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THE DC FUTURE BOOK 2024:

IN ASSOCIATION WITH COLUMBIA THREADNEEDLE INVESTMENTS

The tenth annual report sponsored by

COLUMBIA THREADNEEDLE INVESTMENTS

10th ANNIVERSARY

ISSUE #10

About The Pensions Policy Institute (PPI)

We have been at the forefront of shaping evidence-based policy for over 20 years.

The Pensions Policy Institute (PPI), established in 2001, is a not-for-profit educational research organisation. **We are devoted to improving retirement outcomes**. We do this by being part of the policy debate and driving industry conversations through facts and evidence.

The retirement, pensions and later life landscapes are undergoing fast-paced changes brought about by legislation, technology, and the economy. Robust, independent analysis has never been more important to shape future policy decisions. Each research report combines experience with **INDEPENDENCE** to deliver a robust and informative output, ultimately improving the retirement outcome for millions of savers.

Our **INDEPENDENCE** sets us apart – we do not lobby for any particular policy, cause or political party. We focus on the facts and evidence. Our work facilitates informed decision making by showing the likely outcomes of current policy and illuminating the trade-offs implicit in any new policy initiative.

Our Vision:
Better informed policies and decisions that improve later life outcomes
We believe that better information and understanding will help lead to a better policy framework and a better provision of retirement income for all.

Our Mission:
To promote informed, evidence-based policies and decisions for financial provision in later life through independent research and analysis
We aim to be the authoritative voice on policy on pensions and financial and economic provision in later life.

Est. 2001

By supporting the PPI, you are aligning yourself with our vision to **drive better informed policies and decisions that improve later life outcomes,** and strengthening your commitment to better outcomes for all.

As we look forward now to the next 20 years, we will continue to be the trusted source of information, analysis, and impartial feedback to those with an interest in later life issues. The scale and scope of policy change creates even more need for objective and evidence-based analysis. There is still much to do, and we look forward to meeting the challenge head on.

For further information on supporting the PPI
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The DC Future Book in association with Columbia Threadneedle Investments


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The DC Future Book 2024

The DC Future Book 2024: Foreword

I'm delighted to present this milestone edition of the latest DC Future Book. Since its inaugural publication in 2015, we have proudly sponsored this important work and we are thrilled to continue our support through to this 10th anniversary edition.

Produced by the Pensions Policy Institute (PPI), the DC Future Book sets out the current DC landscape in the UK and provides projections for future trends and evidence-based research for policymakers and the broader industry.

The UK pensions landscape has seen momentous change over the last decade. Broadly driven by the rapid decline in DB schemes and acceleration of DC provision where employees bear the investment risk while employers benefit from more predictable costs. One of the most notable achievements has been the take up of auto enrolment, which has resulted in 14 million active members in DC schemes, compared to only 4.6 million a decade ago when the DC Future Book was first published (2015). However, further reforms are required to bring more people into pension saving.

This rise in DC schemes has also seen master trusts emerge as the dominant pension provider. As of 2023, there are currently 36 master trusts authorised to operate in the UK market, playing a crucial role in enabling auto-enrolment, particularly for smaller schemes. Yet, the true cost-effectiveness of master trusts is complex. Evaluation need not just be on administrative efficiency, but also on their investment returns and quality of services.

In Chapter 4, we explore the evolution of the DC pensions landscape in greater detail, including the impact of past and present policy changes and what the next 10 years could look like for DC savers.

Like many investors over the past 10 years, interest from DC schemes in alternative asset classes has grown significantly – drawn to seemingly higher and more diversified sources of returns. However, the perceived barriers and complexities, including higher costs, pose challenges for DC schemes investing in private markets or illiquid investments. Recent Mansion House Reforms aim to address these barriers by encouraging investment in productive assets, such as private equity and infrastructure, to bolster economic growth and sustainability.

This tenth year edition of the DC Future Book also outlines the benefits of the new Value for Money (VFM) Framework as well as the necessary bridging of a generational gap in understanding of technology. This is required to truly unlock all possible advancements for DC savers, such as the Pensions Dashboards Programme and the use of AI in delivering personalised investment advice and guidance to DC savers of all ages. Whilst the demand and importance of ESG integration in DC investment strategies schemes has increased over the years, the Future Book highlights ongoing challenges related to the reliability of data provision.

We strongly encourage policymakers and industry leaders to prioritise the accessibility of financial advice and guidance for DC savers. Together, we must strive to help current and future retirees look forward to a comfortable retirement by providing frameworks that deliver better outcomes and safeguard the financial future for thousands of workers.

It is through collaboration, innovation and thoughtful policy that we can continue to improve pension provision for all savers.

I hope you enjoy reading the 10th anniversary edition of The DC Future Book.

Michaela Collet Jackson
Head of Distribution, EMEA, Columbia Threadneedle Investments

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Introduction

This report is the tenth edition of the Pensions Policy Institute's (PPI) **The DC Future Book: in association with Columbia Threadneedle Investments**, setting out available data on the Defined Contribution (DC) landscape alongside commentary, analysis and projections of future trends.

Demographic and policy changes mean that, compared to previous generations of pensioners, current and future retirees will:

- Live longer on average
- Receive their State Pension later
- Be more likely to reach retirement dependent on Defined Contribution (DC) savings, with little or no Defined Benefit (DB) entitlement
- Have greater flexibility when accessing and using their DC savings over the course of later life.

These changes increase the risk borne by pension savers and the complexity of decisions they must make at, and during, retirement. Given the potential risks involved for those retiring with DC savings, and the rapid expansion of the workplace DC market, it is important that a comprehensive compendium of DC research, statistics and longitudinal data is available to allow observation and analysis of developing trends.

Chapter One - What is the DC landscape?
Outlines the State and private pension system in the UK, and the main DC landscape changes over the past few years.

Chapter Two - What does the DC landscape currently look like?
Provides a picture of the current DC landscape, including data on automatic enrolment, saving levels, investment strategy, access to savings, and advice and guidance.

Chapter Three - How might the DC landscape evolve in the future?
Explores how the DC landscape might evolve in the future both for individuals and on an aggregate level, using PPI modelling.

Chapter Four - The past and future 10 years of DC pensions
Explores the landscape of Defined Contribution (DC) pensions over the past 10 years, what the DC landscape could potentially look like over the next 10 years, and the impacts of previous and future policy changes on DC savers.

Chapter Five - Reflections on policy
Contains reflections on the policy themes highlighted by the report from leading thinkers and commentators in the pensions world and beyond.

Chapter One:

What is the DC landscape?

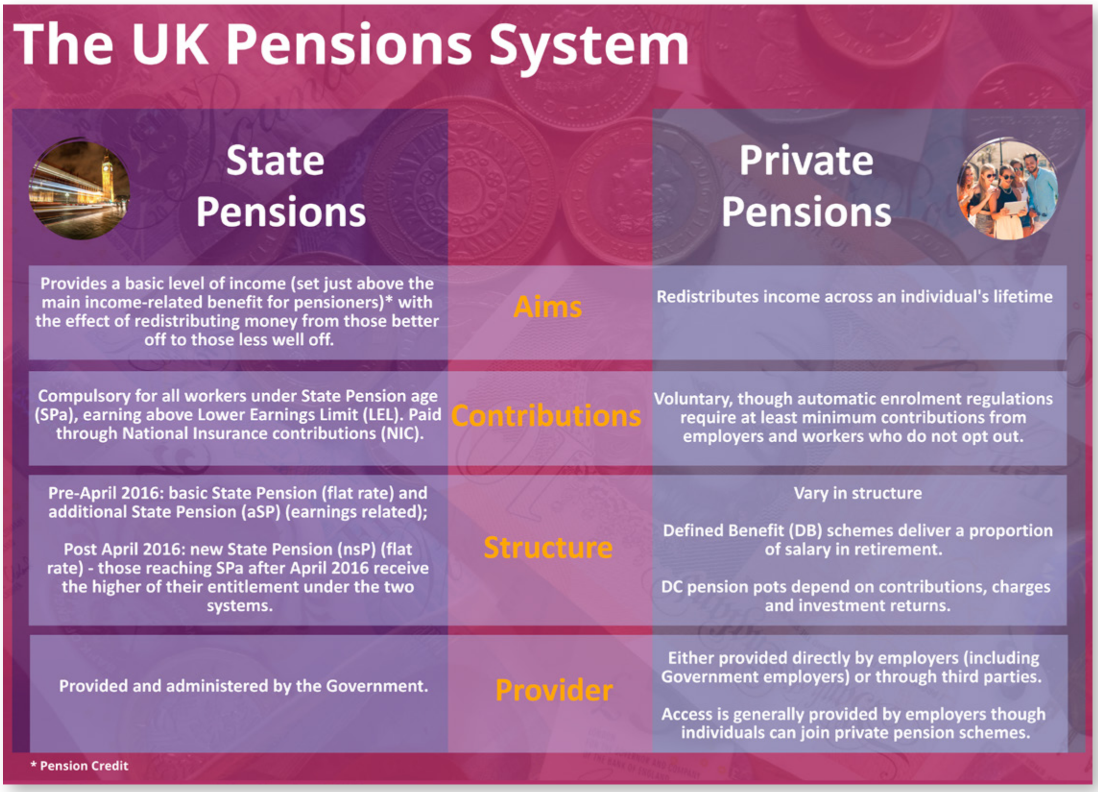
Chapter One: What is the DC landscape?

This chapter outlines the State and private pension system in the UK and the main Defined Contribution (DC) landscape changes over the past few years.

There are two main tiers in the UK pension system (Box 1.1):

- A compulsory, State tier; and,
- A voluntary, private tier[1]

Box 1.1: The UK pension system



Pensions in the private tier can be either workplace (provided through an employer, either directly or through a pension provider, such as an insurance company or master trust) or personal (set up by the individual, who has a direct contract with the provider). While workplace pension saving is more prevalent than personal accounts, the market for non-workplace pensions is relatively large, especially in terms of assets under management (AUM). Non-workplace pensions are used by people in self-employment who don't have access to a workplace pension, as well as people who want to supplement their workplace pension savings. This means that some people have both workplace and personal pensions at the same time.

[3] For further detail regarding the UK pension system, see PPI's Pension Primer (2024)

There are different types of private pension schemes
There are two main types of pension scheme in the UK, DB and DC. Workplace pensions can be either DB or DC, while personal pensions are DC only.

DB schemes:

- Promise a specific level of benefit when an individual retires, based on a member's salary and years as an active member. Employers make the promise to provide a guaranteed income for retirement and are responsible for making additional contributions if there are deficits in scheme funding.
- Operate on a pooled fund basis. All contributions are paid into a common fund, which is invested to provide all retirement benefits. In unfunded public sector schemes, contributions are used to pay the benefits of current scheme pensioners; the balance between contributions and payments is covered by the Government.
- DC schemes:
- Operate on a money purchase basis with a specified rate of contributions being paid into the scheme, but with no guarantee as to the amount that will be paid out. When an individual reaches retirement, the accrued benefit can be withdrawn and may be used to buy a retirement product, such as an annuity or drawdown product.
- At retirement, the amount of a DC scheme will depend on the accumulated fund, any amount deducted from the fund as a tax-free lump sum (which is usually up to 25% of the total fund) and the method of accessing savings. The size of the pot depends on contributions, length of saving, employer contributions, investment performance, charges, and the choice of retirement product or means of access. If investment returns or retirement income product rates are poor, then the resultant pension will be lower.

In addition to DB and DC schemes, a third type of pension scheme, Collective Defined Contribution (CDC), has now been introduced. The Pension Schemes Act 2021 legislated a framework for the establishment of CDC schemes in the UK, with the first scheme, the Royal Mail Collective Pension Plan, authorised in April 2023. So far, this is the only CDC scheme to receive authorisation from The Pensions Regulator (TPR), and the scheme is set to launch 7 October 2024.

CDC Schemes:

- Contributions are usually expressed as a percentage of salary or total earnings. The rate of contribution could be a flat rate or could be tiered by age, and/or length of service, and/or seniority, and/or level of earnings.
- A CDC scheme provides members with an income for the entirety of retirement, similar to that provided by a DB scheme, rather than a pension pot that can be accessed flexibly. Unlike DB incomes, however, CDC income levels are not guaranteed and can be subject to increases and decreases during both the accumulation phase and after retirement, depending on the scheme's funding position.

There are benefits associated with saving in private pensions over other types of saving
Private pension savings, along with other savings and assets, are used to top up State Pension income and improve people's standard of living in retirement.

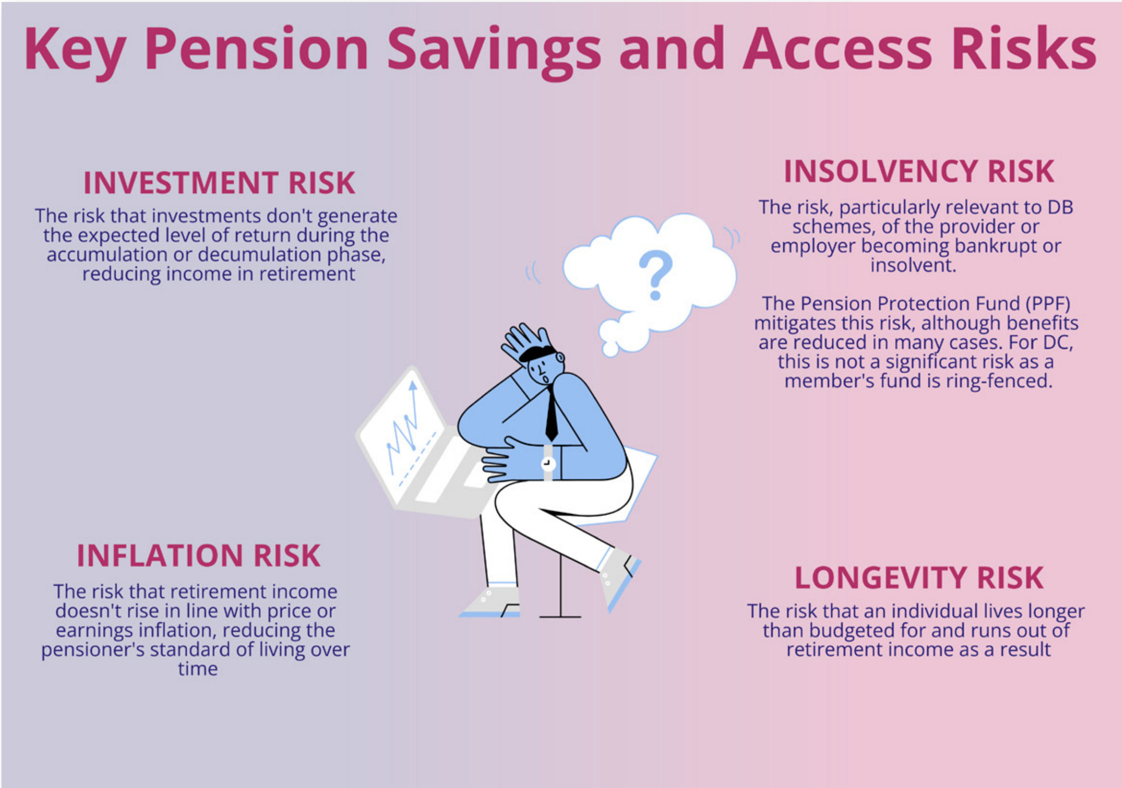
Private pensions provide benefits over other forms of saving:

- Eligible employees enrolled in workplace pensions receive employer contributions.
- Pension contributions and investment returns are given tax relief, subject to certain limits.
- The long-term nature of pension saving allows for compound investment returns to accrue over time, which can substantially increase fund sizes.

However, there are also risks associated with private pensions

The most significant pension-related risk is the risk of not saving enough to achieve an adequate standard of living in retirement. Other significant risks are as follows (Box 1.2):

Box 1.2



Investment, inflation and longevity risk are of most importance to DC savers. Within DB schemes, these risks are largely borne by the sponsoring employer, whereas, in DC schemes, the individual must bear these risks themselves. As a result, the widespread transition from DB to DC provision has led to the transfer of substantial levels of risk from the employer to the individual.

Inflation risk is a particularly important consideration within the current economic landscape. Unexpected and significant increases in inflation are likely to have far-reaching effects for people during both their saving phase throughout their working-life, as well as during retirement. High levels of inflation, particularly if sustained over prolonged periods, have the potential to significantly impact DC outcomes.

For people in the pension saving phase, high inflation may impact savers in two main ways:

- Increased pressure on their income from rising bills may reduce their ability to save, which could lead to increased opt-out rates and/or decreased contribution levels for those saving above the minimum rate; and
- The value of pension savings will be eroded if investment returns do not keep pace with inflation.

For people in retirement, the effects of inflation on retirement outcomes will be more immediate. Pensioners are affected differently by cost-of-living increases because they spend on goods and services in different proportions to the rest of the population, and their income does not always increase at the same rate as the cost of living. While the State Pension Triple Lock provides a high level of inflation protection for pensioners, incomes drawn from DC savings are more vulnerable to inflation risk.

There are other risks associated with saving in and accessing private pensions, including, but not limited to:

- Making sub-optimal decisions about how to access retirement savings,[2]
- Poor understanding of the income level required for an adequate standard of living, and the amount that needs to be saved to achieve that income level,
- Excessive product charges, though this is somewhat mitigated by the charge cap in workplace pensions,
- Poor annuity rates,
- Poorly designed investment strategies,
- Market turbulence,
- Lost pensions, meaning losing track of one or more pension pots,
- Becoming a victim of fraudulent schemes or other pension scams,
- The risk of needs in retirement changing unexpectedly, for example, as a result of developing health and social care needs, and
- The interaction between pension savings and means-tested benefits.

The type of private pension scheme into which people save has implications for the level of risk they face Members of DC pension schemes face more individual risk than members in DB pension schemes (Box 1.3).

Box 1.3

[2] Although this risk was always present, the risk has increased following the introduction of pension flexibilities. Drawdown investment pathways will help to somewhat mitigate this risk for drawdown customers, but those accessing DC pensions may need further protection in the form of advice, guidance and structured choice architecture. Pension Wise was created in order to mitigate this increased risk by offering a free source of guidance for DC savers.

The impact of these risks will be mitigated for people who have only a small amount of DC savings and have other, larger, sources of income in retirement from, for example, DB pension entitlement. However, for those with very low incomes, even small amounts of DC savings may have significant proportional effects on later-life living standards, while those with significant levels of DC savings will also face significant risks.

The pensions landscape has changed over the last few decades as a result of demographic, market, policy and regulatory shifts (Box 1.4-1.7)

Box 1.4 Demographic shifts

Demographic Shifts

Increases in life expectancy and shifts in the old age dependency ratio affect the ability of people to support their own retirements and taxpayers to fund State Pensions and pensioner benefits.

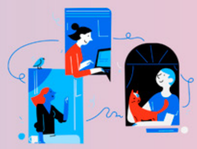
Increases in healthy life expectancy affect the length of time people are capable of staying in work before they retire. These shifts provide part of the Government's rationale for rises to SPa, although increases to SPa do not fully reflect increases in life expectancy meaning that SPa changes will not necessarily fully mitigate the increasing cost of state pension provision.

Health Expectancy

Based on trends up to 2017-19 (the latest data that excludes the effects of the pandemic), it would take 192 years to achieve a five-year improvement in male healthy life expectancy.

For women, healthy life expectancy has been on a downward trend since 2009-2011.

Dependency Ratio



In 2024 there were 279 people over SPa for every 1,000 people of working age.

This is projected to grow to 372 for every 1,000 by 2070.

Life Expectancy

In 2024, a 66-year-old man can expect to live on average to age 86 and a 66-year-old woman to age 87.

Many will live significantly longer, with 14% of men and 21% of women currently aged 66 expected to live until age 95.

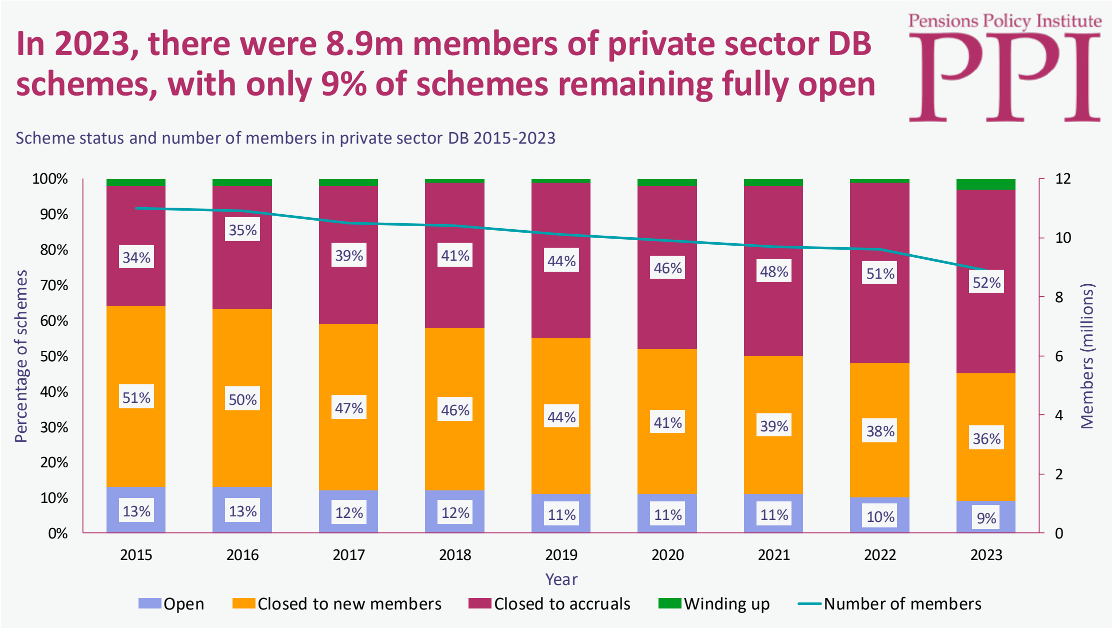
When the contributory State Pension was introduced in 1925, a 65-year-old man could expect to live to around age 76.

Box 1.5: Market changes

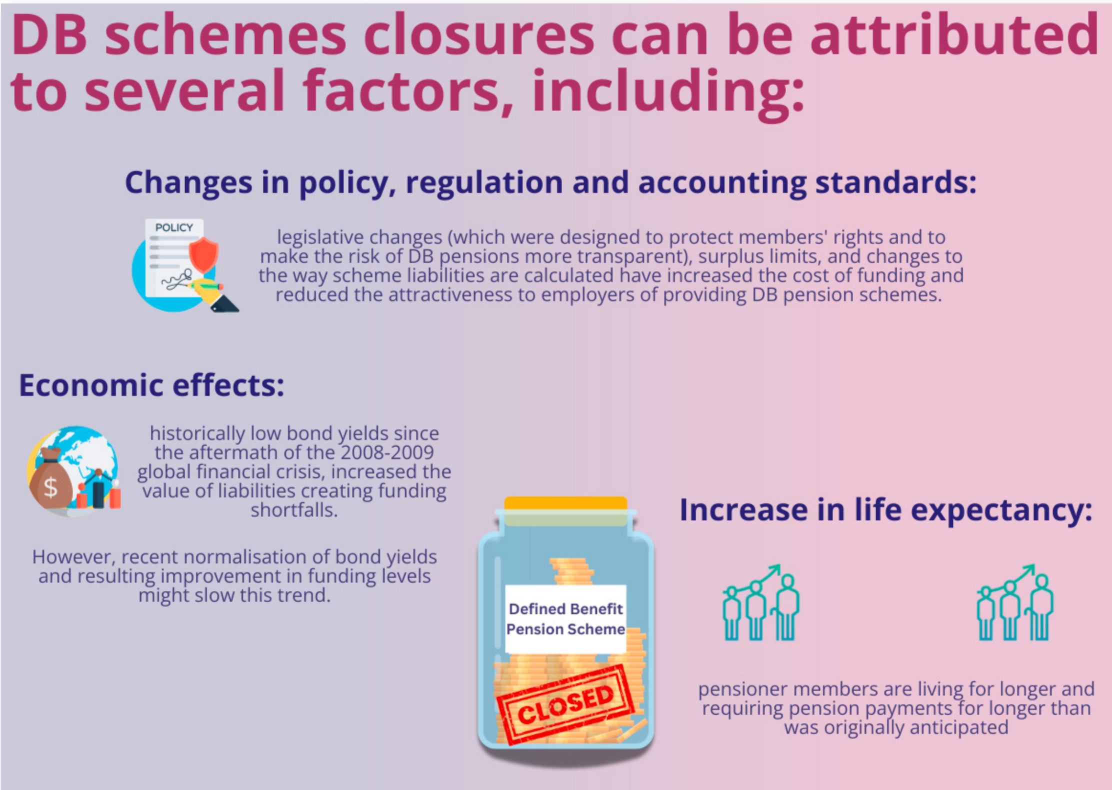
DB pension schemes historically dominated private sector pension provision and continue to be the main source of provision within the public sector. Membership of private sector DB schemes peaked in 1967, with around eight million active members. Since then, private sector DB membership has been in decline, especially in recent years. As of 2023, there were around 700,000 active members, with only 9% of schemes remaining fully open (Chart 1.1)

[3] PPF (2023)

Chart 1.1[3]



DB schemes closures can be attributed to several factors, including:

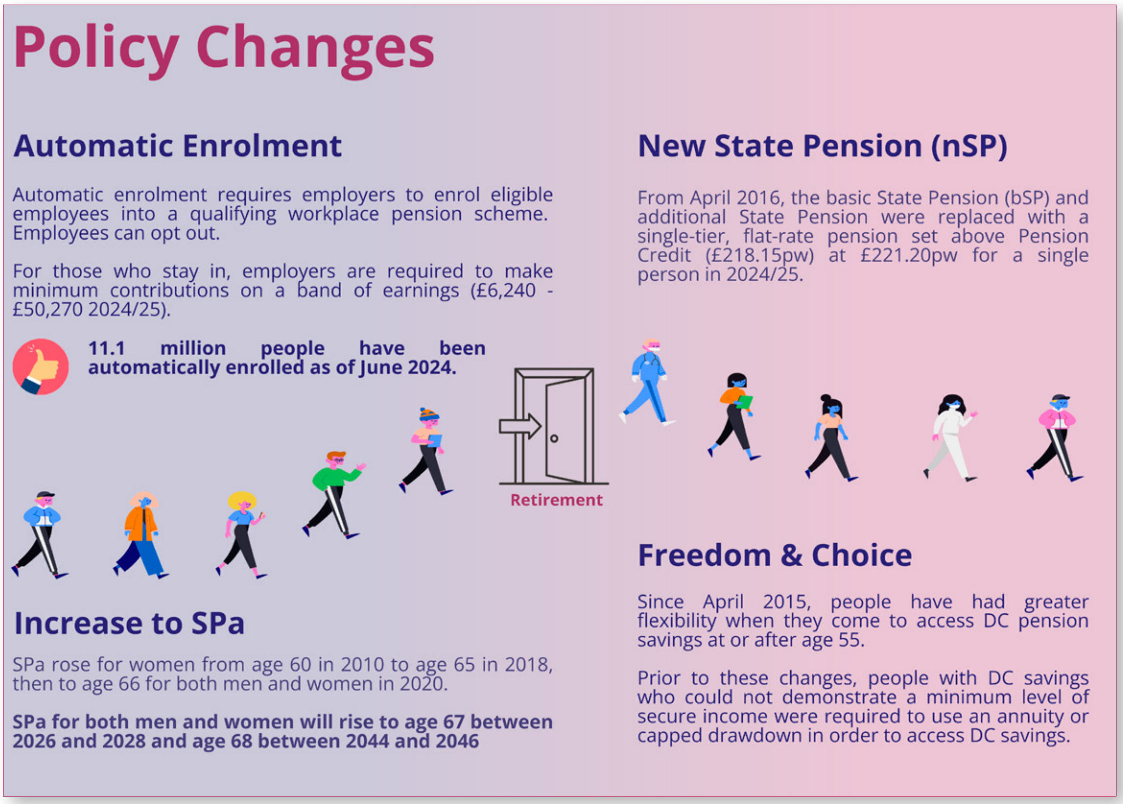


Labour market shifts that have led to fewer people spending most of their working life with a single employer may have also diluted the rationale for offering private sector DB schemes. As provision of DB schemes became more challenging for private sector employers, the less risky DC model became more attractive to them. Many employers also choose to contribute less into DC arrangements. As a result of the increased popularity of DC schemes, and the introduction of automatic enrolment in 2012, the number of active savers in DC schemes has increased rapidly and overtaken the number of active DB savers. In 2023, there were 14 million active members in DC schemes, compared to around 700,000 active members in private sector DB schemes in the latest available data (2023).

