens and consider broader savings as part of a financial wellness strategy (which also fits with health wellness).
- Rethink annual allowance, lifetime allowance and tax relief. Pensions should be much simpler if you want them to become a normal part of people’s everyday lives.
- Remove the option to cash in pension at crystallisation (trivial and serious ill health excepted).
- The Government needs to stop tinkering with legislation and leave it as it is for a couple of years.
- Allow DB schemes to move future pension increases to a discretionary model under a CDC arrangement.
- Improve pensions education of MPs.
- Make financial education form part of the school curriculum.
- Make "freedom and choice" subject to a minimum income requirement.
- Increased employer contributions for AE.
- Move the public sector towards DC.
- Change "Pensions" to a more engaging word!
Visit the Eversheds Sutherland Future of Pensions hub:

www.eversheds-sutherland.com/futureofpensions