High levels of DB provision continue within the public sector, with 7.1 million active members in 2022/23. Many public sector DB schemes are funded on a pay-as-you-go basis (with contributions of current active members paying for income payments to current retirees, and the Government making up any shortfall), rather than being backed by assets like private sector DB schemes. There are some exceptions to this among public sector schemes – the Local Government Pension Scheme (LGPS), for example, is asset-backed.

While DC provision has overtaken DB in terms of numbers of savers, DB entitlement will continue to be an important component of retirement income for many in years to come, even in the private sector. In 2023, there were 4.1 million deferred, and 4 million pensioner members of private sector DB schemes, who will continue to claim DB benefits for many decades regardless of the status of the scheme of which they are a member.[4]

Box 1.6: Policy changes



[4] PPF (2023)

Box 1.7: Regulatory changes

Regulatory Changes

In 2023, the Government launched consultations on a number of policy proposals aimed at improving outcomes for DC savers:

Value for Money (VFM)

Having already introduced a detailed VFM assessment for schemes below £100 million in 2021, in January 2023 the Government launched a consultation on its VFM framework that aims to provide a transparent and consistent way for schemes to assess their performance relative to others in the market. The framework covers three components: investment performance; costs and charges; and quality of services. The framework aims to shift the focus from costs to value, through requiring consideration of factors critical to longer-term saver outcomes. It is expected that the introduction of the framework will also further accelerate the pace of consolidation among smaller schemes that may be underperforming.

Deferred Pots

Following a call for evidence in January 2023, in July 2023 the Government announced a consultation on 'Ending the proliferation of deferred small pots'. The consultation sets out a framework for an automated consolidation solution, with a central clearing house created to act as a central point informing schemes where to transfer a member's eligible deferred pot. Multiple schemes will be authorised by TPR to act as consolidators and members will have the option to self-select a scheme into which their pots will be consolidated, or a default consolidator will be used where a member does not make an active choice. It is proposed that a pot will become eligible for automatic consolidation 12 months after the last contribution was made into the pot, with the pot size limit initially being set at £1,000, with a statutory requirement for the Secretary of State to review this limit at regular intervals.

As for the latest updates in 2024, the work on small pots continues to be a key regulatory focus. Earlier this year, the PPI launched a report titled 'How could a Lifetime Provider Model impact members, employers, and industry?', in response to the previous Government's call for evidence.

Decumulation

In July 2023, the Government announced a consultation on 'Helping savers understand their pension choices', following on from a call for evidence in 2022. The consultation sets out policy proposals for a decumulation framework that will provide support for members at the point of access, both in terms of engagement and product offerings. The consultation also includes questions on how to enable the Government-established master trust Nest to offer a full range of decumulation products to its members.

Asset Allocation

In July 2023, the Government announced the Mansion House Compact, signed by many of the UK's largest DC schemes, representing around two-thirds of the UK's DC workplace pensions market. The Compact commits the signed DC schemes to the objective of allocating at least 5% of their default funds to unlisted equities by 2030.

Box 1.7: Regulatory changes

In addition to these developing regulatory changes, there have been other recent regulatory changes that are now embedded within the DC landscape:

Environmental, Social and Governance (ESG) Considerations

Since October 2019, trustees have been required to set out within a Statement of Investment Principles (SIP): how they take account of financially material considerations, including but not limited to ESG considerations; their policies in relation to the stewardship of investments, including engagement with investee firms and the exercise of the voting rights associated with those investments; and the extent to which, if at all, non-financial matters are taken into account in the selection, retention and realisation of investments.

From October 2020, these regulations increased further, with trustees of DC schemes with 100 or more members required to produce an implementation statement explaining how they have followed and acted upon the stated investment principles set out in their SIP. This includes reporting on the way in which the scheme monitors its asset managers who undertake investment and engagement activities on its behalf and whether these managers have acted in accordance with the trustees' stated policies. In December 2019, the Financial Conduct Authority (FCA) introduced similar reporting requirements for contract-based schemes, including a new duty for Independent Governance Committees (IGCs) to consider and report on their firm's policies on ESG issues, member concerns and stewardship.

Further regulation has been introduced in line with recommendations from the Task Force on Climate-related Financial Disclosures (TCFD). Since October 2021, DC schemes with more than £5bn AUM, and all master trusts, must produce an annual report specifically on their consideration of climate change risks. From October 2022, this was extended to apply to DC schemes with AUM between £1bn and £5bn.

Drawdown Investment Pathways

In 2018, the FCA found that around a third of those who have used non-advised drawdown were invested in cash, or cash-like assets, rather than strategies with the potential for higher returns that better suit the member's aims. The FCA estimated that around half of these savers were likely to experience poorer retirement outcomes as a result of their investment choice.

As a result, drawdown providers are now required to offer "investment pathways" to members. These pathways require non-advised members to make a decision about how they intend to access their savings in the near future and then be given an appropriate underlying investment portfolio on that basis. Drawdown investment pathways came into force in February 2021. The FCA has also made it illegal to default consumers into cash drawdown; savers must now actively opt in if they want to invest in cash, or cash-like assets.

*It is important to note that the policy changes and agendas highlighted were set by the previous Government. As a result, regulatory focus may shift in the coming months.

[8] https://www.gov.uk/government/speeches/chancellor-jeremy-hunts-mansion-house-speech

Demographic, market and policy changes affect needs and resources in retirement
The above changes can all affect the needs and resources of, and the risks faced by, people at and during retirement. Compared to previous generations, future retirees will:

- live longer and take their State Pension later,
- be more likely to reach retirement with DC savings,
- be more likely to reach retirement with no or low levels of DB entitlement,
- have near total flexibility in accessing their savings,
- face more risk and complexity at and during retirement, and
- be more likely to have a need for long-term care in later life, and will face challenging decisions about how to fund this.

Conclusions

Changes in private pension provision have shifted the balance of risk increasingly towards members

As the UK private pensions landscape has shifted rapidly from DB to DC, largely as a result of DB scheme closures and the introduction of automatic enrolment, there has also been a transfer of risk from employer to employee. With more savers bearing a greater level of individual risk and complexity in DC schemes, there is a risk that they will experience poorer later-life outcomes if they do not receive adequate support.

The previous Government set out a range of policy solutions to improve outcomes for DC savers

Areas of regulatory change under the previous government included a VFM framework that aims to provide a transparent and consistent way for schemes to assess their performance, an automated consolidation solution to the small, deferred pots challenge, and a decumulation framework that will provide support for members at the point of access, both in terms of engagement and product offerings.

The current Government has launched a new Pension Schemes Bill

As of July 2024, the Government has launched a pensions review aimed at boosting investment, increasing pension pots, and tackling inefficiencies in the system. Additionally, the Government seeks to improve outcomes for savers through the new Pension Schemes Bill, as announced in the King's Speech. This Bill builds on reforms set out by the previous administration, focusing on the consolidation of small pension pots and the introduction of a VFM framework. The Government also plans to consolidate the DB market and require pension schemes to offer retirement products.

[9] FCA (2019)

Chapter Two:

What does the DC landscape look like?

Chapter Two: What does the DC landscape look like?

This chapter provides a picture of the current Defined Contribution (DC) landscape, including data on automatic enrolment, saving levels, investment strategy, access to savings, and advice and guidance.

Automatic enrolment

Automatic enrolment requires all employers to enrol eligible employees into a qualifying pension scheme. To be eligible for automatic enrolment, an employee must be:

- aged between 22 and State Pension age (SPa), and
- earning £10,000pa or above in at least one job.

Once enrolled, employers are required to contribute on behalf of workers while they remain active members in line with these requirements:

- The minimum required level of aggregate contributions is 8% of band earnings (£6,240 to £50,270 in 2024/25), though employers and employees may choose to contribute more,
- Employers must contribute at least 3% of band earnings on behalf of employees, though some employers may choose to cover the whole 8%, with some employers even offering pension contributions above this level.
- Employees whose employer makes only minimum contributions are required to contribute a minimum of 5% of band earnings (though tax relief is applied to contributions, reducing the impact on take-home pay) unless they opt out. Employees with employers who choose to contribute at 8% or higher are not legally required to make any additional contributions, although some employers will require that employees contribute themselves in order to receive the higher rate of employer contribution.

New and newly eligible employees are automatically enrolled and have a one-month window to opt out and have their personal contributions refunded. People who cease contributing after the opt-out period has expired are not eligible to claim back their contributions, which will remain invested until at least age 55 when they can legally access their accumulated pot. Those who opt out or cease contributing are automatically re-enrolled every three years.

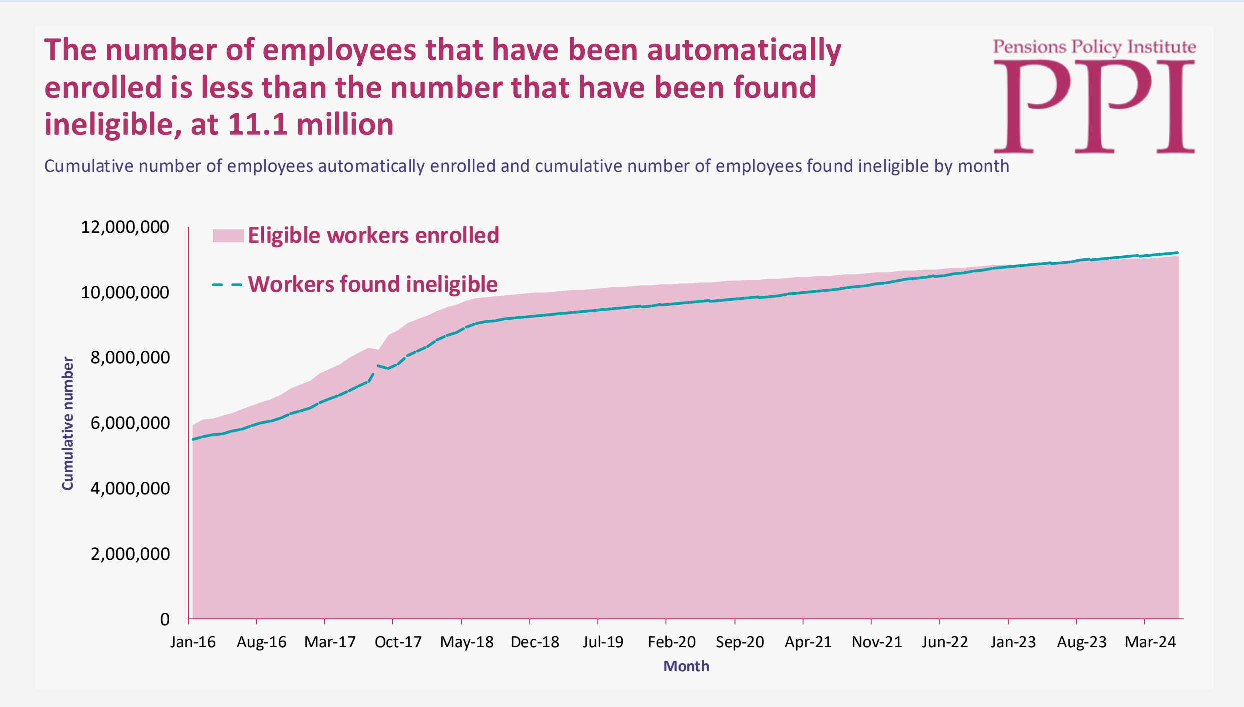
Automatic enrolment was introduced on a staged basis, starting with the largest employers, in October 2012. By the end of 2018, all existing employers were required to have automatically enrolled their employees and all new employers after that date have the obligation to automatically enrol their employees with immediate effect.

Employees and automatic enrolment

11.1 million people were automatically enrolled by June 2024

By June 2024, 11.1 million employees were automatically enrolled. However, the number of employees found ineligible for automatic enrolment because of age or earnings has also continued to grow, and, at 11.2 million, is now more than the number of employees who have been found eligible (Chart 2.1). The number of employees found ineligible has been growing at a more rapid rate than those found eligible, which may be the result of an increased number of employees in lower income jobs, or more employees working in multiple jobs. Because these automatic enrolment statistics are cumulative and employees' eligibility is assessed each time they join a new employer, the number found ineligible is increased by people who move jobs more frequently, or who are more likely to be ineligible due to age or earnings, such as younger workers and those on low incomes who are more likely to be in less secure employment on average.

Chart 2.1[5]



In addition to employees who have been brought into pension saving through automatic enrolment and employees who have been found ineligible for automatic enrolment, as of June 2024, 12.2 million employees were already active members of a qualifying scheme on the staging date or duties start date (the deadline by which employers had to comply with the automatic enrolment duties for workplace pensions).[6] When including those who were already active members of a qualifying scheme and those who were newly brought into pension saving through automatic enrolment, it means around 88% of employees are eligible for automatic enrolment.[7]

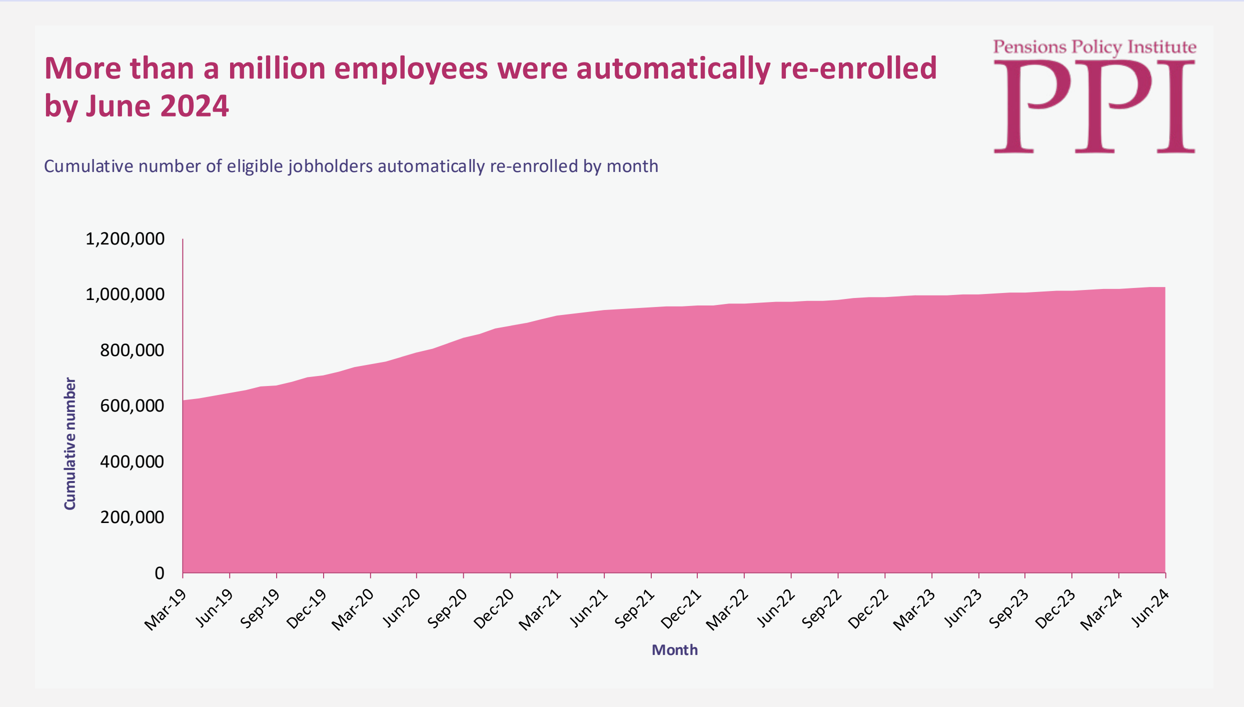
[5] TPR (2024)
[6] TPR (2024)
[7] 2024 PPI analysis of Labour Force Survey (LFS)

More than a million employees have been automatically re-enrolled

Employers are required to automatically re-enrol all eligible employees who have opted out or ceased making contributions every three years. For employees who were already working for the employer at the time of automatic enrolment staging, this means they are re-enrolled three years after the date that they opted out for the first time, and every three years after that if they continue to opt out. For employees who joined the employer after automatic enrolment began, re-enrolment may take place sooner than three years after they first opted out, as re-enrolment is actioned across the full workforce at a set date every three years, rather than on an individual employee basis.

As of June 2024, 1.02 million employees had been automatically re-enrolled, growing from 1 million in June 2023 (Chart 2.2).

Chart 2.2[8]



Further reforms may be needed if more people are to be brought into pension saving

The 2017 Automatic Enrolment Review recommended that the minimum age for automatic enrolment eligibility should be reduced from 22 to 18.[9] This could increase eligibility by around 3%, and encourage saving for later life as the norm for young adults from the start of their working lives. At the time of the Review, the previous Government committed to implement this recommendation, alongside the recommendation to remove the lower limit on band earnings so that contributions are calculated from the first pound of earnings, by the mid-2020s.

[8] TPR (2024)
[9] DWP (2017)

In September 2023, the Pensions (Extension of Automatic Enrolment) Act 2023 received Royal Assent. The Act aims to expand automatic enrolment by enacting the proposals from the 'Automatic Enrolment 2017 Review'. The Act grants the Secretary of State certain powers to amend or abolish the Lower Earnings Limit (LEL) for contributions and lower the minimum automatic enrolment age limit. However, the provisions of the Act are not expected to result in immediate change. Instead, it grants the Secretary of State the power to consult and report on the anticipated outcomes of the proposed changes before implementing them.

While implementation of this reform would increase eligibility among young workers, others will remain excluded from automatic enrolment. Those who are self-employed or have several jobs which each pay below the £10,000pa threshold are not eligible, even if combined income across multiple jobs totals more than £10,000pa.

The self-employed group, which includes around 4.3 million people,[10] is excluded from accessing the benefits of automatic enrolment because they do not have an employer who can automatically enrol them and contribute on their behalf. Meanwhile, many people with multiple jobs are excluded from automatic enrolment as a result of low earnings, although they may make an active choice to opt into pension saving. Changing eligibility criteria to take account of combined income across multiple jobs could bring an additional 108,000 women and 24,000 men into automatic enrolment.[11]

Despite concerns that opt-out rates would increase, they have remained broadly stable

Employees have the opportunity to opt out and have their contributions returned to them within one month of being automatically enrolled. Prior to the introduction of automatic enrolment, the Department for Work & Pensions' (DWP) impact assessment predicted that around one in three people would opt out.[12] In practice, opt-out rates have been consistently lower than this, at around one in 10. As automatic enrolment was gradually rolled out, there were concerns that opt-out rates might increase, either once smaller employers started reaching their staging dates or as minimum contribution levels increased, first from 2% to 5% in 2018 and then from 5% to 8% in 2019.[13] However, opt-out rates remained broadly stable throughout staging and contribution rate increases.

Recent events, including the pandemic and the ongoing cost-of-living crisis, have raised fresh concerns about opt-out rates. Opt-out rates have remained broadly stable at around one in 10 over the decade since automatic enrolment was introduced, though there have been higher rates of opt-outs during times of particular economic uncertainty, such as the peak of the pandemic in 2022 when opt-out rates temporarily increased to nearly 11%, before stabilising again around 8%. However, opt-outs increased again to above 12% in 2023, and there are concerns that this trend could continue or even grow as the impact of the current cost-of-living crisis continues.[14]

Fewer than 1% of savers stopped contributing as a result of an active decision not to continue saving after the opt-out period

While employees have a one-month period in which they can opt out of their workplace pension entirely, some people cease contributing to their scheme after the opt-out period has expired and their contributions remain invested in the scheme. People stop saving for a number of reasons:

- They leave their current job (and will be automatically enrolled via their next job if eligible),
- Their earnings fall below the limit for eligibility, or
- They do not wish to continue contributing to their pension scheme.

[10] Francis-Devine, Buchanan & Powell (2024)
[11] PPI (2022) The Underpensioned Index
[12] DWP (2008)
[13] DWP (2020)
[14] DWP (2023) https://www.gov.uk/government/statistics/workplace-pension-participation-and-savings-trends-2009-to-2022/workplace-pension-participation-and-savings-trends-of-eligible-employees-2009-to-2022

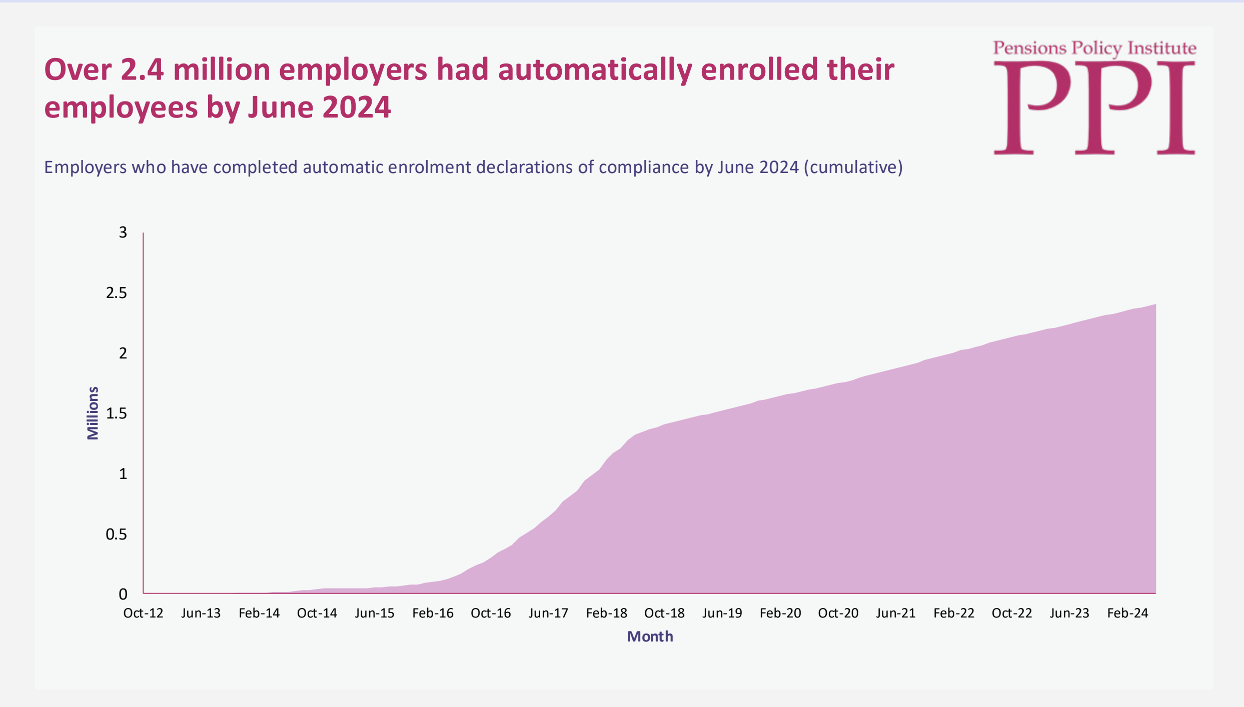
What we know about contributors and non-contributors

- From April 2014 to March 2021, an average of 2.7% of employees stopped making contributions to their workplace pension each month. Within this group, 64% (1.7% of total savers) stopped contributing because the employment ended, 11% (0.3% of total savers) became ineligible for automatic enrolment (either because of older age or, more likely, a reduction in earnings), and 25% (0.7% of total savers) stopped contributing as a result of an active decision not to continue saving.[15] Many within the group that stopped contributing as a result of their employment ending will have moved to a new job and been automatically enrolled by their new employer. Although opt-out rates have increased, cessation has remained at 1% as of 2023. Given the difficulty in finding up-to-date figures for this data, it's important to note that the latest available statistics are from 2021, which may not fully reflect the current situation.

Employers and automatic enrolment

Automatic enrolment is now fully implemented, with all employers reaching their staging date by 2018. All employers are now required to automatically enrol new employees and re-enrol existing employees who have opted out. The number of employers automatically enrolling grew exponentially as smaller employers began staging in 2014. By the end of automatic enrolment staging, 1.1 million employers had been through the process. By June 2024, this had risen to over 2.4 million employers, as a result of new employers joining the market (Chart 2.3).[16]

Chart 2.3[16]



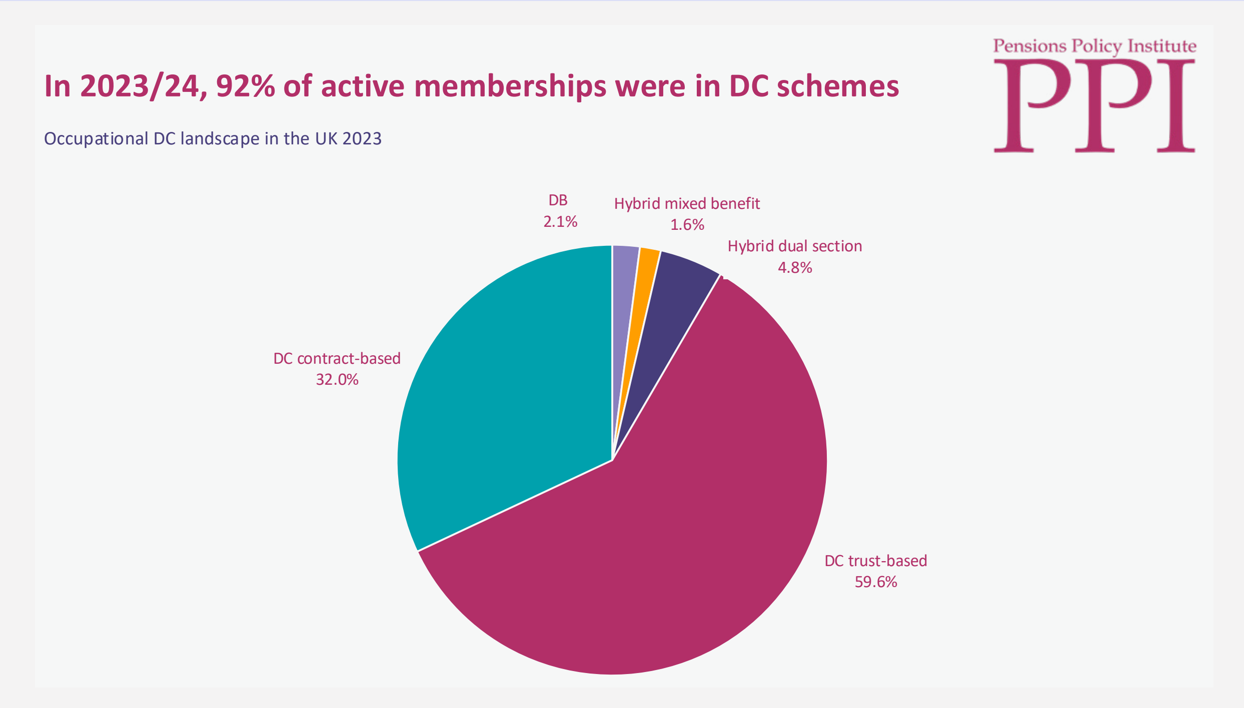
[15] TPR (2024)
[16] TPR (2024)

Scheme type

Around nine in 10 active memberships are now within DC schemes

Employers have a choice about the type of pension scheme they use for automatically enrolling their employees. The provision of Defined Benefit (DB) schemes has dwindled in the private sector (as outlined in Chapter One), and private sector employers are much more likely to automatically enrol their employees into DC schemes. The use of DC schemes, and especially master trusts, has risen dramatically with automatic enrolment, with around nine in 10 active memberships now in DC schemes (Chart 2.4).

Chart 2.4[17]



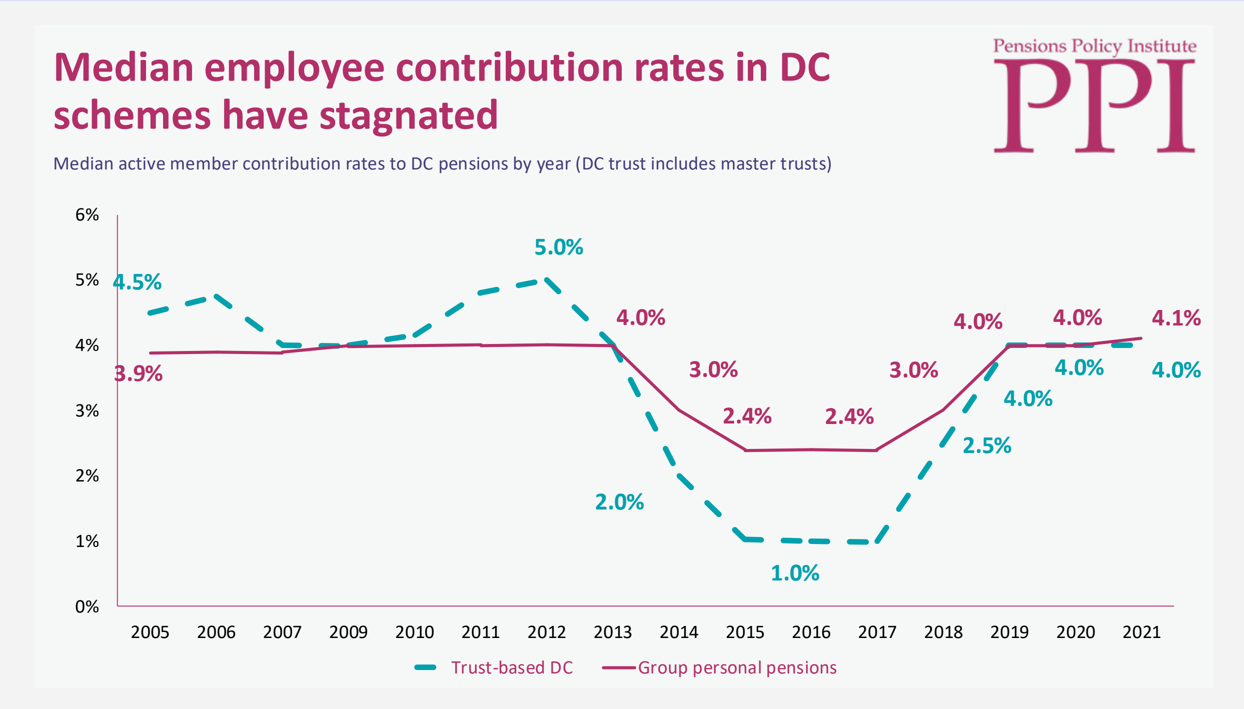
Contributions

Average employee and employer contributions have stagnated around the minimum mandated rate

While those who were already members of workplace pensions prior to the introduction of automatic enrolment for the most part continued contributing at the same rates, large numbers of new savers contributing at minimum rates reduced the average contribution level. As automatic enrolment was introduced, median employee contribution rates initially fell as a result of more employees joining pension schemes for the first time and paying minimum contributions alongside their employers. Average employee contribution rates increased in correlation with increases to minimum required automatic enrolment contribution rates in 2018 and 2019. However, since these changes were made, and with no further increases currently planned for minimum contribution rates, average employee contribution rates have stagnated at 4% in trust-based DC schemes and have seen only a very small uplift of 0.1% to 4.1% in Group Personal Pensions (GPP) (Chart 2.5).

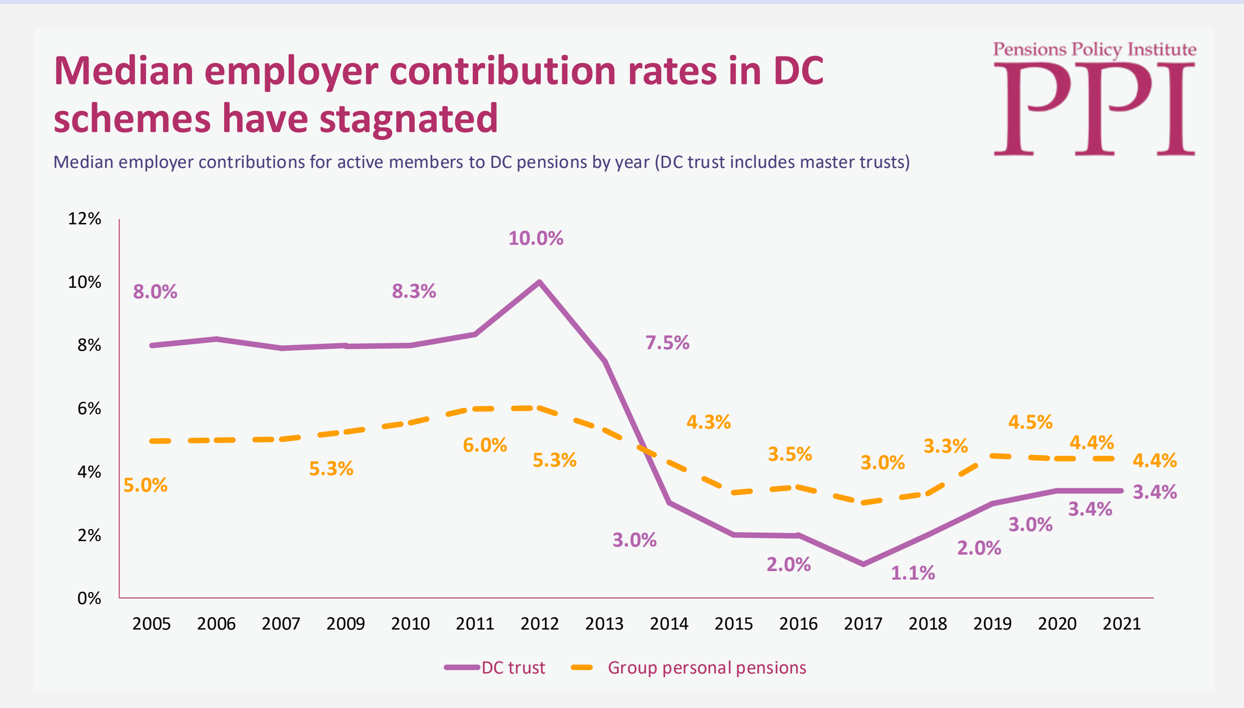
[17] Last year's data (2022/23) was used for the percentage of DC contract-based schemes, as this has not been updated for 2023/24 yet https://www.thepensionsregulator.gov.uk/en/document-library/research-and-analysis/occupational-defined-contribution-landscape-2023

Chart 2.5



Median employer contribution rates have increased as a result of increases in the minimum required rate of contribution in 2018 and 2019. However, like employee contribution rates, average employer contributions have stagnated in the last couple of years (Chart 2.6). Data for 2022 and 2023 is not yet available, but it is expected that contributions rates for employees and employers will have remained stable at around the minimum rate.

Chart 2.6



Minimum contribution rates are unlikely to deliver adequate and sustainable retirement outcomes
Under an assumption of full entitlement to the new State Pension (nSP) and a lifetime of minimum required automatic enrolment contributions, anyone earning over £12,700 will require additional savings beyond the default 8% of band earnings to reach their target replacement rate, which will allow them to replicate working-life living standards in retirement. While there is a broad consensus that higher contribution rates are required to achieve adequate and sustainable retirement outcomes, there are differing views on the level of contribution needed, ranging upwards from around 12%. PPI modelling carried out in 2021 suggests that for those on median earnings, total contribution rates may need to be as high as 20%, a further 12% above the minimum required under automatic enrolment in order to meet their target replacement rate.[18]

Now that all scheduled minimum contribution rate increases have been implemented, there have been recommendations across the industry for further increases to be considered. While past increases to minimum contributions have not resulted in substantial increases in opt outs, any further increases need to be balanced against the potential risk of encouraging higher opt-out rates, especially in the current economic climate.

The Automatic Enrolment Review in 2017 recommended removing the lower earnings band for contributions, so both employees and employers would pay contributions based on the first pound of earnings up to the higher earnings band. The DWP's ambition is to implement this policy in the mid-2020s. If enacted, this change will increase saving levels for all those whose employer contributes based on band earnings (some employers choose to contribute based on total rather than band earnings), and would have the greatest proportional impact on lower earners. This change is also included in the Pensions (Extension of Automatic Enrolment) Act 2023, which received Royal Assent.

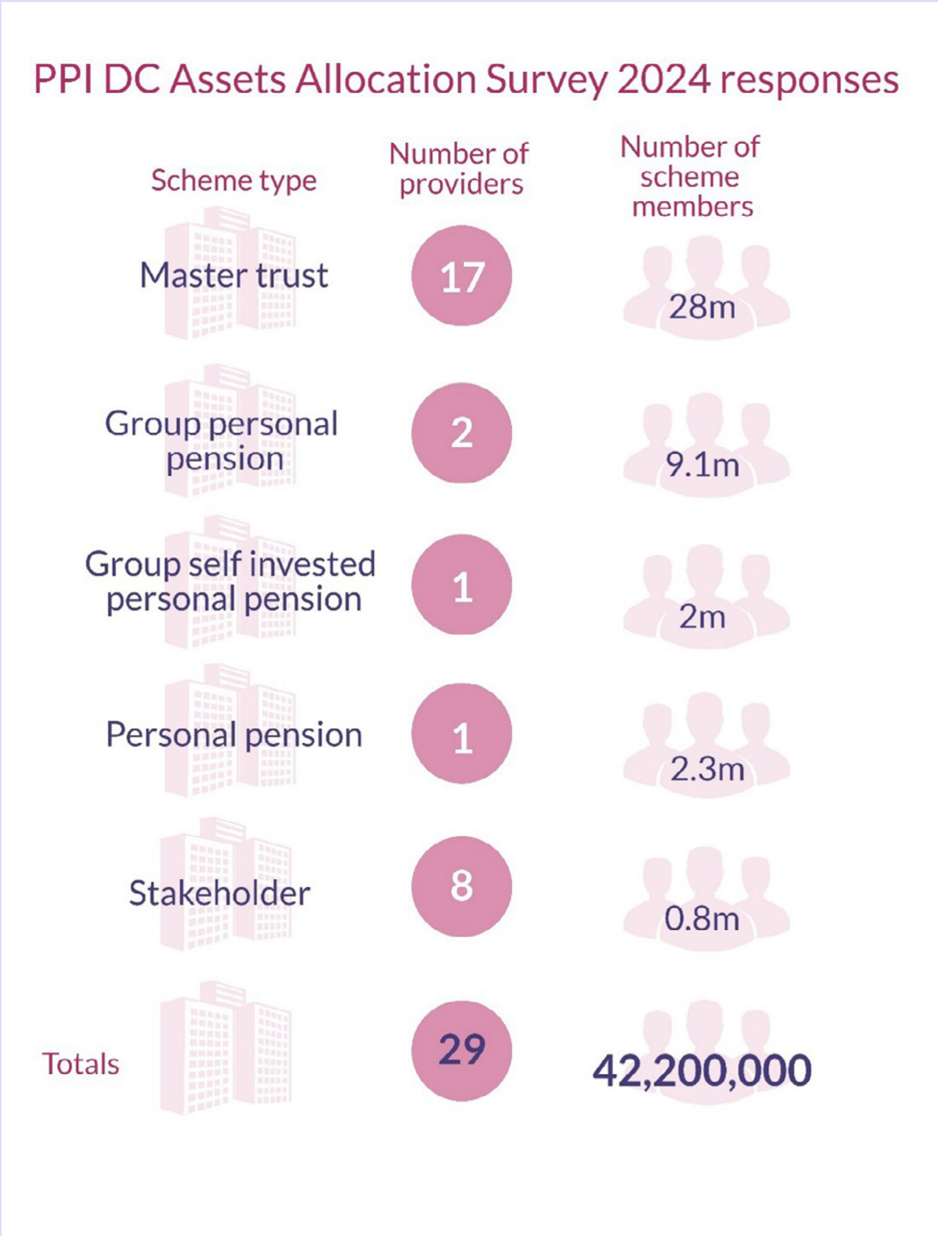
[18] PPI (2021) What is an adequate retirement income?

DC investment

In addition to contribution rates, the returns achieved through scheme investment also impacts DC members' pot sizes at retirement, and, as a result, the adequacy of their retirement outcomes. The next section explores how assets are allocated within DC pension schemes' investment strategies.

The following data is based on responses to the PPI DC Asset Allocation Survey 2024. The participating schemes collectively manage 42.2 million pots (Box 2.1) with aggregate assets under management (AUM) of around £530.4 billion.

Chart 2.1[19]



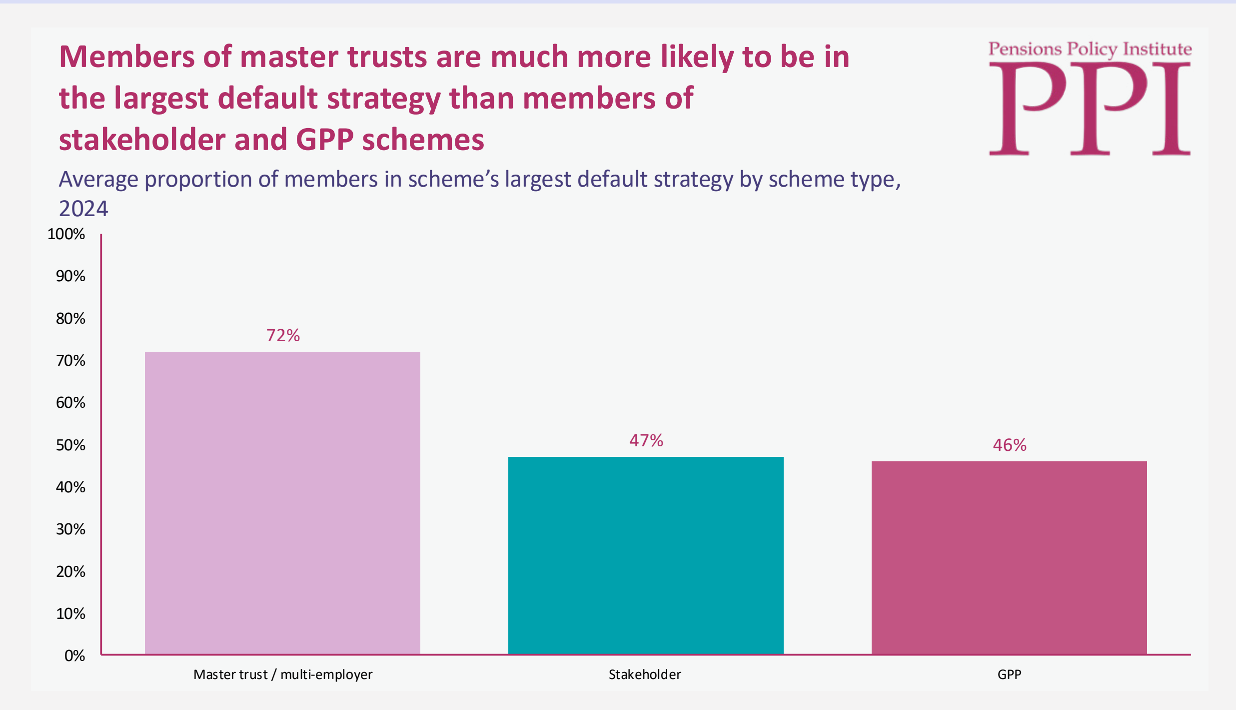
[19] This infographic shows the number of schemes that responded to the PPI DC Asset Allocation Survey 2024 and the number of members these schemes reported. It is not representative of the full DC market.

The PPI DC Asset Allocation Survey is an annual online survey that collects data on size, charges and asset allocation across the DC universe. Since its inception in 2015, alongside the first edition of The DC Future Book, the survey has grown from four providers covering around four million pots, to 29 schemes covering around 42.2 million pots. This year's survey was carried out from May to July 2024. Responses to the DC Asset Allocation Survey have become increasingly concentrated in large master trust schemes, reflecting shifts in the DC landscape. All data from the survey is self-reported by participating schemes and is therefore dependent on the accuracy of the data provided, as well as the sample of schemes that respond each year. While many of the same schemes respond to the survey annually, changes in respondents' year-to-year can impact the trends identified in the data.

Members of master trusts are more likely to be invested in their scheme's largest default fund compared to members of single-employer schemes

The majority (72%) of master trust members are invested in their scheme's largest default strategy. Where providers offer single-employer schemes, a smaller proportion of members are in the largest default strategy offered (Chart 2.7), likely to be primarily the result of a greater range of default funds being offered across different employers. In both instances, the proportion quoted in this year's edition is substantially lower than previous years, as the survey asked specifically about the scheme's largest default strategy rather than default strategies more broadly; this change was made in order to simplify and improve the quality of data on asset allocation gathered by the survey.

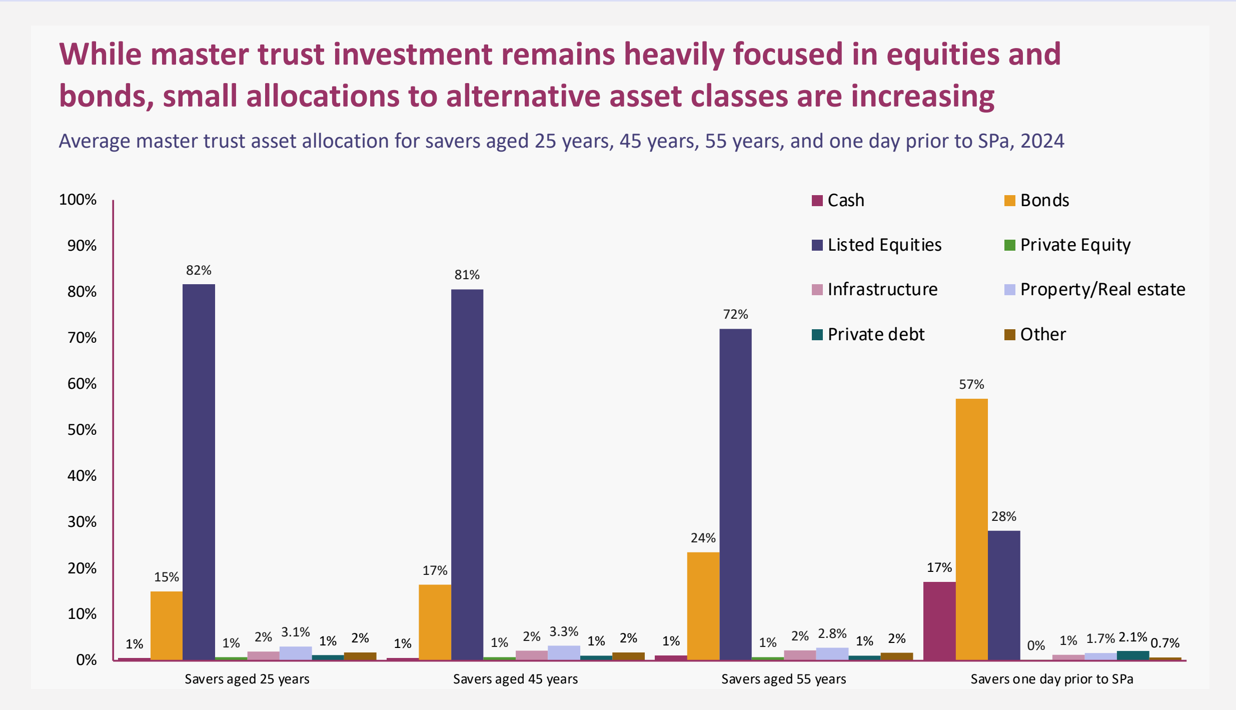
Chart 2.7



Although DC investment remains heavily focused in equities and bonds, small allocations to alternative asset classes are increasing

On average, master trusts allocate the majority of their assets (82%) to listed equities for savers aged 25 years (Chart 2.8). Among master trust respondents that were able to provide a more detailed breakdown of the types of listed equities within which they are invested, 74% of overall AUM were allocated to developed market equities, 7% to UK equities and 11% to emerging markets. There has been a significant increase in allocation to developed market equities compared to last year's data, in which 55% of allocation was to developed market equities.

Chart 2.8[20]

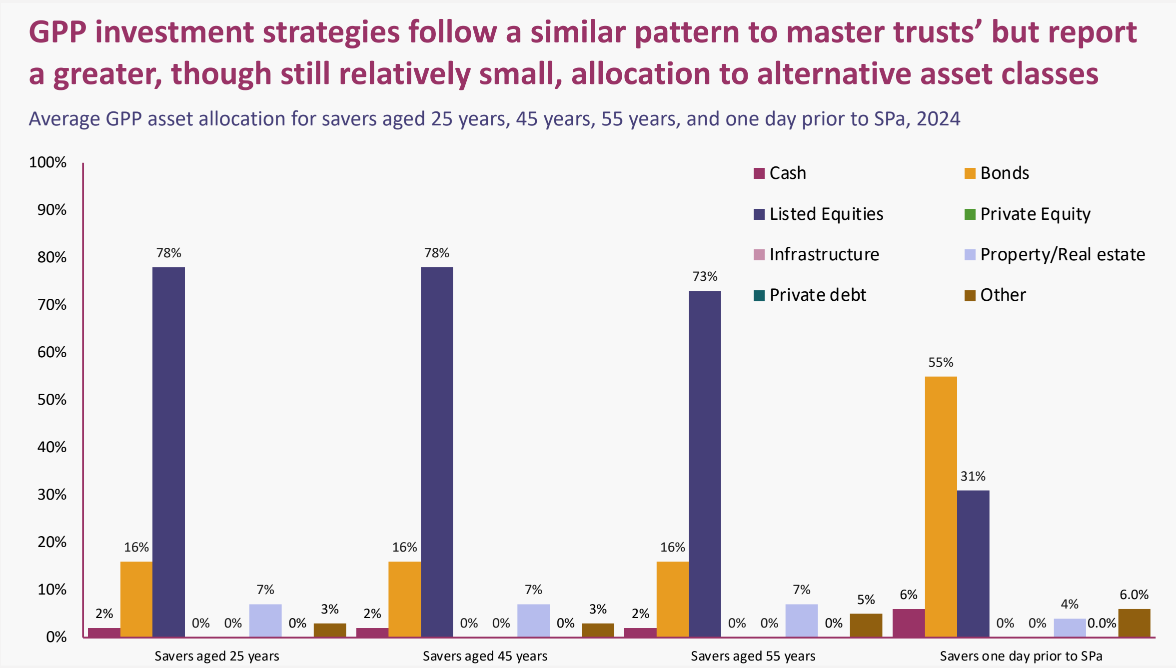


All master trust respondents to the survey utilise either a lifestyle or target date approach, and move in favour of bonds and cash, with 74% of AUM allocated one day prior to SPa, compared to just 18% for savers aged 45 years. This reflects the need to protect the value of pension savings as members approach retirement. Small allocations to alternative asset classes are present in master trust allocations, mostly focused on infrastructure and real estate, with higher allocations for savers aged 55 years, and one day prior to SPa.

[20] Totals do not equal 100% due to rounding

GPP respondents to the survey also utilise a lifestyle or target date approach, with shifts in asset allocation over time following a similar pattern to master trust investment strategies as members approach retirement. However, GPPs report a greater allocation to the 'other' category which includes alternative asset classes beyond those specifically named on the chart, for example commodities (Chart 2.9).

Chart 2.9[21]



DC default funds in the accumulation phase are taking a passive approach to investment, along with a greater focus on return-seeking assets over a defensive approach

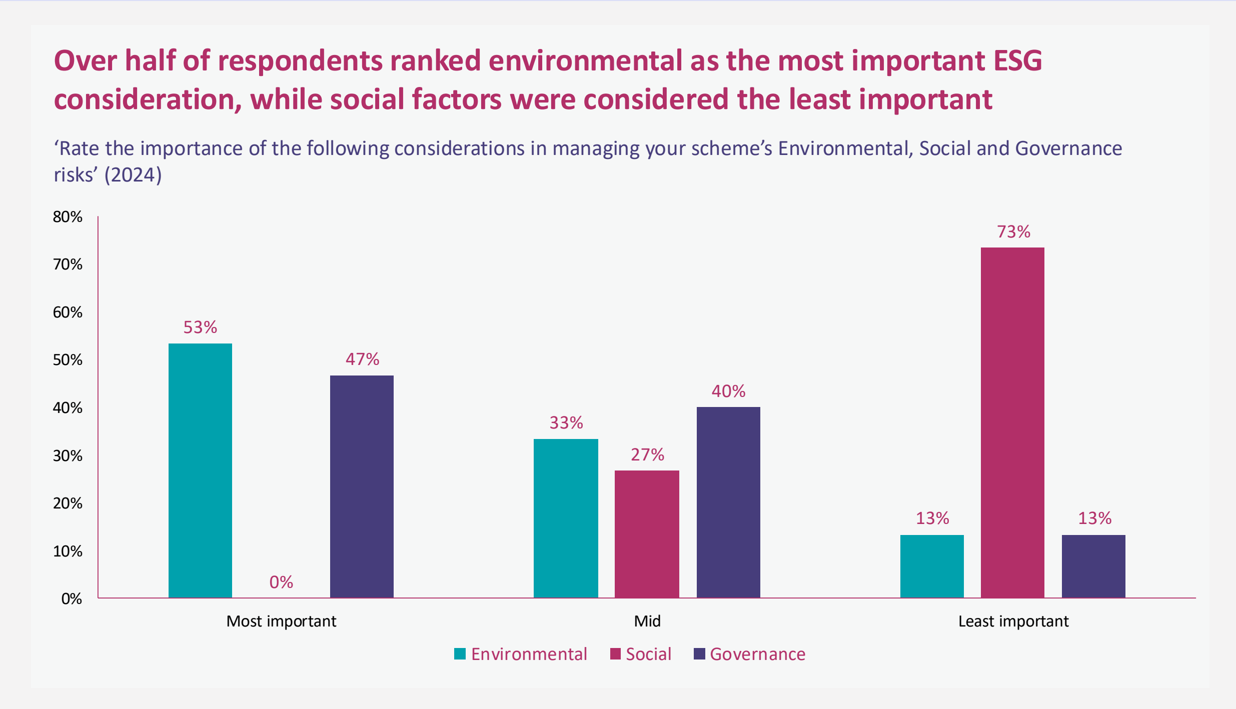
In previous years, the DC Asset Allocation Survey asked what proportion of AUM in default funds was actively managed. This year's survey approached this question differently, instead asking respondents to characterise their investment approach in the accumulation phase as a whole on two scales: active vs. passive, and return-seeking vs. defensive. Among master trusts, characterisation of default investment strategy leaned heavily towards a passive approach, with an average score of 73 on a sliding scale between active at 0 and passive at 100, and towards a return-seeking focus, with an average score of 12 on a sliding scale between return-seeking at 0 and defensive at 100. However, with all master trust default funds captured by the survey utilising a target date or lifestyle approach, this focus shifts to become more defensive as retirement approaches.

[21] Totals do not equal 100% due to rounding

Environmental, Social and Governance (ESG) factors are recognised as important considerations in investment strategy, with the majority of schemes prioritising environmental most highly

All respondents recognised the importance of ESG factors in managing their scheme's investment risks, with around half ranking environmental factors as most important and the other half ranking governance factors most highly. Social factors were most likely to be viewed as least important (73%). (Chart 2.10).

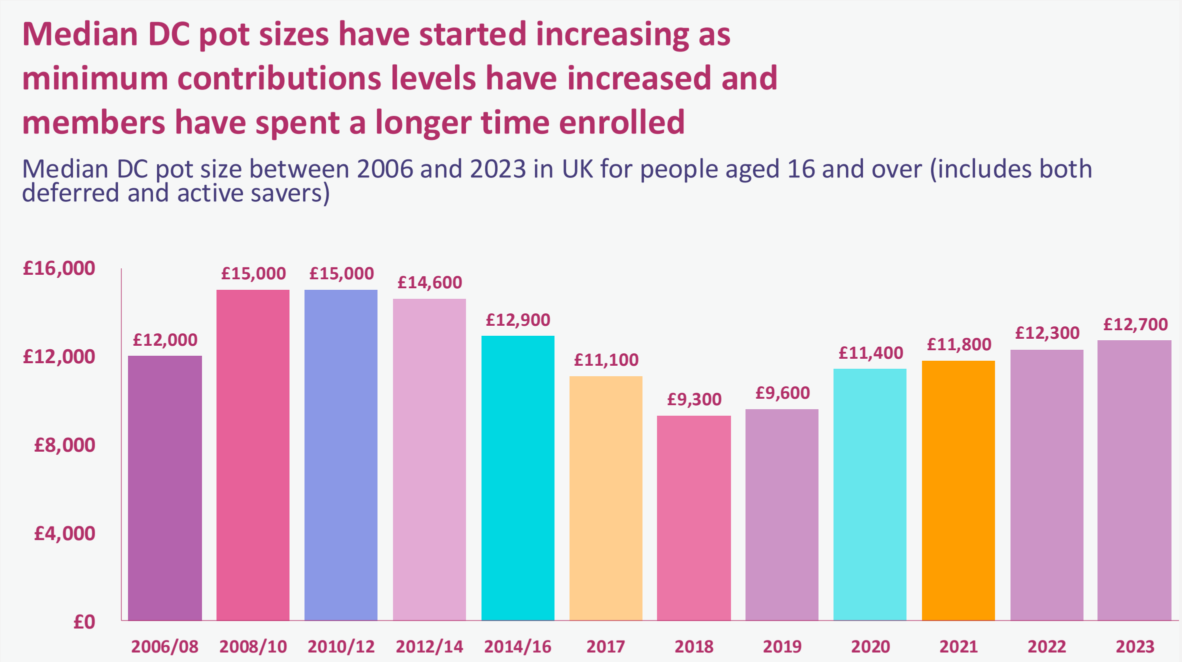
Chart 2.10



DC saving levels

The introduction of automatic enrolment initially caused the median DC pot size to decrease as millions began contributing to a pension for the first time and accruing initially small pots. Between 2010 and 2018, the median DC pot size decreased from £15,000 to £9,300. However, as a result of the increase in minimum contributions, and pots having some time to increase in value, median pot sizes began to grow from 2018 onwards, reaching £12,700 in 2023 (Chart 2.11). While growth in median pot sizes suggests a positive trend, the low contribution rates of many savers mean that they will accrue pension savings at a level that is unlikely to enable them to achieve adequate and sustainable retirement outcomes.

Chart 2.11



Although median DC pot sizes initially declined following the introduction of automatic enrolment, this resulted from an increase in the number of people saving for a pension who had not been saving previously, which skewed the baseline population for analysis. Aggregate assets across all DC savers collectively have increased dramatically since the introduction of automatic enrolment. For example, between 2015 and 2023, aggregate assets in DC grew from £324 billion to £600 billion. The strong investment returns from certain asset classes, such as equities, from 2009 to 2021, excepting the disruption to financial markets in the early stages of the pandemic in 2020, would also have been a contributory factor to the growth of DC assets.

Accessing DC savings in retirement

People can now access DC pension savings flexibly from age 55

Prior to 2015, most individuals accessing DC pensions were required to annuitise their savings (after taking an optional 25% tax-free lump sum). There were exceptions for those with savings below the trivial commutation amount of £18,000, who could take the total pot as a lump sum, and those who could provide themselves with a guaranteed lifetime income of £20,000 per year from other sources (for example, DB entitlement or an annuity), who could access the remainder of their savings flexibly via drawdown. Those with pots of more than £18,000, but without a guaranteed minimum income of £20,000 per year, were required to use their DC savings to secure a retirement income, either through purchasing an annuity or through the use of a capped drawdown product (which limited income withdrawals to 150% of an equivalent annuity).

In the 2014 Budget, the Government announced that, from April 2015, individuals would be able to flexibly access their DC pension savings with no requirement to secure a guaranteed income, with the objective of giving savers more freedom and choice over how they access their DC savings and provide a retirement income for themselves.

The options open to people with DC savings are limited only by the products available and the amount of savings people have. They are also governed by taxation. Those with DB pension savings cannot use flexible access unless they transfer their DB entitlement into a DC scheme first, and some DB schemes in the public sector do not allow transfers.

From age 55 (increasing to age 57 from 2028), people with DC savings may do one or a combination of the following:[22]

- Withdraw the total fund (25% tax-free up to the limit of £268,275, the remainder taxed as income).
- Leave their pension fund invested and withdraw unlimited amounts, taxed at their highest marginal rate of income tax, with 25% of each withdrawal tax free. This is known as an uncrystallised funds pension lump sum (UFPLS) because the member does not "crystallise" their pension by buying a retirement product.
- Purchase an annuity. A lifetime annuity is a retirement income product that pays an income from the date of purchase until the date of death. There are many different types of annuity on offer, including level vs. escalating (which adds protection against inflation), and single-life vs. joint-life (which adds protection for a surviving spouse).
- Purchase an income drawdown product. An income drawdown means that the pension fund remains invested and potentially benefits from investment growth, but an individual can withdraw an income from it flexibly until the fund is depleted.

The data on access to savings in this report uses information provided by Association of British Insurers (ABI) members and therefore does not cover the full market. However, the data provides a picture of the overall trends in accessing DC savings.

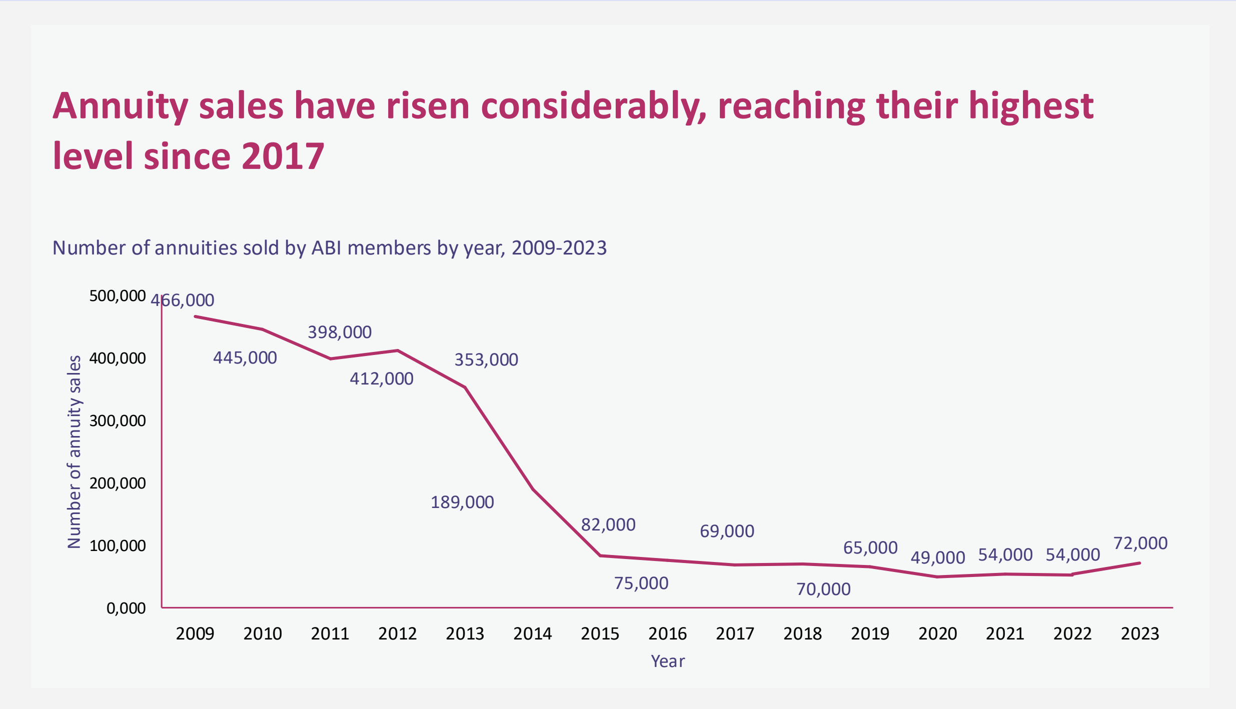
Annuities

Prior to the introduction of the new pension flexibilities in 2015, the majority of people used their DC savings to purchase an annuity as this was the main option available to many savers due to the regulations around how savings could be accessed at the time. In 2012, over 90% of DC assets accessed were used to purchase annuities, and overall sales of annuities peaked in 2009 at around 466,000.[23] Since then, they have been declining.

When pension flexibilities were introduced, annuity sales declined more rapidly, and averaged around 70,000 per year throughout 2016 to 2019. 2020 saw a further sharp decline in annuity sales, with just 49,000 sold over the course of the year, as a result of the pandemic increasing annuity prices, making annuities less attractive, and/or people delaying retirement because of the pandemic's negative effect on their savings. In 2021, annuity sales increased by 10% to 54,000, but remained much lower than pre-pandemic levels. In 2023, annuity sales spiked compared to the previous year, with 72,000 annuities purchased (Chart 2.12).

[22] This list is not exhaustive as the retirement income market is still evolving in light of the new policy.
[23] ABI (2015)

Chart 2.12

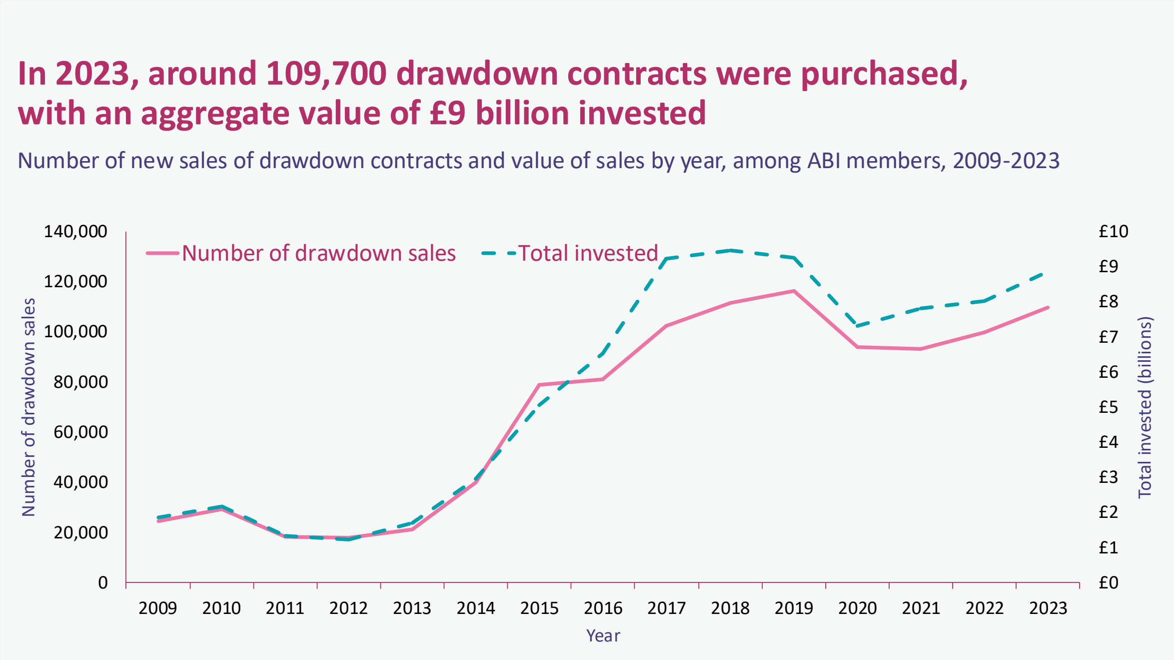


Annuity sales have now increased to pre-pandemic levels, with nearly 20,000 more annuities sold over the course of 2023 than in 2022. This was attributed to falling annuity prices, as the Bank of England continued to raise the base rate to its highest level in recent years (5.25% as of August 2023).

Income drawdown

The use of income drawdown was fairly consistent between 2010 and 2014, with around 20,000 new contracts being purchased each year. In 2014, after the announcement of the pension flexibilities, the number of drawdown sales doubled to almost 40,000 new contracts. Since then, it has been steadily increasing to around 116,000 in 2019. In 2020, however, drawdown sales declined to 94,000, which was linked to the pandemic and associated volatility in investment markets, as was seen with the decline in annuity sales. Annual drawdown sales have since increased into 2023 by around 10% to 109,700 from 100,000 (Chart 2.13).

Chart 2.13[24]

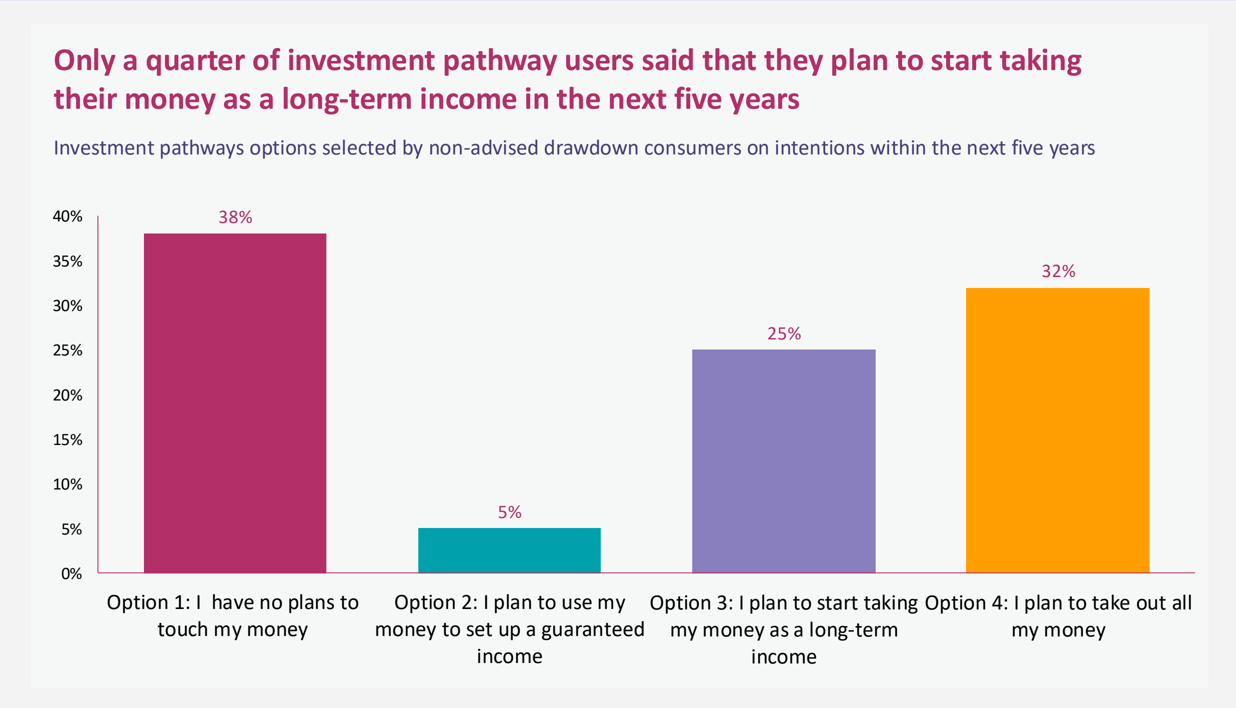


Drawdown investment pathways

As set out in Chapter One (Box 1.7), drawdown investment pathways were introduced in February 2021, and require non-advised drawdown customers to make a decision about how they intend to access their pension pot in the near future, where they will then be given an appropriate investment strategy to meet their aims. Take up of investment pathways among drawdown customers was at 51% in Q1 2024, with 4% instead choosing to self-select their investments, and the remaining 45% opting to stay in current investments. Among those who entered into the investment pathways, the majority selected that they plan to either leave their money invested without taking any income in the next five years or that they plan to withdraw all of their money within this time. Only a quarter said they intended to begin taking a flexible income from their pot within the next five years (Chart 2.14).

[24] ABI data

Chart 2.14[25]



Lump sums

Since April 2015, those aged 55 and over can take partial or full cash lump sums from their DC savings, regardless of the size of their pot. Withdrawals are taxed at the individual's highest marginal rate of income tax, with 25% tax free.[26] The number of full (total pot) lump sum withdrawals was initially high at 300,000 in the financial year 2015/16, due to pent up demand, but decreased to around 252,000 in 2019/20.

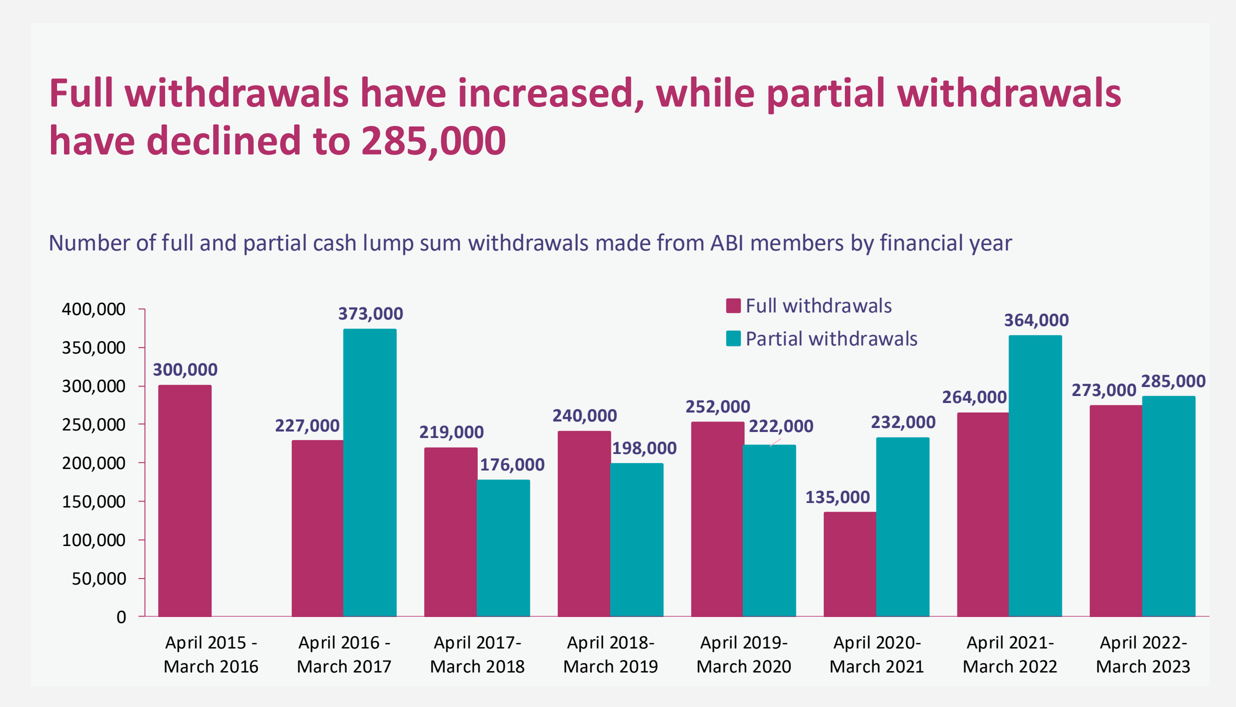
In 2022/23, full withdrawals increased to above pre-pandemic levels at 273,000, while partial withdrawals decreased to 285,000. This resulted from a combination of factors, including savers holding off from accessing their pots during the uncertainty of the pandemic, as well as cost-of-living pressures, and taking an early exit from the labour market as a result of the pandemic causing people to access their pension pots in higher numbers at earlier ages.

In the first half of the 2023/24 financial year, April to September, 160,000 pots were fully withdrawn through a lump sum. Full-year data for 2023/24 is not yet available, but if withdrawal rates remain stable compared to the first half of the year, this would mean an increase to around 320,000 pots fully withdrawn, higher than the number of full withdrawals made in 2022/23.

[25] ABI data

[26] Prior to April 2015, only those with DC pots under £15,000 (increased to £18,000 in 2015) could withdraw their entire pot as a lump sum without incurring a tax penalty.

Chart 2.15[27]



There is still a reasonable amount of variation in the number of withdrawals taken each year, so it is unclear what the overall trend might be over the longer term. This has been further exacerbated by the unpredictability and volatility brought on by the pandemic and the ongoing cost-of-living crisis.

DB transfers

While pension freedoms apply to DC rather than DB pensions, some members of DB schemes are allowed to transfer out of DB and into DC, with their entitlement converted into a Cash Equivalent Transfer Value (CETV). People may choose to transfer from DB to DC in order to be able to access their pension savings flexibly or to feel a greater sense of ownership over their pension savings. While transferring may benefit some people, there are two main risks associated with transfers from DB to DC:

- Individual risk: Where people transfer out of a DB scheme when it is not in their best financial interest.
- Scheme risk: Where substantial transfers out of DB schemes could cause schemes to change or review their investment strategies. However, in some cases, transfers out could help scheme funding through the reduction of ongoing liabilities.

While DB transfers increased following the introduction of pension flexibilities, they have since begun to decline. The number of DB to DC transfers reduced from 26,600 in 2021/22 to 18,000 in 2022/23.[28] Because of the risks associated with accessing DC savings, high numbers of DB transfers raise concerns that some savers could experience poorer retirement outcomes as a result of transferring. The Financial Conduct Authority (FCA) has increased guidance for those advising on DB transfers in order to support better retirement outcomes. Now, anyone transferring a DB entitlement worth £30,000 or more is required to take regulated advice before doing so, and there are a diminishing number of advisers willing to help, given the liability to recourse.

[27] ABI data
[28] FCA Retirement income market data 2022/23

Advice and guidance

Because of the complexity of decisions about how to access DC savings, people may need to access guidance and/or advice to support them in making choices to achieve positive retirement outcomes. The introduction of the new pension flexibilities in 2015 has impacted the market for advice and guidance in a variety of ways:

- Some people who previously would have bought an annuity will choose to access pension savings through other means, such as drawdown. Some of these people may use advisers at and during retirement to help manage more flexible access methods.
- DC pension scheme members are now eligible for £500 of tax-free employer-arranged advice, if their employer chooses to provide this, and may take £500 from their pension pots up to three times to pay for advice. However, very few employers actively offer this.
- Some organisations offer online "robo-advice", which is aimed at people who would benefit from advice but may not have access because they cannot afford or believe they cannot afford, regulated financial advice. Online advice uses algorithms to help answer money-based questions and should allow advice to be offered more quickly and cheaply.
- The introduction of pension flexibilities was accompanied by a new, national guidance service known as "Pension Wise". Pension Wise offers free independent guidance (online, by telephone or face-to-face) to those aged 50 or above with DC savings (Box 2.3). Pension Wise has since merged with two other guidance providers, The Pensions Advisory Service (TPAS) and the Money Advice Service (MAS), to form a single guidance body, the Money and Pensions Service (MaPS), which provides guidance on pensions and other financial issues under the umbrella of MoneyHelper.

Box 2.3: Take up of Pension Wise guidance[29]

During the 2023/24 financial year:

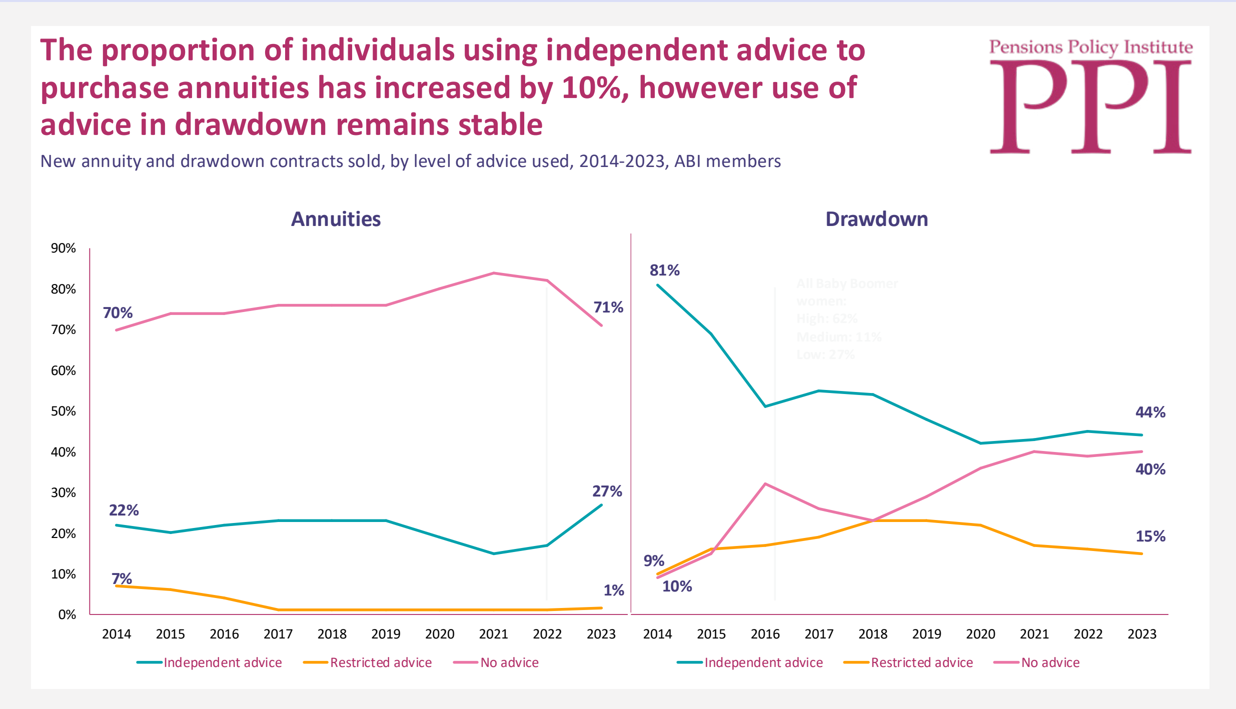
- There were around 11,000 face-to-face appointments, compared to 8,000 in the previous year.
- There were around 170,000 telephone appointments, compared to 163,000 in 2022/23. Pre-pandemic, there were 50,300 telephone appointments in 2019/20. The rapid growth in telephone appointments was largely attributed to the removal of face-to-face appointments at the time. However, as face-to-face appointments have returned, though still well below pre-pandemic levels, telephone appointments have continued to increase.
- There is a significant gap between the number of appointments arranged and appointments attended, both for face-to-face and telephone. In 2023/24, around 76% of face-to-face appointments and 65% of telephone appointments arranged were attended.
- In addition to appointments, there were around 78,400 self-serve journeys completed via the Pension Wise website, compared to 72,600 in 2022/23.
- In Q3 2023 Pension Wise had a 94% customer satisfaction rate among those who had telephone appointments, and an 80% satisfaction rate among those who completed a self-serve journey. 93% of telephone customers and 84% of self-serve customers were likely to recommend the service.

[29] https://maps.org.uk/moneyhelper-pension-take-up-dashboard/ These figures differ from those reported in previous editions of The DC Future Book as previously data was only publicly available on the number of appointments arranged, which is higher than the number actually attended. This year's edition uses attendance data which is available alongside arranged data on the MaPS website.

New regulations came into force from 1st June 2022 that require pension providers to give members accessing their pension pots a 'stronger nudge' towards Pension Wise's guidance services, including offering to book a Pension Wise appointment on the member's behalf.[30] As this is still a relatively new policy, it remains to be seen how substantial the impact will be on the uptake of Pension Wise appointments, especially as behaviour remains unstable as a result of the pandemic and ongoing cost-of-living crisis.

The number of people seeking independent advice when buying annuities has increased substantially
Following the introduction of pension flexibilities in 2015, the use of regulated advice declined among those purchasing a drawdown product but remained relatively stable at a low level for those purchasing an annuity. Since 2018, non-advised purchase has grown among both annuity and drawdown customers. However, 2023 saw a substantial increase in the proportion taking independent advice, from 17% to 27% for annuities, but the use of regulated advice in drawdown remained broadly stable, from 61% to 59% (Chart 2.16).

Chart 2.16[31]



Purchasing retirement income products without the use of advice or guidance increases the risk that individuals will make sub-optimal decisions for meeting their income needs in retirement. An increase in the proportion of annuity and drawdown customers taking advice has the potential to improve retirement outcomes.

[30] DWP (2022a)
[31] ABI data

Conclusions

Automatic enrolment has continued to bring more savers into pensions
By June 2024, 11.1 million employees were automatically enrolled, with more than a million now having been automatically re-enrolled. The number of employees found ineligible for automatic enrolment has also continued to grow, to 11.2 million by June 2024, so further reforms may be needed if the goal is to bring more people into pension saving.

Contribution rates remain around the minimum, but average DC pot sizes continue to grow
Both employee and employer contribution rates have remained stable in line with the minimum mandated amount. This rate of saving is unlikely to deliver adequate and sustainable later-life outcomes, but increases to minimum rates must consider the potential for increased opt outs as a result.

While average DC pot sizes declined in the early years of automatic enrolment, they started to increase between 2018 and 2019. In 2023, the average DC pot size reached £12,700.

Trends in access to DC savings have not yet returned to pre-pandemic levels
Annuity sales spiked in 2023 compared to 2022, increasing back to pre-pandemic levels. Drawdown sales increased by around 10% between 2022 and 2023, but remain below pre-pandemic levels.

Drawdown investment pathways have begun to embed within the pensions landscape, with 49% of drawdown customers entering the pathways. Only a quarter of those entering the pathways say they plan to start taking a flexible income from their pot within the next five years, with most saying they either have no plans to touch their money (38%) or plan to fully withdraw their pot (32%) in this period.

[33] https://maps.org.uk/moneyhelper-pension-take-up-dashboard/ These figures differ from those reported in previous editions of The DC Future Book as previously data was only publicly available on the number of appointments arranged, which is higher than the number actually attended. This year's edition uses attendance data which is available alongside arranged data on the MaPS website.
[34] DWP (2022a)

Chapter Three:

How might the DC landscape evolve in the future?

Chapter three: How might the DC landscape evolve in the future?

This chapter uses PPI modelling to explore how the Defined Contribution (DC) landscape might evolve in the future both for individuals and on an aggregate level.

The evolution of the DC market depends on many factors

Previous chapters have set out the current state of the DC market and outlined the factors which are likely to lead to changes in the future, including:

- automatic enrolment,
- the shift from Defined Benefit (DB) to DC pension provision in the private sector,
- the use of pension flexibilities, and
- changes to the way that advice and guidance are utilised and delivered.

The way that the DC market evolves in the future will also depend on how individuals respond to policies such as automatic enrolment and pension flexibilities, as well as external factors such as employer behaviour and the performance of the overall economy.

Box 3.1: Explanation of the modelling

This chapter uses the PPI suite of models and data from the Office for National Statistics' (ONS) Wealth and Assets Survey (Round 7), to explore how DC assets may change and grow in the future under the assumption that current trends continue. The chapter also sets out the potential distribution of DC assets, under a range of possible future economic scenarios, and based on historical data.

The future value of DC assets depends on many variables:

- Employee behaviour – participation and contribution levels
- Employer behaviour – contribution levels, scheme choice, remuneration decisions
- Industry behaviour – charges, investment strategies, default offerings, new scheme development (e.g., Collective Defined Contribution (CDC) schemes)
- Economic, demographic and financial market effects – market performance, interest rates, inflation, and the age and size of the working population.
- Policy changes – taxation, changes to minimum pension age, introduction of new scheme types, or a policy of auto-escalation and/or opting down of contributions under automatic enrolment.

The model outputs should be viewed as an illustration of a range of potential scenarios arising from current trends, and not a prediction of the future.

The following analysis explores how a continuation of current trends in DC saving could affect the membership numbers and the aggregate value of DC scheme assets in the next 20 years.

How might scheme membership develop in the future?

Under automatic enrolment, employers could choose to use their existing workplace pension provision as long as it qualified under the automatic enrolment regulations. Those without existing provision, or who wished to change their offering for new or existing members, had the choice to set up and run a DB, DC or Hybrid/risk-sharing scheme themselves, or to offer membership in a DC scheme run by a third party. Some employers offer a combination of these.

Box 3.2: Assumptions

The following analysis is based on the assumptions that:

- All eligible workers are automatically enrolled and 15% opt out or cease contributing after the opt-out period has expired, before accruing meaningful amounts of assets.

Of newly enrolled workers:

- 80% are enrolled into a master trust scheme
- 20% are enrolled into a non-master trust, automatic enrolment DC scheme[32]

The displacement of members, leaving one type of scheme and entering another (as a result of movements in and out of the labour market, or between jobs) results in roughly the same proportions of the workforce in different types of schemes. New members of DC schemes, who may be leaving DB schemes or be newly automatically enrolled, are split in the proportions outlined above between automatic enrolment and workplace DC schemes which pre-dated automatic enrolment.

By 2044, there could be 10.6 million people actively saving in master trust schemes, and 14.9 million active DC savers overall

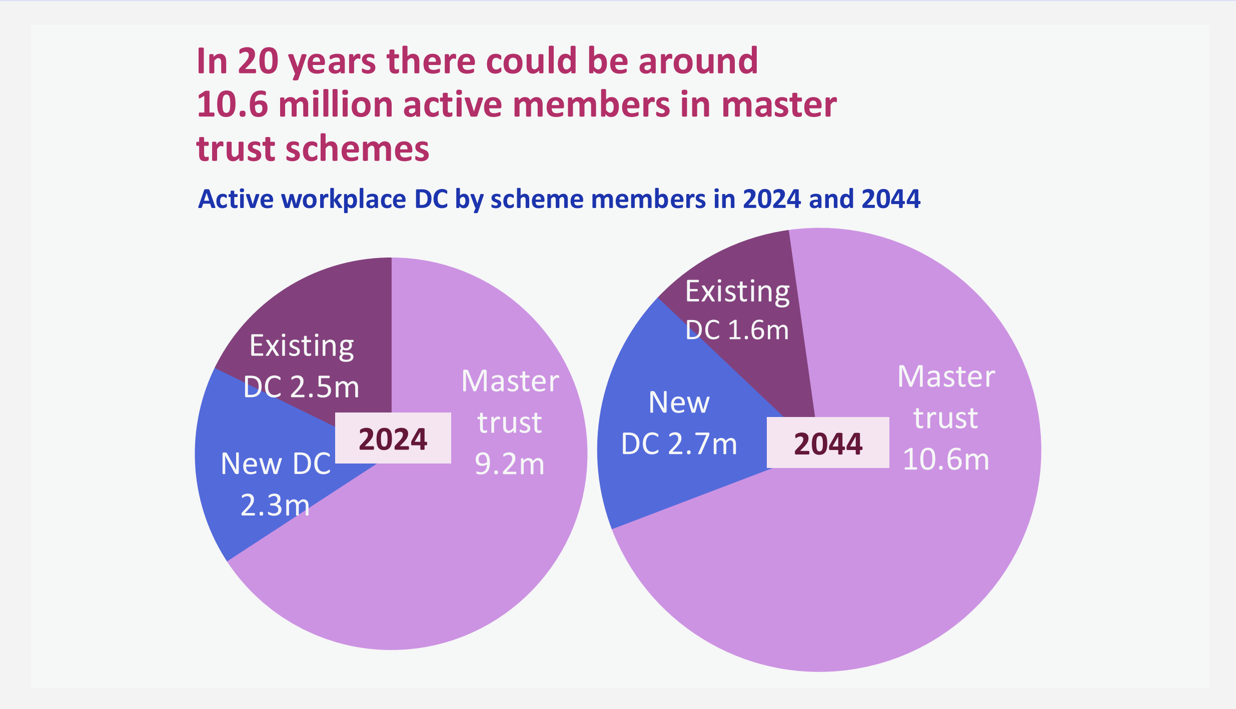
In 2024, there are around 14 million active members in DC workplace pension schemes. Around 9.2 million of these are in master trusts, around 2.5 million are in DC schemes which existed prior to automatic enrolment, and around 2.3 million are in new DC schemes created subsequent to automatic enrolment (but which are not master trusts).[33]

Assuming current trends in scheme allocation continue, by 2044 there could be around 14.9 million active members in DC workplace pension schemes, with around:

- 10.6 million in master trust schemes,
- 1.6 million in DC schemes which pre-dated automatic enrolment, and
- 2.7 million active members in other automatic enrolment DC schemes (Chart 3.1).[34]

[32] Based on information about scheme allocation from The Pensions Regulator (TPR) – does not account for opt-ins or ineligible workers who are automatically enrolled.
[33] PPI Aggregate Model
[34] PPI Aggregate Model

Chart 3.1[35]



Box 3.3: Assumptions

The following analysis is based on the assumptions that:

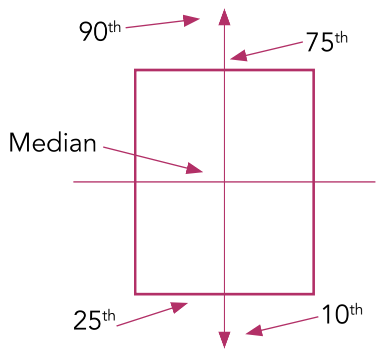
- Those currently saving into a workplace DC pension (trust- or contract-based) continue saving at their current level and continue contributing, with their employer, in the same proportions.
- Those who are not currently saving, but are eligible, are automatically enrolled and do not opt out.[36]
- Before charges, investments yield a nominal average annual investment return of 6%.[37]
- Earnings increase by 3.5% on average per year over the course of the projection.[38]
- Annual Management Charges (AMCs) range between 0.5% and 0.75% depending on scheme type. These are the member-borne charges, including administration and investment costs.

Economic assumptions are based on Office for Budget Responsibility (OBR) projections appropriate to the projection period.[39]

[35] PPI Aggregate Model
[36] It is expected that a proportion of people will opt out of automatic enrolment; reasons for doing so are specific to each person and difficult to predict. While the aggregate modelling approach allows us to make a blanket assumption across the population, the modelling presented in this section is based on analysis of individuals, making it difficult to accurately predict who would and who would not opt out. The modelling instead presents the potential savings under the current automatic enrolment system.
[37] A blend of OBR returns based on an asset mix to represent typical pension portfolios. The long-term economic assumptions are based on the OBR Fiscal Sustainability Report (FSR) (July 2020)
[38] Based on OBR projections from the EFO (2023)
[39] See the appendix for further detail on assumptions

Box 3.4: Box plots

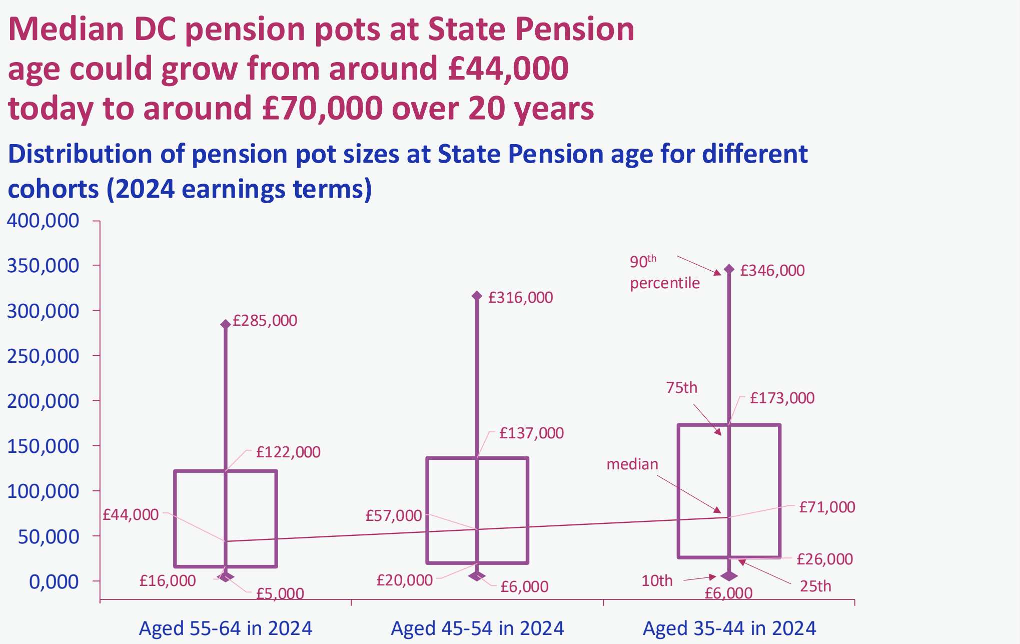
Box plots allow graphic representation of a distribution of outcomes. The rectangle represents the 25th to 75th percentiles of the distribution, while the ends of the vertical line represent the 10th and 90th percentiles. The horizontal line through the middle of the box represents the median.



Median DC pension pots at State Pension age (SPa) could grow from around £44,000 to around £70,000 over 20 years

Assuming that those currently contributing to a pension fund with their employer continue to do so, the median DC pension pot size at SPa could grow over the next 20 years from around £44,000 (for those aged 55 to 64 in 2024) to around £70,000 (for those aged 35 to 44 in 2024), all in 2024 earnings terms (Chart 3.2).

Chart 3.2[40]



[40] PPI Aggregate Model

The low average levels of DC pension savings that people will accrue over the next few decades means that many will be mainly dependent in retirement on income from the State Pension, State benefits and any DB pension, or non-pension savings, they have.

How might the aggregate value of private sector DC assets grow in the future?

The following section explores how the aggregate value of DC assets might grow based on certain assumptions about employee and employer behaviour, and under a range of potential future economic performance scenarios.

Box 3.5: Assumptions

The following analysis is based on the assumptions that:

- All eligible employees are automatically enrolled and existing savers remain saving.
- 15% of automatically enrolled savers opt out or cease contributing, before accruing any meaningful assets.
- Employee/employer contributions vary by scheme type:
  - Those in master trusts and other automatic enrolment DC schemes make contributions with their employers based on band earnings.
  - Existing savers continue contributing at the same rates, on total earnings (if applicable).
- Investment scenarios are a product of the PPI's Economic Scenario Generator (ESG), which uses data from Bloomberg. Long-term median rates are taken from the OBR's FSR.
- Median nominal investment return is dependent on pension scheme and varies between 5.5% and 6%.[41]
- AMCs vary by scheme.

Economic assumptions are based on long-term OBR projections appropriate to the projection period.

By 2044, aggregate assets in DC schemes could grow to around £1.3 trillion

Assuming that current trends continue, the aggregate value of private sector workplace DC assets could grow from around £650 billion in 2024 to around £1.3 trillion in 2044. The aggregate value of assets is sensitive to economic performance. If the market performs very poorly, DC assets could stagnate, reaching around £912 billion by 2044., but in a very positive market performance scenario, DC assets could grow to around £1.8 trillion by 2044 (Chart 3.3).

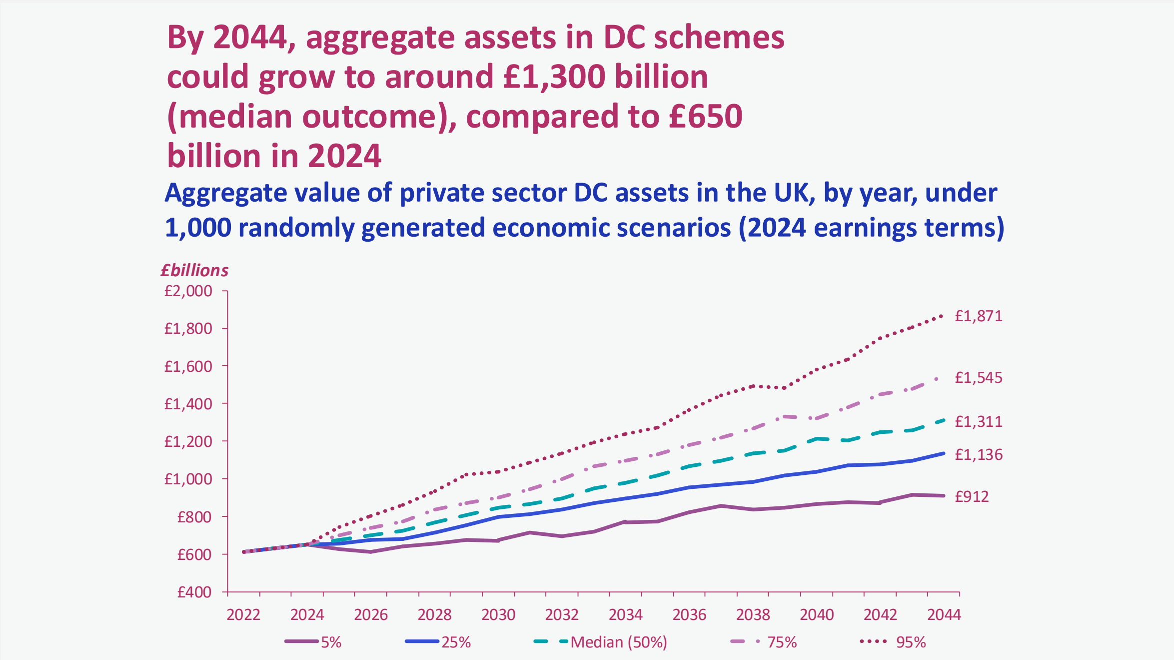
[41] A blend of OBR returns based on an asset mix to represent typical pension portfolios. The long-term economic assumptions are based on the OBR FSR (July 2020).

Box 3.6: Percentiles

The following chart illustrates how a range of economic scenarios could affect the value of DC assets. The values are shown in terms of the likelihood that they will occur:

- The 5% line represents the very poor performance end; in the modelling only 5% of outcomes were worse than presented by this line.
- The 95% line represents the very good performance end; in the modelling only 5% of outcomes were better than presented by this line.
- The 25% and 75% points represent a 25% probability of relatively poor or relatively good performance respectively.
- 50% (median) is the central projected outcome, based on past performance.

Chart 3.3[42]



Employee and employer behaviour, and Government policy will all affect the aggregate value of DC pension schemes in the future

The aggregate value of private sector workplace DC schemes will vary, not just as a result of economic fluctuations, but also as a result of employee and employer behaviour, and Government policy. There are a wide range of possible changes in market conditions, pensions policy and saving behaviour that could materialise in future, and each would have a different effect on the aggregate value of DC assets and the value of a member's pot at retirement.

[42] PPI Aggregate Model: refer to the Technical Appendix for more details on the methodology

Conclusions

- In 20 years, there could be 10.6 million active members in master trust schemes, and 14.9 million active DC savers overall.
- Median DC pension pots at SPa could grow from around £44,000 today to around £70,000 over the next 20 years.
- By 2044, aggregate assets in DC schemes could grow to around £1.3 trillion, from the 2024 value of £650 billion. Investment performance, employee and employer behaviour, the economic and demographic backdrop, and Government policy will all affect the aggregate value of DC pension schemes in the future.

Chapter Four:

The past and future 10 years of DC pensions

Chapter Four: The past and future 10 years of DC pensions

This chapter explores the landscape of Defined Contribution (DC) pensions over the past 10 years, what the DC landscape could potentially look like over the next 10 years, and the impacts of previous and future policy changes on DC savers.

The past decade has seen multiple changes to the DC landscape, with some trends that have occurred over the last 10 years including:

- the shift in responsibility for managing risks associated with private pension saving, from employer to member;
- the acceleration of automatic enrolment and increased coverage among employees;
- the rise of master trusts as the dominant provider for new members;
- a focus on 'value for money' (VFM) resulting in lower member borne fees; and
- in recent years, a focus on diversifying investments within DC schemes.

All of these changes have impacted the DC landscape in different ways. The next 10 years' policy changes and market developments are likely to focus on these key areas:

- Managing risks
- Developing investment
- Greater use of technology
- Managing retirement income

Over the past two decades, responsibility for the risks associated with private pension saving have moved from the employer to the member

The decreasing affordability and increased risk of Defined Benefit (DB) schemes has led to a decline in their provision within the private sector

DB schemes within the private sector have been in decline due to their decreased affordability for employers in recent years. DB schemes reached their peak of around eight million active private sector members in 1967; however, there are currently only around 700,000 active members in private sector DB schemes, according to the latest available data (2023).[43]

DB schemes promise a specific retirement income based on salary and years of service, which is inflation-protected and guaranteed for life, placing responsibility for both investment risk and longevity risk on the employer.

Over recent decades, increased life expectancy, low interest rates, and volatile financial markets have made it increasingly difficult for private sector DB schemes to meet these guaranteed payouts without facing substantial financial burdens. This prompted many private sector employers to close existing DB schemes to new members or stop accruing benefits altogether. As a result, only about 9% of private sector DB schemes remain fully open, paving the way for the rise of DC schemes, which transfer the investment risk to employees and offer greater predictability for employers.[44]

[43] PPF (2023) The Purple Book

[44] PPF (2023) The Purple Book. However, high levels of DB provision continue within the public sector, with 7.7 million active members in 2023.

The growth in DC provision has led to more members bearing pensions risks

The introduction of automatic enrolment in 2012 has significantly increased pension participation and accelerated the growth of DC schemes; as the majority of employers have opted to offer access to DC schemes.

Automatic enrolment has resulted in 14 million active members in DC schemes, compared to only 4.6 million a decade ago when the Future Book was first published.[45] This rise in the number of DC savers therefore means that more people are bearing the investment and longevity risks of DC.

The shift from DB to DC schemes, coupled with the decline in DB provision, will have several significant impacts on future retirees' incomes:

- Variability in retirement outcomes: Retirement income levels will vary widely among individuals, influenced by personal savings habits, investment and access choices, and market conditions.
- Longevity risk: Retirees in DC schemes bear the risk of outliving their savings, lacking the lifetime income guarantee provided by DB pensions unless they purchase an annuity.
- Individuals will need to make informed choices: DC schemes require individuals to make complex decisions about contribution levels and access.

The number of master trusts have increased since the introduction of automatic enrolment

This rise in need of DC schemes has also seen the rise of master trusts. Master trusts provide schemes that can be used by many unrelated employers and their employees. There are currently 36 master trusts authorised to operate in the UK market.[46] Some of the advantages of master trusts include:

- Economies of scale: Master trusts pool the resources of many employers, which allows them to achieve economies of scale.
- Simplified compliance: For many small and medium-sized employers, setting up and maintaining a compliant pension scheme can be complex and costly. Master trusts aim to simplify this process by providing a ready-made, compliant solution, helping employers meet their automatic enrolment obligations without incurring significant additional costs.
- Enhanced governance and oversight: Since the Pensions Schemes Act 2017, master trusts are subject to stringent regulatory standards and governance requirements set out by The Pensions Regulator (TPR).[47] These regulations ensure minimum governance standards, which aim to provide greater security and confidence to employees enrolled in these schemes.

Master trusts emerged as a popular solution to accommodate the increased demand for workplace pensions after the introduction of automatic enrolment. They have facilitated the growth of DC schemes by providing an easy-to-use, cost-effective solution. However, the true cost-effectiveness of master trusts is complex, and should be evaluated not just on administrative efficiency, but also on their investment returns and quality of services they provide. While master trusts are designed to reduce costs through economies of scale, it is important to consider whether these savings are passed on to members through improved investment performance and lower fees. Indeed, there is a material variance in the investment performance and volatility amongst master trusts' propositions. Additionally, the quality of member services, such as communication and retirement planning support, plays an important role in determining the overall value provided by master trusts. Despite their advantages, no single solution in the pensions industry, including master trusts, fully meets all member needs. Given that master trusts hold responsibility for the future retirement incomes of many of today's workers, regulation in this area remains critically important.

[45] PPI (2015) The DC Future Book
[46] TPR (2023) List of authorised master trusts
[47] TPR (2018) Authorisation and supervision of master trusts
https://www.thepensionsregulator.gov.uk/en/document-library/code-of-practice/master-trust-authorisation

One potential future risk mitigation option for master trusts could be transitioning to a Collective Defined Contribution (CDC) scheme. CDC schemes pool contributions in a collective fund, and pay retirement benefits from the pool, meaning investment and longevity risks are shared among all scheme members. This approach is designed to provide members with more predictable outcomes, as opposed to DC schemes which require members to bear more market risks. However, the first single-employer CDC scheme in the UK has yet to open and significant development would need to take place before multi-employer CDC schemes could operate within the UK.

Consolidation among DC schemes has begun to gain traction

The DC market is large and diverse, with a multitude of small schemes, many having limited assets under management (AUM). As of 2023, there are 26,990 DC schemes, and 25,700 have fewer than 12 members.[48] These smaller DC schemes often lack the economies of scale needed to access more sophisticated and potentially higher-return investment options, such as private equity or infrastructure investments.

Consolidation within the DC market is a goal of TPR, the Department for Work and Pensions (DWP) and the Financial Conduct Authority (FCA). In the past decade, the DC pension market has consolidated by nearly 40% in the latest available data (2022).[49]

The plans set out by TPR aim to protect savers' money, enhance the pension system and innovate in savers' interests over the next three years.[50] The main aim of the proposed plan is to have a landscape of fewer, larger pension schemes that deliver better outcomes for savers. The developing VFM Framework is also intended to further support consolidation.

Individual risks increased with the introduction of the pension freedoms

In the 2014 Budget, the Government announced that, from April 2015, individuals would be able to flexibly access their DC pension savings from the age of 55 with no requirement to buy an annuity, subject to income tax at their marginal rate on amounts exceeding the 25% tax-free lump sum. As a result, DC savers are now able to choose from different retirement income options, including flexible drawdown and lump-sum withdrawals. In 2013, 353,000 annuities were sold, while only 72,000 were sold in 2023, reflecting an overall downwards trend.[51]

However, while pension freedoms offered more choice, they also increased the responsibility on individuals to make informed and often complex financial decisions. The removal of the annuity requirement meant that retirees had to actively decide how to access and manage their pension funds. Since members now must make important decisions, careful planning and awareness to avoid potential pitfalls, such as depleting savings too quickly or failing to secure adequate income for the long term, is needed. Advice and guidance is crucial in ensuring members make informed decisions, which will be explored in the next page.

The introduction of pension access flexibility saw a rise in popularity of income drawdown plans

Following the removal of the effective requirement to purchase annuities, income drawdown plans gained popularity as an alternative approach to DC decumulation.

The shift from annuitisation to drawdown and other flexible income options was significant. Table 1 shows the figures which highlight the decrease in number of annuities sold and increase in number of income drawdown plans sold in 2015 compared to 2023.

[48] TPR (2023) DC trust: scheme return data 2022 to 2023 https://www.thepensionsregulator.gov.uk/en/document-library/research-and-analysis/dc-trust-scheme-return-data-2022-2023
[49] TPR (2022) DC trust: scheme return data 2021 to 2022 https://www.thepensionsregulator.gov.uk/en/document-library/research-and-analysis/dc-trust-scheme-return-data-2021-2022
[50] TPR (2024b) Driving consolidation and better saver outcomes at the heart of TPR's corporate planhttps://www.thepensionsregulator.gov.uk/en/media-hub/press-releases/2024-press-releases/driving-consolidation-and-better-saver-outcomes-tpr-corporate-plan
[51] ABI data

Table 1

	Number of annuities sold by Association of British Insurers (ABI) members	Number of new sales of drawdown among ABI members
First edition of the DC Future Book (2015)[52]	82,000	40,000
Tenth edition of the DC Future Book (2024)[53]	72,000	109,700

Financial advice and guidance are necessary in mitigating potential negative outcomes as a consequence of increased freedom and choice, however default investment pathways seek to lessen the burden

The introduction of pension flexibilities led to the creation of a new, national impartial guidance service known as "Pension Wise". Pension Wise offers free and independent guidance online, by telephone or face-to-face, to those aged 50 or above with DC savings. Alongside Pension Wise, help is available to savers of all ages through the Government sponsored "Money Helper" service.

Many users report their experiences with Pension Wise as being highly positive, with 94% of customers who completed appointments claiming they were satisfied.[54] However, despite their positive reviews, uptake remains low. Only 18% of people accessing their DC savings for the first time do so after a Pension Wise appointment. This suggests that many individuals are navigating their retirement options without seeking available guidance that could help them make more informed decisions.

One might expect that a low use of impartial guidance may mean that many people accessing DC savings are using regulated advice, however, there has been a decline in the uptake of financial advice among pension savers.

The percentage of annuity customers using advice has always been considerably low, however the percentage of drawdown customers using advice has seen a steady decline. Table 2 shows the figures which highlight the changes in the use of advice and guidance whilst accessing decumulation options, as set out in Chapter Two.

Table 2

	Percentage of annuity customers using advice	Percentage of drawdown customers using advice
First edition of the DC Future Book (2015)[55]	22%	81%
Tenth edition of the DC Future Book (2024)[56]	29%	60%

[52] PPI (2015) The DC Future Book
[53] ABI data
[54] DWP (2017) Pension Wise service evaluation
https://assets.publishing.service.gov.uk/media/5a81cb85e5274a2e8ab55dd9/pension-wise-service-evaluation-full-year-findings.pdf
[55] PPI (2015) The DC Future Book
[56] PPI (2024) The DC Future Book

Increased freedom and choices surrounding DC saving means savers need to make informed decisions, which are difficult to make without support, even for those with high financial literacy. However, for those who cannot actively choose their investments, default investment pathways have been introduced. These pathways are specifically designed for pension savers who have opted for drawdown, providing a structured investment strategy based on the saver's chosen retirement age and risk profile. The goal is to try streamline decision-making and protect against poor outcomes for members who prefer not to engage in detailed investment choices.

However, it's important to recognise that default investment pathways are not universally suitable. Individual circumstances can vary significantly, and some savers may need more tailored strategies to meet their specific needs and goals. While default pathways offer a structured approach, savers who opt out or choose to actively manage their investments assume greater individual responsibility for risk.

Drawdown may not be the right choice for everyone. The current system lacks an overarching default option for those reaching retirement, meaning that individuals must actively decide their decumulation strategy. In response, the previous Government wanted to require all pension schemes to offer a default decumulation option.[57] However, this forthcoming default option, like drawdown, may not be suitable for all savers. In 2022, it was announced that the FCA and the Government would commence a joint review to examine the regulatory boundary between financial advice and other forms of support. The Advice Guidance Boundary Review aims to clarify and improve the support available to those reaching State Pension age (SPa) whilst they navigate so much choice.

Recent focus within DC pensions has been on improving investments

After the introduction of automatic enrolment, schemes have focused on cost efficiency within investments

Automatic enrolment mandated that employers enrol eligible workers into a qualifying pension scheme, leading to a surge in DC scheme membership. Faced with the challenge of enrolling millions of new members, many of whom had little previous pension savings, and in response to Government messaging and regulations (including the charge cap), schemes prioritised cost efficiency.

To achieve cost savings, DC schemes turned to low-cost investment options, generally listed bonds and passively managed equities. While low-cost investments reduce expenses, they typically do not offer the potential for high returns or volatility management that actively managed funds or some more costly alternative assets might provide.

The previous Government's focus was on extending the concept of VFM to a more holistic definition. This includes a greater focus on returns and volatility management within investment, accompanied by work intended to better enable schemes to invest in more sophisticated and expensive assets.

DC schemes are increasingly considering the role of illiquids, alternative assets and private markets in their investment strategies

Traditionally, DC schemes relied heavily on conventional investment approaches, which consisted of equity and bond portfolios. These traditional strategies aimed to deliver steady returns while managing downside risks. However, as the investment landscape evolved and market and regulatory dynamics shifted, DC schemes have begun to explore alternative approaches to meet the changing needs and preferences of investors and members. More schemes are considering the use of alternative and private market assets, and the DC assets allocation survey has revealed increased allocations to asset classes such as infrastructure, private equity, and real estate, aimed at diversifying portfolios and enhancing long-term returns.[58]

[57] DWP (2023c) Helping savers understand their pension choices: supporting individuals at the point of access: consultation response https://www.gov.uk/government/consultations/helping-savers-understand-their-pension-choices-supporting-individuals-at-the-point-of-access/outcome/helping-savers-understand-their-pension-choices-supporting-individuals-at-the-point-of-access-consultation-response#chapter-5-defaults
[58] BlackRock (2023) Rethinking DC Default Strategies - The role of Private Markets

The infrastructure around DC schemes, as well as their size, makes it harder to invest in illiquids

The infrastructure around DC schemes, in the form of investment platforms and administrative services, have traditionally been built to cater to cheaper, daily-traded, and daily-valued assets. This emphasis on liquidity and low-cost management has its roots in the need to manage large volumes of transactions efficiently and to provide members with the ability to track their pension values on a daily basis. Daily pricing and trading allow for straightforward administration and ease of switching between funds, which are attractive features for both members and administrators.[59] However, this structure favours investments in assets that can be quickly and easily traded, such as equities and bonds listed on public markets, over less liquid investments like private equity, infrastructure, or real estate, which can potentially offer higher returns and better volatility management, but require longer investment horizons and more complex administration.

There are some regulatory changes ongoing to address these issues. For example, the DWP has been exploring ways to encourage DC schemes to invest in a broader range of assets, including illiquid and alternative investments, through easing charge cap regulations and introducing initiatives such as Long-Term Asset Funds (LTAFs), new, open-ended FCA-authorised investment funds.[60] In another ten years, it will be very interesting to see how investment has developed as a result of regulatory changes, consolidation and increases in scale.

The recent Mansion House Reforms seek to increase investment in productive assets

The Mansion House Reforms, announced by the previous Government in 2023, seek to increase investment in long-term, productive assets such as private equity and infrastructure, with the aim of bolstering economic growth and sustainability. This initiative is part of a broader effort to enhance the way DC pension schemes invest member contributions, incorporating environmental, social, and governance (ESG) factors, and exploring the potential of illiquid and alternative assets to diversify and enhance returns.

A central component of these reforms is the Mansion House Compact, which calls on UK DC schemes to commit to investing 5% of their AUM into unlisted equities by 2030, with the aim of "boosting British businesses". This target, if met by all DC schemes, would represent an investment value of around £50 billion. The previous Government believed that increasing investment in UK private equity will benefit savers through greater returns and support the UK economy by fostering growth in domestic companies. Currently, there are 11 scheme signatories to this Compact, including notable names such as Border to Coast, NEST, and USS. These schemes are exploring how increased Government involvement in scheme investing and further investment in UK private equity could impact pension schemes and their members.

The proposed shift towards investing in productive finance, specifically private equities focused on creating business and infrastructure, aims to open up new avenues of funding for critical projects. This strategy aligns with the objectives of DC schemes to secure sustainable and robust investment outcomes for their members. However, the impact of these reforms remains uncertain and several important questions arise.

A central concern is how a focus on benefiting the UK economy aligns with schemes' duties to act in the best interests of their members. Pension schemes are primarily obligated to prioritise the financial wellbeing of their members, and this responsibility must be carefully balanced against broader economic objectives. Another critical issue is the long-term political, economic, and systemic consequences of allowing the Government to direct pension scheme investments. Increased Government influence over pension investments could have far-reaching implications, including potential conflicts of interest and reduced autonomy for pension schemes.

[59] PPI (2019) DC scheme investment in illiquid and alternative assets
https://www.pensionspolicyinstitute.org.uk/media/hpqfg3gc/20190325-dc-scheme-investment-in-illiquids-high-res.pdf
[60] FCA (2023) FCA authorises first Long-Term Asset Fund
https://www.fca.org.uk/news/press-releases/fca-authorises-first-long-term-asset-fund

Additionally, there are questions about how increased investment in UK private equity will affect scheme returns and member retirement incomes. While private equity investments offer the potential for higher returns, they also come with higher risks and potential volatility. It is important to assess whether the potential benefits outweigh these risks. Lastly, the impact of further scheme investment in UK private equity on the broader UK economy needs to be evaluated. Increased funding for domestic companies could drive economic growth, but the overall effect on GDP and individual living standards must be carefully assessed to ensure that these investments deliver the intended economic benefits.

The current Government appears to be continuing and building upon these initiatives. As of July 2024, the Government launched a pensions review, which aims to focus on boosting investment and increase pension savings.[61]

While the Mansion House reforms are intended to deliver potential benefits, they also present several challenges. Shifting towards investments in long-term productive assets necessitates re-evaluating investment strategies and risk management approaches within DC schemes, and it is also important to balance the pursuit of higher returns with effective risk mitigation, in order to safeguard members' interests. Policymakers must navigate these complexities thoughtfully to ensure that the Mansion House reforms achieve their intended goals, without exposing DC scheme members to undue financial risks.

The importance of ESG integration in DC scheme investment strategies has increased over the years

In recent years, the financial consideration of ESG factors has emerged as a significant influence on investment decisions within DC schemes. Metrics designed to measure the ESG credentials of companies are used to provide evaluations of environmental impact, social responsibility, and corporate governance practices, providing investors with insights into the potential financial impact of these factors on long-term investments.

In October 2019, a legal requirement was placed on pension scheme trustees to set out within their Statement of Investment Principles (SIP) how they take account of ESG considerations. As a result, there has been increasing pressure for providers to consider ESG factors in default investment strategies. This increasing awareness is highlighted in the 2023 DC Asset Allocation survey. Respondent schemes were asked to 'rate the importance of the following considerations in managing your scheme's Environmental, Social and Governance', and all respondents recognised the importance of ESG factors in managing their scheme's investment risks, with 92% saying that environmental and governance factors were very important.[62]

Due to issues surrounding provision and reliability of data, integrating ESG into DC scheme investments can prove difficult.

Although integration of ESG factors has increased, it hasn't come without its challenges, mainly in relation to data. DC schemes face challenges due to the large quantity and inconsistent quality of information available on ESG risks and approaches. Approximately a quarter of schemes report that the abundance of information and its inconsistent quality make it difficult to approach ESG risks effectively.[63] Despite growing knowledge and understanding of ESG factors across the industry, significant gaps remain, particularly in understanding social factors. The broad scope and qualitative nature of social factors, coupled with the difficulty in evaluating social risks and opportunities, complicate their integration into investment strategies. Additionally, issues related to ESG data, such as availability, cost, and divergence between different metrics,

[61] GOV UK (2023) Chancellor vows 'big bang on growth' to boost investment and savings
[62] PPI (2023) The DC Future Book
[63] PPI (2021) Engaging with ESG: Environmental, social, and governance factors

pose additional challenges, with consistent and clear data on social factors lacking a common framework.

Many pension schemes depend on their pension provider or external asset managers to conduct research, assessments, and engagement. This reliance means that scheme decision makers are dependent on the quality of information provided to them. It is therefore important for schemes to ensure they have sufficient understanding and access to appropriate data on investment allocation, engagement and stewardship activities undertaken by external managers.

The DC pension industry is now focused on mitigating the risks of saving into DC and accessing flexibly, with a strong overall focus on investment

As discussed, policy and market changes have led to working-age people facing greater risks both when saving and when coming to access savings. Many of today's policies and those expected in future have been designed to help mitigate these risks. There is also an overarching focus on improving investments with the aim of better protecting member contributions from volatility and providing more opportunity to seek returns.

Policy changes aiming to mitigate risk

The new VfM Framework aims to provide better value for members

The previous Government was in the process of developing a new VFM framework to enhance value and promote consolidation among DC pension schemes. The concept of ensuring value for members has been in place since 2016, with trustees required to assess the administration and governance of their DC schemes.[64] Under the new VfM framework, value for members will soon be assessed more comprehensively. This framework aims to evaluate the performance and effectiveness of pension schemes by requiring them to report data on investment performance, costs and charges, and the quality of services. These requirements would include the following:

- Investment performance would be measured using a set of metrics which would necessitate backward-looking investment performance net of all costs and across a range of time periods and age cohorts for all pension scheme providers.
- Schemes would also have to disclose their total charges and administration costs to enable comparison of the quality of their services against the cost of those services.
- Quantitative metrics would be used to measure the quality of services, with the 'outcomes of member satisfaction surveys' being listed as a starting point.[65]

The ultimate goal of the new VFM framework is to ensure that members receive high-quality services at a reasonable cost, mitigating the risk of poor value within the DC pensions landscape. However, implementing the new VFM framework will present challenges, as the administrative burden on providers could lead to increased costs, which might be passed on to members. Additionally, the metrics used to measure value must be carefully designed to avoid unintended consequences, such as incentivising short-term performance over long-term stability, which could introduce new risks to the investment strategy of the pension schemes.

[64] TPR (2016) Value for DC scheme members https://www.thepensionsregulator.gov.uk/en/document-library/scheme-management-detailed-guidance/governing-body-detailed-guidance/5-value-for-members
[65] DWP (2023) Government-regulator response to 'Value for Money: A framework on metrics, standards and disclosures.'

Pensions Dashboards could help increase engagement among the population

The Pensions Dashboards Programme (PDP) is currently developing dashboards designed to mitigate risks related to lost pension pots and uninformed pension decisions by providing a comprehensive view of individuals' pension savings. The dashboards will allow people to log in and view their existing private pension savings and entitlement, alongside their State Pension entitlement, all in one place. By increasing visibility and control over pension savings, the dashboards aim to encourage members to take a more active role in managing their retirement plans, potentially leading to better-informed decisions about contributions and investment choices.

This initiative addresses several risks inherent in the current system. It aims to prevent people from losing track of their pension pots, which can result in fragmented and inefficient retirement savings. Additionally, by supporting better-informed pension access decisions, the dashboards could reduce the risk of individuals making poor financial choices due to lack of information. This is illustrated in Denmark, where engagement with their dashboard (PensionsInfo) has increased by around a third of a million every year from 2007. However, in 2019, 20 years after the dashboard was introduced, it was only used by around 31% of the working-age population, so whether it will drastically improve engagement in the UK, where half of those with DC pots are categorised as having low or very low engagement levels, is still unknown.[66] Some stakeholders believe that the dashboards might only be used by those who are already engaged with their pensions, limiting their overall impact.

The success of the Pensions Dashboards depends on several factors. Data accuracy and security are paramount, as inaccuracies or breaches could undermine trust in the system. Additionally, the dashboards must be user-friendly and accessible to individuals with varying levels of financial literacy. The challenge lies in ensuring widespread adoption and engagement, particularly among those who are currently disengaged from their pension planning.

While the Pensions Dashboards have the potential to significantly mitigate risks associated with lost pension pots and uninformed retirement planning, its success will hinge on its ability to provide accurate, secure, and accessible information, and to engage a broad spectrum of users effectively.

The previous Government proposed two potential solutions to the "small pots problem"

A multiple default consolidator model would reduce the proliferation of small, deferred members pots, potentially improving member outcomes

Deferred pots occur when individuals stop contributing to a pension scheme, often due to changing jobs, resulting in numerous small pots that are financially inefficient. For instance, a £500 pot deferred at age 22 might reduce to around £100 by age 68 due to ongoing charges. These small pots are costly for providers, leading to an estimated annual industry loss of up to £225 million. Without policy intervention, the number of small pots could increase from 13 million in 2023 to over 27 million by 2035, driven by frequent job changes and potentially lowering the automatic enrolment age to 18.[67]

The previous Government's proposal of a multiple default consolidator model in late 2023, aimed to reduce the number of deferred DC pots under £1,000 by transferring small inactive pots into a consolidator scheme chosen by or allocated to the member.

[66] PPI (2024) How could a Lifetime Provider Model impact members, employers, and industry?
[67] PPI (2024) How could a Lifetime Provider Model impact members, employers, and industry?

The default consolidator model would result in small DC pots merging into larger, more manageable ones, potentially enhancing administrative efficiency and reducing costs. This consolidation should help mitigate the financial erosion of members' savings caused by ongoing charges on small pots. Additionally, by streamlining the pension system, the model could reduce the administrative burden on providers, which is intended to help lower costs and improve the overall sustainability of pension schemes.

However, there are potential downsides to this policy. One concern is that members might be defaulted into consolidator schemes with higher charges or poorer investment performance than their original schemes. There is also a risk that the administrative process of consolidating pots could be complex and costly, potentially offsetting some of the intended financial benefits. Australia offers a valuable example. Australia's Superannuation system allows members to choose different schemes than their employers' default, supported by Clearing Houses. Since 2015, small inactive pots are transferred to the Tax Authority and then to active accounts. In 2021, their Lifetime Provider Model further streamlined accounts, with 76% of holders having one account by June 2022.[68]

The Lifetime Provider Model would need to work well with other policies under development

The Government also set forward a proposal for a Lifetime Provider Model; an alternative approach to managing DC pensions by having members choose which pension provider they want to handle their pension savings throughout their career. Under this proposed model, when individuals begin new employment, they will be presented with a choice of entering their new employer's pension scheme or remaining with their current provider. As well as the multiple default consolidator model, the Lifetime Provider Model would be designed to help tackle the problem of small, deferred pension pots.

A key feature of this model is its default provision, where members who do not actively select a provider will be allocated to the last scheme they were saving into when the policy was introduced, or the first scheme they join. However, concerns arise regarding those who are defaulted into a Lifetime Provider, as they may remain in a scheme with higher charges, poorer investment performance or poorer services than if they had chosen their scheme intentionally.

To address potential drawbacks of default allocation under the Lifetime Provider Model, a robust VFM framework would be important. Firstly, if the VFM framework ensures that most schemes offer high value for members, strong regulatory protection, and operate efficiently at scale, default allocation should not pose significant financial risks. Secondly, an effective VFM framework could potentially form a future basis to provide engaged employees with the metrics needed to make informed choices when selecting a Lifetime Provider. Choosing a provider with sophisticated investment strategies could potentially lead to better retirement outcomes, though switching schemes may involve costs that could offset these benefits, depending on the process.

However, it is important to note that both the Lifetime Provider and multiple default consolidator models are just proposals, and the current Government may not go ahead with them. The Lifetime Provider Model, in particular, is unpopular with stakeholders due to concerns about members being defaulted into suboptimal schemes and the complexity of managing such a system, alongside the costs of adjusting the pensions infrastructure and the potential for increased marketing costs arising. Introducing a Lifetime Provider Model before the VFM framework is fully established and operational could diminish support for members who wish to actively choose their provider, and this timing could also increase the risk of members remaining in underperforming or costlier schemes.

Careful consideration, and a cost/benefit analysis would be necessary to ensure that the introduction of the Lifetime Provider Model would align with the development of dashboards, a robust VFM framework and the implementation of effective default consolidation measures.

[68] PPI (2024) How could a Lifetime Provider Model impact members, employers, and industry?

CDC schemes could provide a new risk-sharing model for future savers

CDC schemes represent a hybrid between DB and DC models, offering a new approach to retirement savings. In CDC schemes, members' contributions are pooled into a collective fund, which is then invested to generate returns. Unlike DC schemes where individual account holders bear investment risks, CDC schemes spread these risks across the collective membership. This risk-sharing mechanism is designed to provide more stable and potentially higher retirement incomes compared to purely individual DC accounts.

One of the key ways CDC schemes mitigate individual risk is through the pooling of investment and longevity risks. By combining contributions from multiple members, CDC schemes aim to reduce the impact of market volatility on individual retirement savings. This pooling also helps smooth out fluctuations in investment returns, potentially leading to more predictable retirement incomes. CDC schemes also offer a measure of longevity risk protection by pooling the risk of members living longer than expected.

However, implementing CDC schemes requires robust governance structures to oversee the collective fund and ensure equitable distribution of benefits among members. Transparency and member understanding of the risk-sharing nature of CDC schemes are also critical for their successful adoption.

CDC schemes have long existed in other countries, and the first CDC scheme in the UK is set to open soon, hosted by Royal Mail. If further CDC schemes are developed and made available to employers, this could offer opportunities to help mitigate the risks of individual DC schemes. By combining elements of both DC and DB schemes, CDC schemes aim to offer a more sustainable and resilient pension solution in today's dynamic economic environment. They provide a middle ground where individuals can benefit from the potential returns of collective investing, while mitigating the individual risks associated with market fluctuations, longevity uncertainties, as well as providing more predictability of costs for employers.

The use of technology and artificial intelligence (AI) within the DC landscape can have implications for both pension providers and members

As the DC landscape continues to evolve, the use of technology within pension management will become increasingly important. When it comes to managing personal finances, the majority of it is accessible from a smartphone, for example online banking, and pensions are following suit. The adoption of technology offers several advantages, particularly for younger generations who are typically more tech-savvy. Members from younger generations are more likely to view their pension savings online, and 62% would welcome a comprehensive portal offering a single view of their wealth management, linking pensions savings with other personal finance elements.[69] Digital platforms also allow for 24/7 access to pension information, which can enable members to manage their retirement plans at their own convenience, and could help promote active management of retirement savings.

Technology is also likely to continue streamlining administrative processes, reducing the reliance on paperwork and resulting in lower operational costs for pension providers. However, the reliance on technology also brings several challenges and potential downsides. One significant concern is the risk of technical failures. Dependence on digital platforms exposes the system to vulnerabilities such as system crashes, data breaches, and cyber-attacks. These issues could disrupt services and compromise sensitive member information, which may undermine trust in digital solutions. Additionally, the shift away from paper-based systems eliminates a tangible backup, meaning it is up to providers to ensure thorough digital archiving and recovery mechanisms to protect against data loss.

[69] PWC UK (2018) The virtuous circle: value for all from pensions technology https://www.pwc.co.uk/pensions/assets/pensions-technology-survey-2018.pdf

Older members may also face challenges in adapting to digital platforms, due to their limited familiarity with certain parts of technology. This digital divide could result in lower engagement and a reduced understanding of their pension plans, potentially impacting their retirement outcomes. To help bridge this gap, providers could offer comprehensive training and support to ensure that older members can navigate digital tools effectively.

Balancing technology with human interaction is important in the pensions industry. While digital solutions offer numerous benefits, some members may still prefer personal advice and face-to-face interactions.

AI simplifies pension communications and can provide advice and guidance

The evolving role of advice and guidance in the DC landscape holds significant implications for DC savers and retirement outcomes. As individuals increasingly bear responsibility and risk for their retirement planning, access to regulated advice and impartial guidance becomes more important. Having access to regulated advice can help individuals develop personalised financial plans and select suitable investment strategies for their specific circumstances, improving their overall retirement outcomes. Impartial guidance can also help individuals understand their pension options and make better-informed decisions.

AI is already being used within the pensions industry, particularly within communications. AI-generated summaries of pension communications are becoming more prevalent, as members are increasingly relying on AI to interpret lengthy documents. This is because members are more likely to engage with concise, easily digestible summaries that address their needs and preferences.[70]

AI is also playing a growing role in delivering personalised advice and guidance to DC savers. AI-driven tools can analyse vast amounts of data to offer tailored recommendations based on individual preferences, risk tolerance, and financial goals. These tools aim to provide real-time insights, allowing members to make informed decisions aligned with their unique circumstances. Additionally, AI-powered chatbots and virtual assistants offer scalable support, enabling savers to access guidance conveniently and efficiently. AI can also provide automated advice on investment recommendations, and build customised portfolios, allowing for client risk and return preferences.[71]

However, the increasing use of AI in pensions raises ethical questions, such as the potential for discrimination based on personal characteristics. Transparency will play a key role in preventing distrust and assisting compliance with human rights laws. Pensions rely on long-term trust, making it important to justify AI predictions and recommendations clearly, even with incomplete data. Active governance and accountability are likely to play a formative role the development of AI models. Without proper oversight, there is a risk of misleading or harmful outcomes in the complex realm of pensions and social security.[72]

While AI-driven advice and guidance has the potential to mitigate individual financial risks held by members, careful consideration of ethical implications, ongoing oversight, and complementary human expertise will play a significant role.

[70] Quiet Room (2023) How AI will change the way people read pensions communications https://quietroom.co.uk/insights/how-ai-will-change-the-way-people-read-pension-communications/
[71] Mercer (2023) Mercer CFA Institute Global Pension Index 2023 https://rpc.cfainstitute.org/-/media/documents/article/industry-research/mercer-cfa-insitute-global-pension-index-2023.pdf
[72] Mercer (2023) Mercer CFA Institute Global Pension Index 2023 https://rpc.cfainstitute.org/-/media/documents/article/industry-research/mercer-cfa-insitute-global-pension-index-2023.pdf

Conclusions

Over the past two decades, responsibility and the risk of poor retirement outcome has shifted from employers to individual members. This transition, driven by the financial challenges and sustainability issues of DB schemes, has reshaped the dynamics of retirement planning. The decline of DB schemes in the private sector, once dominant for providing guaranteed retirement incomes, has been paralleled by the rise of DC schemes.

DC schemes, supported by policies like automatic enrolment and pension freedoms, have increased members' exposure to investment and longevity risks. Employees now bear more responsibility for their retirement security, necessitating informed decision making and proactive engagement in financial planning. As the pension landscape continues to evolve, addressing challenges such as adequacy of savings, investment outcomes, and retirement income security will be crucial to safeguarding the financial wellbeing of future retirees in an increasingly uncertain economic environment.

There has been a focus within DC pensions on improving investments to enhance member outcomes. Initially, schemes emphasised cost efficiency following the introduction of automatic enrolment. However, DC schemes are slowly shifting from conventional investment approaches, which consisted of predominantly equity and bond portfolios to more alternative assets, illiquids, and private markets. Unfortunately, the infrastructure and size of DC schemes can present challenges for investing in illiquids, with the recent Mansion House Reforms aiming to address these barriers by encouraging investment in productive assets.

The integration of ESG factors has become increasingly significant within DC schemes, reflecting a broader commitment to sustainable investing. However, issues relating to data provision and reliability make ESG integration challenging.

The DC pension industry is increasingly focused on mitigating risks associated with saving into DC plans and accessing funds flexibly, with a strong emphasis on investment strategies. The new VFM Framework aims to enhance value for members, while Pensions Dashboards could boost engagement by providing comprehensive pension views. To address the proliferation of small pots, the previous Government proposed solutions such as the multiple default consolidator model and the Lifetime Provider Model, which require careful integration with other policies. CDC schemes offer a model that balances risk among members, and the use of technology and AI could streamline processes and provide guidance.

[64] B&CE/Ignition House (2022)
[65] ABI (2022)
[66] B&CE/Ignition House (2022)

10th ANNIVERSARY

Chapter Five:

Reflections on policy

Plus ça change toujours la même chose?: A brief retrospective of the UK pension system

From left to right:

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So here we are. After almost a decade after the launch of the inaugural 2015 edition of The DC Future Book, we've now reached the landmark 10th edition. In this short retrospective, we assess the major policy and regulatory changes to have impacted UK defined contribution (DC) pension outcomes over the period, how well the system (policymakers, regulators and the pensions industry) has dealt with the pressing DC issues of the past decade, concluding with what needs to happen over the next decade if more optimal retirement outcomes are to become the norm. Of course, what needs to happen and what will likely happen aren't necessarily the same thing.

So, where to begin? Let's cut to the chase by focusing on the six key themes of the past decade: the introduction of freedom and choice in decumulation, auto-enrolment propelling pensions participation, changes to both the State Pension and State Pension age (SPa), the rise of the master trust, evolving investment strategies and the ever-increasing focus on environmental, social and governance (ESG) risk factors in investment decision making.

Revolution in decumulation

Back in 2015, a shell-shocked pension industry was trying to figure out what the newly introduced freedom and choice decumulation reforms would mean for the DC pensions landscape and retirement outcomes.[73] Indeed, having moved from a paternalistic, near-mandatory annuitisation of DC pots to a libertarian freedom of access regime for all, without an accompanying "how to" guide and with a paucity of frames of reference, well signposted relatable guidance, accessible advice and product innovation, almost a decade on the thorny issue of how best to optimise the "nastiest, hardest problem in finance"[74] remains a conundrum. Compounded by little shopping around and a reluctance by DC savers to seek out independent financial advice when accessing their DC pots,[75] the resulting poorly informed decumulation decision making[76] has been evidenced by the numbers withdrawing unsustainably from their DC pension pots[77] and the Treasury's consequent tax take. Decumulation scams have also been on the rise.[78] Granted, change is on the horizon with DC trustees poised to provide, or work with a partner in providing decumulation services and solutions for members. However, there's still much to do if decumulation outcomes are to become more optimal, not least in determining how best to support, or mitigate, the enormous decision-making burden that comes with freedom and choice.[79]

[73] Announced in his 19 March 2014 Budget speech, Chancellor George Osbourne caught everyone by surprise in announcing, "Pensioners will have complete freedom to draw down as much or as little of their pension pot as they want, anytime they want. No caps. No drawdown limits. Let me be clear. No one will have to buy an annuity."
[74] In the words of Nobel prize winning economist Bill Sharpe.
[75] See: Retirement income market data 2022/23 I FCA 16 April 2024.
[76] The almost total absence of financial education, especially from an early age, and the consequent lack of numeracy and financial literacy across the adult population, means that even the simplest of calculations or concepts are largely unfathomable to most people. As a result, most people simply don't know what's feasible and realistic at and in retirement.
[77] See: Retirement income market data 2022/23 I FCA 16 April 2024.
[78] Through a City of London Police National Fraud Intelligence Bureau Freedom of information (FOI) request, the Pensions Management Institute (PMI) found that more than £2.6bn was stolen from UK investors between 2020 and 2023.
[79] See: Pensions Watch Issue 28. Chris Wagstaff. Columbia Threadneedle Investments. November 2023 and Pensions Watch Issue 30 Chris Wagstaff. Columbia Threadneedle Investments. June 2024.

The gathering momentum of auto enrolment

Meanwhile, auto-enrolment (AE) of the nation's eligible employees, which began in 2012, was building up a head of steam, with 5.4m employees having been auto-enrolled by 58K employers by 2015. Fast forward to 2024 and those numbers have risen to 11.1m employees and 2.4m employers.[80] Having been the principal driver of the dramatically increased participation in trust-based occupational DC schemes, not least master trusts, the success of AE quickly resulted in the number of active DC members far surpassing those of defined benefit (DB).[81] Indeed, scheme membership has grown more than 12-fold since the beginning of 2012 from 2.3m to 28.8m, of which 10.38m are active DC members.[82] Simultaneously the overall workplace pensions participation rate was propelled from, a distinctly unhealthy, 47% in 2012 to 63.5% in 2015 and an even healthier 80% in 2023.[83] According to The DC Future Book, the assets of workplace DC schemes have grown from around £324bn in 2015 to around £600bn in 2023.[84] That said, consultants LCP have pointed out that the success of auto enrolment has culminated in "over two million new pension pots being left behind every year".[85]

However, the number of those who fail to meet the AE eligibility criteria has risen at a similarly robust rate from 5.2m to 11.2m over the period.[86] Although, in 2017, the DWP-commissioned Automatic Enrolment Review[87] recommended lowering the minimum age for AE from 22 to 18 and removing the lower limit on band earnings so that contributions were calculated from the first pound of earnings, these recommendations have still yet to be implemented.[88] Moreover, a disproportionate number of those ineligible are women working part-time – thereby compounding the gender pensions gap. Then, of course, there's the elephant in the room that continues to be ignored – the nation's 4.25m self-employed,[89] few of whom have any meaningful pension provision. On a slightly more positive note, minimum AE contribution rates, as a percentage of band earnings, rose in quick succession from 2% pre-2018 to 5% and then 8% in 2019.[90] However, that's where they've stayed ever since despite continued representations on their inadequacy and helpful suggestions on how raising minimum contribution levels sustainably might be achieved - principally via auto escalation[91] and the ability to opt down, not just opt out. This inadequacy continues to be reflected in small average DC pot values, with two-thirds of pension pots valued under £30K when accessed for the first time.[92]

[80] See: Automatic enrolment declaration of compliance report I The Pensions Regulator
[81] DC has usurped DB as the dominant occupational workplace pension medium since 2019 - 2014 if occupational contract-based and non-workplace DC is included. See: Office for National Statistics – Employee workplace pensions in the UK, 2021 provisional and 2020 final results. 20 April 2022.
[82] Occupational defined contribution landscape in the UK 2023. The Pensions Regulator. May 2024.
[83] Workplace pension participation and savings trends of eligible employees: 2009 to 2023. DWP. 31 July 2024.
[84] See: The DC Future Book 2015. By Daniela Silcock, Tim Pike and Shamil Popat. The Pensions Policy Institute in association with Columbia Threadneedle Investments. October 2015. p.46 and The DC Future Book 2023. By Lauren Wilkinson, Daniela Silcock and John Adams. The Pensions Policy Institute in association with Columbia Threadneedle Investments. September 2023. p.40.
[85] See: 'Magnetic Pensions' – a better solution to small pension pots – LCP I Lane Clark & Peacock LLP
[86] See: Automatic enrolment declaration of compliance report I The Pensions Regulator
[87] See: Automatic Enrolment Review 2017. Maintaining the Momentum. DWP. December 2017. https://www.gov.uk/government/publications/automatic-enrolment-review-2017-maintaining-the-momentum
[88] Despite the passing of the Extension of Auto Enrolment Act 2023.
[89] Number of self-employed workers in the UK 1992-2024. Statista. 16 May 2024.
[90] The gross of tax employee contribution has risen from 1% to 3% to 5% of band earnings, while that for the employer has risen from 1% to 2% to 3%.
[91] This, so-called, Save More Tomorrow approach, formulated by behavioural economists Shlomo Benartzi and Richard Thaler in 2004, and originating from the same behavioural school of thought as auto enrolment, enables DC savers to commit today to paying increased contribution levels only in the event of receiving future pay rises. By not having to pay any money today, and not experiencing any reduction in their current take-home pay, the individual delays this cost, thereby better aligning it with the (seemingly far off) future benefits that will ultimately accrue. See: Richard H. Thaler, University of Chicago and Shlomo Benartzi, University of California, Los Angeles. Save More Tomorrow: Using Behavioural Economics to Increase Employee Saving. Journal of Political Economy, 2004, vol. 112, no. 1, pt. 2.
[92] See: Retirement income market data 2022/23 I FCA

The new State Pension and equalisation and raising of State Pension age

With demographic headwinds strengthening, unsurprisingly both the State Pension and SPa have come under the spotlight over the past decade. In 2016, the more generous New State Pension was introduced for younger pensioners, with the unique-to-the-UK, triple lock annual uplifts[93] being retained for both this and the incumbent Basic State Pension.[94] Although tempered by the eventual, and somewhat controversial, equalisation of SPa to age 65, by November 2018, and the increase in SPa to 66 between March 2019 and October 2020,[95] but exacerbated by persistent price inflation post-pandemic, the State Pension soon became by far the largest line item in the UK's social security budget. Although further increases to SPa are already scheduled for 2026 and 2037 to ages 67 and 68 respectively, speculation continues to mount on yet further rises, prospectively linked to longevity improvements, and potentially means testing the State Pension.

The rise of the master trust

Back in 2015, there were 88 trust-based, multiple-employer occupational pension schemes, or master trusts. Few had meaningful assets under management and there was no dedicated authorisation and supervision regime. Despite this, they collectively accounted for over one third of UK active DC savers.[96] Today, after the introduction, in October 2018, of The Pension Regulator's authorisation and supervision regime,[97] there are 35 authorised master trusts[98] with governance-intensive structures, 26.1m DC memberships representing over 90% of non-micro DC scheme members, of which almost 10m are active members, and assets of around £123bn, representing 78% of occupational DC assets.[99] Indeed, accounting for 84% of total DC memberships, master trusts have become the vehicle of choice for around 1.3m employers, with 82% of DC members concentrated in the largest five schemes.[100] However, the rise of the master trust still has some way to run with multiple policy and regulatory moves afoot that will likely further propel the number of DC members and assets under their custodianship.[101] So much so, that the biggest master trusts will likely join the ranks of the UK's largest asset owners.

Evolving investment strategies

DC investment strategies have evolved significantly over the past decade as a result of three principal catalysts: freedom and choice, an increasing focus on illiquid and private market assets and the greater integration and reporting of ESG risk factors. The latter warrants its own section below.

[93] The triple lock guarantee, first implemented in 2011, means the state pension increases annually in April by the highest of three measures: 1. the previous September's Consumer Price Index (CPI) figure; 2. the average wage increase in the UK; 3. 2.5%, if both CPI and earnings are lower than this percentage.

[94] Men born on or after 6/4/51 and women born on or after 6/4/53 are eligible for the New State Pension. Those born before these dates remain on the Basic State Pension, though for some this is supplemented by the second state pension (SSP). Courtesy of the triple lock, the Basic State Pension, for those with 30 qualifying years of National Insurance Contributions (NICs), has risen from £6,204 in 2016/17 to £8,814 in 2024/25, while the New State Pension, for those with a 35-year NICs record, has increased from £8,094 to £11,427 over the same period.

[95] The equalisation of SPa to 65 started in May 2010. See: https://www.gov.uk/government/publications/state-pension-age-timetable/state-pension-age-timetable

[96] With 3.9m active members, master trusts accounted for 36.4% of active DC members. See: The DC Future Book 2015. By Daniela Silcock, Tim Pike and Shamil Popat. The Pensions Policy Institute in association with Columbia Threadneedle Investments. October 2015. p.37.

[97] The Pension Schemes Act 2017 (the 2017 Act) and Occupational Pension Schemes (Master Trusts) Regulations 2018 (the Regulations) introduced authorisation and supervision of master trusts by The Pensions Regulator (TPR).

[98] See: List of authorised master trusts | The Pensions Regulator

[99] Occupational defined contribution landscape in the UK 2023. The Pensions Regulator. May 2024.

[100] As at November 2023. See: Evolving the regulatory approach to master trusts - GOV.UK (www.gov.uk)

[101] These include measures to consolidate multiple small DC pots and those small and micro DC schemes (of which there are more than 21K) that fail to offer value for money; the possibility of a lifetime pensions pot, promoting investment in governance-intensive private market and other illiquid assets, notably those which support UK trend economic growth made investible through the new government's National Wealth Fund, and a focus on improving decumulation outcomes by requiring trust-based schemes to provide, or work with a partner in providing, decumulation products and services for members.

So, to illiquids and private markets. Given that most DC schemes are cash flow positive and have a very long-term investment time horizon, it comes as no surprise that such assets are increasingly appearing on DC investment radars, particularly the larger master trusts, though the real and perceived barriers to adoption continue to deter many single DC trusts.[102]

Meanwhile, the DC world has also seen a gradual and now almost wholesale change in focus for default glidepaths and default funds, following the introduction of freedom and choice. Indeed, the progressive glidepath of de-risking into longer dated fixed income and cash funds in preparation for annuitisation and the taking of tax-free cash, has transitioned to a milder de-risking into a combination of multi asset and cash funds to facilitate the move into income drawdown and the taking of tax-free cash. The period has also seen passively managed investment funds increasingly dominate the growth phase.

The greater integration and reporting of ESG risk factors

In stark contrast to the position in 2015, DC investment decision making has also increasingly incorporated financially material ESG risk factors,[103] principally in response to legislation and regulation. Indeed, since October 2019, the Statement of Investment Principles (SIP) of a trust-based DC scheme[104] has had to include trustees' policies on managing financially material ESG factors. Then there's the annual Implementation Statement, introduced in October 2020, detailing how and the extent to which the SIP has been followed during the year with a focus on corporate voting and the most significant votes cast over the period. Then, in October 2021, came the Taskforce for Climate-related Financial Disclosures (TCFD) reporting - mandatory for all master trusts and any DC scheme with £5bn+ of assets under management. A year later the regulation was extended to £1bn+ DC schemes. It has also become increasingly evident that better integrating financially material social risks and opportunities into investment decisions is a key DWP focus.[105]

Prescriptive policy aside, although DC more generally continues to lag DB in its focus on and integration of ESG risk factors, principally as a consequence of DC schemes smaller size,[106] the larger master trusts are increasingly leading the way on sustainability by deeply embedding climate risk, social impact and often nature and biodiversity into their investment decision making.

[102] See: Investing in private markets: the barriers are coming down. Defined Contribution Investment Forum. April 2024. Available at: Investing-in-private-markets-part-one-FINAL.pdf (dcif.co.uk)
[103] DC trustees are required by law to take all financial factors into account in their investment decision making. However, whether sustainability-related issues constitute financial factors largely remains a grey area. Addressing this head on, the newly formed and broadly constituted Financial Markets Law Committee (FMLC) issued a report suggesting that as sustainability-related issues can clearly impact an investment's risk and return, then such issues are financial factors. Moreover, the report, by homing in on systemic risks, such as climate change and nature loss, noted that pension schemes cannot fully insulate themselves from systemic risks simply by diversifying or relying on governments and regulators to do so on their behalf. See: Pension Fund Trustees and Fiduciary Duties: Decision-making in the context of Sustainability and the subject of Climate Change. Financial Markets Law Committee. 6 February 2024.
[104] Those with more than 100 members.
[105] In a drive by the DWP for the pensions industry to better assess and integrate financially material social risks and opportunities into investment decisions, the DWP Taskforce on Social Factors, after having consulted on 35 recommendations, produced a draft guidance document in March 2024 to help pension schemes do exactly that.
[106] Size typically being assumed to dictate the level of governance. That said, according to Barnett Waddingham's analysis of 22 DC default plans at end-2023, 86% are aligning their asset portfolios to a 2050 or sooner net-zero emissions target, with 77% targeting a 50% reduction in emissions by 2030. See: Sustainability in DC Governed Default Investment Strategies. Barnett Waddingham. July 2024.

So, what's next?

While the past decade has seen some welcome advances in improving DC outcomes, as legacy DB benefits increasingly disappear, it is evident that DC will, on its current trajectory, continue to be a very poor substitute.[107]

Indeed, current projections suggest that, with such small average DC pot sizes, the State Pension will increasingly become the mainstay of most retirement outcomes.[108] And that means a minimum, or basic, rather than a modest or comfortable standard of living in retirement could become the norm.[109] Disconcertingly, this outcome is at odds with many savers' unrealistic expectations.[110] Moreover, for a system that has continued to evolve piecemeal, with periodic bouts of political interference, it is perhaps inevitable that the resulting complexity and uncertainty surrounding pension saving and decumulation decision making has compounded these sub-optimal outcomes.

Whether in another decade's time we are celebrating a dramatic improvement in retirement outcomes, having addressed the many identified shortcomings within DC, notably as part of an imminent "big bang" pensions review, or lamenting the missed opportunities of a lost decade that could have led to better retirement living standards for all, only time will tell. Although the measures contained in this summer's Pensions Bill, which build on the momentum of changes proposed by the previous government, are certainly a step in the right direction, one thing's for sure: the issues are pressing and time waits for no one.

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107 See: Fixing Defined Contribution: A five-pronged approach. Chris Wagstaff. Columbia Threadneedle Investments. July 2022.

108 See: The Ski-Slope of Doom – Is this the most worrying chart in pensions? Sir Steve Webb. LCP. April 2021. Also see: Pensions Watch – Issue 8 – May 2021 | Columbia Threadneedle Investments.

109 The PLSA Retirement Living Standards (RLS) 2024 suggest the level of annual net income needed by a single person living outside of London to support a minimum, modest and comfortable standard of living in retirement is £14,400, £31,300 and £43,100, respectively. See: https://www.retirementlivingstandards.org.uk/details

110 Most DC savers struggle to understand what is feasible and realistic at and in retirement.

The past decade of DC pensions

Chris Curry, Director of the Pensions Policy Institute

They say a week is a long time in politics. Well 10 years is a very long time in pensions, or at least it seems that way. It isn't often that you get the opportunity to look back at something that you have written 10 years ago – especially when that article was looking forward to the future.

So much has happened in 10 years. My thought piece in the first Future Book report was talking about the implementation of the recently announced Freedom and Choice reforms, the introduction in the following year of the new State Pension and the ending of contracting-out, the roll out of automatic enrolment, and the first independent State Pension age review. All of those things have evolved and become established and are now part of the pensions furniture.

But 10 years ago, I also highlighted the challenges that still faced DC pensions in the UK. I mentioned cost, value, simplicity and defaults. It is fair to say that while progress has been made in some of these areas, we are still grappling with some of them.

There has definitely been success in keeping costs low within workplace DC pensions, with most well below the 0.75% charge cap. A drive – even if not directly mandated – for scheme level consolidation has undoubtedly helped with this, as has a focus – which continues with the latest FCA consultation – on value for money. Other areas of policy focus have sometimes been at odds with this – increasing requirements for ESG and the potential impact of climate changes on long term investments, as well as a desire for more diversification of asset classes (bringing in alternatives, illiquids and more recently UK productive finance) can all increase costs and have all potentially had an impact on default funds. Value for Money is, of course, wider than just costs though, and improving the performance of DC funds is an important goal.

One potential remaining challenge though is the difference between workplace and non-workplace DC pensions, with money in non-workplace pensions not subject to the same charge caps and protections. With more money moving out of workplace pensions to take advantage of Freedom and Choice flexibilities, and as part of individual level consolidation, this distinction is becoming more obvious.

10 years ago I also looked forward to the roll out of automatic enrolment, wondering aloud where there might still be gaps in the system – even back then we were aware of the challenges of DC pension saving for those who don't have as strong a relationship with paid work as the stereotypical median earning man, and in particular the lower outcomes for women, people from ethnic minority groups, those with disabilities and those with different work patterns, such as the many types of self-employed, in the gig economy or with flexible hours. I think it is fair to say that those gaps still exist today. We know that there is still a large gender gap in pensions. While DC pension systems have always reflected the labour market disparities that women and other under-pensioned groups face, if anything the specific parameters around automatic enrolment in the UK tend to exacerbate rather than close the gap. There is still no equivalent to automatic enrolment for those who are self-employed.

While automatic enrolment has, overall, definitely been a success, we only really have the foundations in place. Successive volumes of The Future Book have shown clearly how coverage of workplace pensions has increased as the original roll out of automatic enrolment was completed, and how participation rates remained high not just as contributions initially increased, but also through the challenges of the Covid-19 Pandemic. But this is only half of the challenge.

Contribution rates to DC pensions have not been increasing over the last 10 years. And we know that the minimum contribution rates that many people are still on were never designed to be sufficient, by themselves, to provide most people with an adequate income in retirement. Despite the marginal improvements in outcomes that can be driven by lower costs, better value for money and better and more sustainable long-term return, fundamentally people will need to save more, somewhere, to help support themselves in later life. This could be through higher DC contributions, saving elsewhere, or using other assets (such as housing assets), but more money has to be put aside.

A more recent challenge for DC pensions and the wider pensions industry, made clear by Covid and the ongoing economic challenges from wider global instability, is affordability. While the costs of living increase, the argument for putting aside more money for the future – especially in the short term – can be difficult to make. But for a system that is sustainable long term, that is the choice that has to be made. Introducing the reforms recommended by the 2017 Automatic Enrolment Review would make a start on increasing contributions and bring more people into automatic enrolment but are only the next step in ensuring that the system keeps up with the way that the world is changing. Pensions are not the only savings challenge that people face, and ideas that combine higher DC pension saving with increasing short-term financial resilience (such as side-car accessible savings) might better meet these new challenges.

In my first thought piece 10 years ago, my overriding conclusion from that very first Future Book was that "we need to do much better in helping individuals understand what they can do to make best use of DC pensions, and how to do it – or make sure that it happens on their behalf". And despite a decade of fairly significant changes and reform, I think this is still the biggest challenge we face. While we are helping more people save more than ever in DC pensions, we still need to ensure that people make the most of that saving. While better value for money, better investment returns, better run schemes, better information through Pensions Dashboards will all help, I wouldn't bet against the next 10 years seeing just as much change as the past.

ESG and its importance in the next ten years

Lauren Peacock, Responsible Investment Manager, Scottish Widows

The last 10 years

We have come a long way in terms of embedding ESG factors into the pensions landscape and it can be helpful to reflect on what progress has been made before we look forward.

In 2018, we saw a change in UK regulation that shifted the dial on ESG integration for pension schemes. The Occupational Pension Schemes (Investment) Regulations 2005[111] which applies to UK trust-based schemes[112] was updated[113] to clarify disclosure on ESG, stating that, "A statement of investment principles must be in writing and must cover… financially material considerations". Financially material considerations are referred to as 'environmental, social and governance considerations (including climate change)'. This change in the law meant it was a requirement for trustees to state their views on ESG and caused a wave of education, discussion and strategy on the topic often supported by consultants and with a nod to pension schemes members interests.

A couple of years later the Financial Reporting Council Stewardship Code was updated with higher expectations placed on signatories. In addition, the Principles for Responsible Investment annual questionnaire was also re-launched. Alongside regulatory expectations, several regulatory working groups have also sprung up to support the implementation of the practical aspects of ESG. Groups such as the Voting Reporting Group and the DWP's Taskforce for Social Factors have been working to provide industry guidance and solutions through discussion and recommendations.

In 2021, the spotlight was on tackling climate change as Glasgow hosted COP26, bringing together policy makers and providing a platform for business, NGOs and broader stakeholders to discuss climate progress and action. With the launch of the Glasgow Financial Alliance for Net Zero, a growing number of pension schemes and financial institutions were committing to net-zero by 2050 to signal their support for decarbonisation and management of climate risk in their portfolios – and so did we at Scottish Widows. Net-zero commitments and ESG integration have become a standard in the industry and while practice and approaches differ, the sector has matured in its understanding that consideration of financially material ESG factors is just plain good risk management while providing opportunities for growth and shaping a more sustainable world to retire into.

Testing times

Following the strong focus on ESG activity and optimism pre-pandemic, since then some new factors have entered the landscape. A series of events and patterns have emerged including legal actions, a reduction in collaborative work and changes in engagement and voting behaviour within a background of geopolitical events and changing attitudes to sustainability. We have also seen an increased regulatory focus on tackling greenwashing and providing consistency via taxonomies.

Political and societal attitudes impact the financial industry. While awareness on climate

[111] Legislation. Gov.uk (2005). The Occupational Pension Schemes (Investment) Regulations 2005
[112] The Occupational Pension Schemes (Investment) Regulations 2005 (legislation.gov.uk)
[113] Norton Rose Fulbright. (2020). UK Pensions Briefing - Trustee investment decisions and the role of ESG: A practical guide to the next steps UK Pensions Briefing - Trustee investment decisions and the role of ESG: A practical guide to the next steps | Global law firm | Norton Rose Fulbright
[114] Department for Work and Pensions. (2018). The Occupational Pension Schemes (Investment and Disclosure) (Amendment) Regulations draft-occupational-pension-schemes-investment-and-disclosure-amendment-regulations-2018.pdf (publishing.service.gov.uk)

change[114] has increased, the topic has also become more political and divisive, which can be difficult for investors to navigate. For example, in a survey by Pew Research, 12% of Republicans considered dealing with climate change a priority while 59% of Democrats did[115]. Policy making in this space has been mixed. In July 2024, the Climate Change Committee[116] reported that with regards to climate change in the UK, 'Policy is needed to provide confidence to investors and consumers; manage risks in new markets; remove barriers to delivery; and, in some cases, provide financial incentives where that is still necessary, especially in home heating'. Meanwhile in the US, the Time newspaper[117] has commented that the Inflation Reduction Act has 'has reshaped the world and the US'.

There have been several attempts[118] to increase action on climate change through legal means. More recently legal action has also targeted those working in responsible investment. At the start of 2024 we witnessed Exxon Mobil sue NGO Follow This and asset manager Arjuna[119] for filling a resolution at their company AGM. The move has shocked the responsible investment community as well as the wider financial services industry. This changing landscape has contributed to caution and a potential cooling affect.

Climate Action 100+ was launched in 2017[120] to bring investors together to engage companies on climate change. The initiative is voluntary and sought to organise and support investors engage with high emitting companies. In 2020 the initiative had 450 signatories and $41 trillion in assets under management. A few years into the initiative, in 2022, Climate Action 100+ launched its 2nd phase to align with the goals of the Paris Agreement which state that, "to limit global warming to 1.5°C, greenhouse gas emissions must peak before 2025 at the latest and decline 43% by 2030"[121]. In 2023 and 2024, a number of asset managers[122] departed from the initiative and while there is much debate about the reasons for the departures the moves form part of a trend of changing engagement on climate and a testing time for ESG.

The increased focus on ESG has also come with an increase in reporting, which in 2024 is still being refreshed and refined to ensure proportionality and intended impact. After its relatively recent update in 2020, the UK Stewardship Code was also refreshed in 2024, the Interim Changes to Reporting for Stewardship Code Signatories[123], state that collaborative engagement and escalation should be undertaken "where necessary". This is a potential softening of wording on signatories who will only have to report collaborative and escalation engagement if they are willing and able to.

Moving forward

As with many trends, the push back on ESG from some quarters in recent years could be considered a natural cycle of enthusiasm and bandwagon jumping, followed by an alignment in priorities and focus. Climate change will continue to be a focus for asset owners and the wider financial industry because of the risk it represents to the economy. Net Zero Tracker[124] reports

[114] Nature Communications. (2021). Ten-year panel data confirm generation gap but climate beliefs increase at similar rates across ages Ten-year panel data confirm generation gap but climate beliefs increase at similar rates across ages | Nature Communications
[115] Pew Research Centre, (2024). Top priorities for Republicans are the economy, terrorism and immigration Top priorities for Republicans are the economy, terrorism and immigration; for Democrats, health care costs, the economy, education and the environment | Pew Research Center
[116] Climate Change Committee. (2024). Progress in reducing emissions 2024 Progress in reducing emissions 2024 Report to Parliament - Climate Change Committee (theccc.org.uk)
[117] TIME. (2024). The Inflation Reduction Act Has Already Changed The World. The Inflation Reduction Act Has Already Changed the World | TIME
[118] BBC. (2024) The legal battles changing the course of climate change. The legal battles changing the course of climate change - BBC Future
[119] Financial Times. (2024). Exxon accused of 'bullying' tactics in legal pursuit of climate activist investors. Exxon accused of 'bullying' tactics in legal pursuit of climate activist investors (ft.com)
[120] Climate Action 100+. (2017). How we got here. How we got here | Climate Action 100+
[121] United Nations. The Paris Agreement. The Paris Agreement | UNFCCC
[122] Financial Times. (2024). JPMorgan and State Street quit climate group as BlackRock scales back JPMorgan and State Street quit climate group as BlackRock scales back (ft.com)
[123] FRC. (2024). Interim Changes to Reporting for Stewardship Code Signatories. Interim Changes to Reporting for Stewardship Code Signatories (frc.org.uk)
[124] Net Zero Tracker. (2024). Energy and Climate Intelligence Unit, Data-Driven EnviroLab, NewClimate Institute, Oxford Net Zero. Net Zero Tracker | Welcome

that 1,178 out of 1,977 of the world's largest companies have a net-zero target. The picture gets more complicated when trying to assess whether those targets are achievable and whether the plans companies have published to go alongside them are credible. CDP's Corporate Environmental Action Tracker[125] has started assessing how attainable company net-zero targets are. Their initial analysis indicates more companies are not on track to meet their targets than those that are. Alignment will no doubt be a focus in the next 10 years and involve challenging assessment and decision making.

When it comes to meeting climate goals and international societal goals such as the SDGs[126] we have a long way to go. Collaborative engagement will remain a key tool for investors to manage risks in their portfolio and increase long term positive company performance. The type of engagement may just change as methods evolve and adjust. For example, engaging with companies collaboratively doesn't necessarily require large groups of investors, a smaller group can still affect company change. Moving forward investor engagement may not grab 'assets under management' headlines but build around more targeted themes in smaller focused groups, especially regarding the transition to net-zero. Similarly, despite a changing landscape, the ability and appetite for investors to escalate engagement through voting is growing. In addition to voting for environmental and social shareholder resolutions, using director nomination votes is another tool in the investor toolbox. As well as avoiding the significant resources of filing shareholder resolutions, director votes can be more targeted and hold board members accountable. The use of these votes could become more systematic moving forward as poor climate performance is addressed through board accountability.

The ups and downs of the last few years have also brought about positives through new connections and collaborations. On a personal level it has been wonderful to witness the collaboration between civil society and business. For many investors, the wealth of experience in NGOs is invaluable and has led to meaningful work and more impactful engagement. I hope this trend continues in the next 10 years as engagement work deepens and matures. In addition, I think asset owners will continue being vocal on responsible investment and coming together on shared challenges, such as asset manager voting behaviours.[127] The asset owner voice is an important aspect to the financial system as its those voices which speak on behalf of pension holders and creating a world worth retiring into.

Sustainability and ESG are fast moving areas of work that require research, resource and focus. We learn more about the sub-themes every day through science, research and stories. We understand more about micro plastics being found in humans[128] and the impact of higher cost-of-living on people[129] but can still grapple with how to ensure a climate transition is 'just' and that diversity efforts centre on inclusion. Regulation has ensured that ESG integration is here to stay, and investors have an important role to play in driving the positive real-world impact they can have through their portfolios and stewardship actions. As our understanding matures the switch from target setting and reporting to full ESG integration will be a challenge for many investors. Policy makers will play a key role in supporting the financial industry with the right incentives to invest and a stable and clear policy position. The next ten years will see investors grabble with the complexity of sustainability and their role in affecting change and protecting their portfolios. Only those investing in internal resources and open to new markets and methods will have the ability to develop their strategies.

[125] Carbon Disclosure Project. Corporate Environmental Action Tracker. Corporate Environmental Action Tracker - CDP
[126] United Nations. (2024). With less than one fifth of targets on track, world is failing to deliver on promise of the Sustainable Development Goals, warns new UN report
Press Release | With less than one fifth of targets on track, world is failing to deliver on promise of the Sustainable Development Goals, warns new UN report - United Nations Sustainable Development
[127] IPE. (2023). UK asset owner group publishes manager voting (mis)alignment review. UK asset owner group publishes manager voting (mis)alignment review | News | IPE
[128] Nature. (2024). Microplastics are everywhere — we need to understand how they affect human health. Nat Med 30, 913 (2024). Microplastics are everywhere — we need to understand how they affect human health | Nature Medicine
[129] United Nations. (2022). Cost of living crisis hits poorest the hardest, warns UNCTAD
Cost of living crisis hits poorest the hardest, warns UNCTAD | UN News

Risks and Challenges of Freedom and Choice

Adrian Boulding, Director of Retirement Strategy, Dunstan Thomas

Arguably the most significant thing that George Osborne did for pensions during his lengthy tenure as Chancellor of the Exchequer was his declaration in the 2014 Budget speech: "Let me be clear: no one will have to buy an annuity". The full set of reforms came into effect in April 2015, giving DC pension savers at retirement an un-restricted choice between income drawdown, annuity or cash.

This landmark reform is usually referred to as 'Freedom and Choice'. That name was also conjured up by George Osborne, as it was the title given to the Command Paper presented to Parliament on the reforms within the 2014 Budget pack. However, a more balanced name for these landmark reforms might have been 'Freedom, Choice and Responsibility'.

Before the reforms, for most ordinary people the output of a working life spent in DC schemes was a 25% tax free cash sum and an annuity. HMRC watched closely over pension schemes paying out more cash than this, while Bank of England and FCA supervised annuity providers to ensure that once annuity payments had commenced, pensioners felt absolutely secure they would continue through to their death and, where chosen, to the death of a partner beyond that.

However, in the very moment that the rabbit jumped out of the hat on Budget Day, the real responsibility for DC retirement income jumped from government to the individual scheme members.

This was done for members' benefit. The main thrust of the government's argument was that the nature of retirement was changing, and it was right to give people much greater flexibility over the timing and manner of taking their retirement income. However, the Command Paper also noted that it would lead to a change in the way that decumulation assets were invested.

Much of the pensions savings money that would have, under previous rules, flowed into corporate bonds and gilts following annuity purchase, would now be invested in the range of funds offered by drawdown providers, including a proportion into equities and other growth assets. In this respect George Osborne may have been ten years ahead of his time, as current and recent Chancellors have been encouraging a switch of pension assets towards a focus on growth.

Ten years on we can now see the result of the reforms, as a new normal for DC retirees has emerged. Comprehensive data is provided by FCA's regular publication 'Retirement Income Market Data'. The latest such data covering the year to March 2023 shows that annuities remain a popular choice, with 59,000 annuities purchased by people who have actively chosen that this is what they want to do, rather than something that they felt they had to do. However, this number is dwarfed by the 218,000 new income drawdown plans established in that same year. A new preference has emerged, with DC savers retaining control over their savings as they move into retirement with income drawdown.

Even more pots than this – 420,000 in all – were fully cashed in at retirement. However, 90% of those fully-cashed-in pension pots had less than £30,000 in them, which is why there is a separate legislative programme that hopes to automatically consolidate small workplace pension pots with the bulk of an individual's lifetime saving so that those monies can efficiently become part of the pensioner's regular income in retirement.

The transition that we have witnessed from annuity to drawdown as the predominant form of DC retirement income has passed the responsibility for managing the associated risks to the consumer. Those risks can be classified in four key ways: sustainability, inflation, investment and longevity.

Sustainability Risk

If the pensioner takes too much out early on, then the drawdown pot will be irreversibly depleted and will run out, or reduce to a trickle, in later retirement. There are many tools and rules of thumb to help manage this, perhaps the best known being the 4% rule that annual withdrawal amounts be set initially at 4% of the pot value on retirement and increased with inflation thereafter. However, with FCA data showing that two in every five drawdown customers are making regular withdrawals totalling 8% or more of their pot value per year, sustainability is a genuine long term concern for the drawdown market.

Inflation Risk

It is a commonly held misconception that pensioners will be spending less by the time they reach their 80's. Annuitants seem to think so, as FCA data shows that 85% of annuities are purchased on a level, non-escalating basis. Yet the recent IFS paper 'How does spending change through retirement', drawing upon longitudinal ONS data, shows that pensioner expenditure increases faster than inflation up to age 80 and still increases, albeit more gently, beyond that.

Investment Risk

The clever insurers that have issued annuities for over two centuries understand investment risk and buy safe assets with predictable cashflows that match the timing of payments out. In contrast, drawdown customers are offered a range of funds, with more or less volatile equity content, that may have been created more with accumulation customers in mind than decumulating pensioners. These funds can exhibit rapid price falls, and if the pensioner makes withdrawals when prices are low then they will be cashing in rather more units than they might have anticipated in their financial plan.

Longevity Risk

This one is a real challenge and is not helped by some of the simpler tools or guidance on the market. It is far too simplistic for a member at retirement to be thinking about a single point like the age they expect to die at. I can't hope to make every pensioner an Actuary, but people do need to understand that there is a rather wide window of ages at which their death is likely. If they only plan for the mid-point then 50% of them will run out of money before they pass.

Ten years ago, Government offered guidance to individuals and encouragement for the market to launch new innovative products better suited to the needs of retirees. The guidance service is good but not used by enough people. Innovation has been slow, but today there are encouraging signs that new ideas like blending annuity with drawdown, and a decumulation version of Collective Defined Contribution (CDC) will, within the next ten years, provide a rather richer range of choices for future retirees.

A young saver's perspective

Rosa Wright, Intern, PPI

Current young savers will face a very different retirement landscape than previous generations. The increased prevalence of DC schemes has facilitated a shift of responsibility from employers to individuals to create adequate retirement outcomes. With changes in the housing market, working cultures and life expectancy current young savers are facing the risk of inadequate retirement savings.

Historically, the pensions landscape has been predicated upon baseline assumptions about standards of living, one of those being homeownership. Homeownership in retirement has been essential to maintaining adequate living standards, keeping housing expenses low for retirees. For Generation Z savers however, a volatile housing market presents a new set of challenges for their retirement outcomes. These challenges include:

- **House Prices:** Between 2012 and 2021 house prices rose 53% whilst wages grew only 19%.
- **Decrease in Social Housing:** Post-Right to Buy the stock of affordable social housing has shrunk and not been replenished at the rate it was sold.
- **Private Renting:** Private renting has soared because of these previous factors, with the private rental market doubling in size in just a decade.
- **Forced to choose:** Many Gen-Zs are being forced to choose between saving for a house or retirement. 17% of young savers say they've opted out of making pensions contributions altogether, with 32% of that number doing so to save for a home.

These factors present varying risks to retirement outcomes; renting in retirement can lead to a substandard quality of life, with most pensions provisions not being large enough to cover private rental costs. Homeownership can mediate these risks but opting out of retirement savings all together may also leave people with inadequate pension provisions to cover other costs and could lead to later retirement.

Changes in working cultures and attitudes could also impact retirement outcomes for young savers. The lasting effects of Covid-19 created significant changes for many working cultures; young savers are prioritising flexibility, comfort and autonomy to ensure work-life balance. Changes seen in working attitudes amongst young people include:

- **Freelancing:** 70% of Gen-Zs say they are currently freelancing or plan to do so in the future.
- **Artificial Intelligence:** A third of those surveyed state the main reason for turning away from traditional employment is because "there's less chance of being laid off or replaced by AI".
- **Comfort:** 45% of respondents place financial comfortability as their largest career ambition, with 18% planning to retire early despite trend suggestions that Gen-Z will have longer working lifespans due to changes in life expectancy and State Pension age.

The shift towards freelancing culture could affect retirement adequacy for young savers as self-employed savers will be ineligible for automatic enrolment. In 2020, 78% of all employees were saving into a private pension, compared to only 16% of self-employed individuals. Alongside changes in working attitudes, growing trends in time spent out of work and unemployment, exacerbated by the cost-of-living crisis and the growing mental health crisis, may also negatively impact retirement outcomes. The issues surrounding these crises are:

- **Unemployment:** Youth (aged 16-24) unemployment rates have been steadily increasing with the number of economically inactive individuals reaching record highs. The rate for young people is 41.0%, up from 38.8% the previous year.
- **Missed work:** One in five young people aged 16-25 have missed work in the past year due to mental health problems, with one in ten saying they've had to quit a job due to poor mental health.
- **Cost of Living:** One in ten unemployed Gen-Zs said they have had to turn down a job because of inability to afford employment related costs like travel and uniform.

These varying factors are somewhat symbiotic in nature, with issues like unemployment being exacerbated by health crises and the cost-of-living, but simultaneously issues like poor mental health and the effects of the cost-of-living being worsened by unemployment. Periods of unemployment simply gives individuals less opportunity to save; a 25-year-old out of employment for 12 months could be over 5% worse off at retirement. Disability also has adverse effects on retirement outcomes with disabled retirees having private pensions income equivalent to 36% of the population average; 51% of disabled people will not have adequate savings for retirement.

Increases in life expectancy also needs to be considered when thinking about young savers retirement outcomes. Gen-Z are on average expected to live to 100 and beyond, meaning that not only will their provisions need to cover a longer period than previous generations, but also raises the possibility of increased costs in later life due to additional care needs. An increase in State Pension age to 71 could mitigate the risk of future State Pensions becoming unaffordable for government, however, this opposes trends in young savers plans for an early retirement and working into older age will be challenging for various working groups such as carers, disabled working people, and manual labourers. Additionally, some young savers are not expecting the fall back of a State Pension because the new State Pension is at risk of becoming "unsustainable" as more retirees and fewer workers puts extra demands on an already strained system.

To conclude, although many young savers should see positive impacts on retirement outcomes from lifelong automatic enrolment, varying factors outside the private pensions landscape could negatively impact retirement savings for Gen-Z. Changes in working cultures and shifts towards freelancing could see young savers made ineligible for automatic enrolment. Furthermore, the housing crisis risks young savers choosing between renting in retirement or opting out of pensions savings altogether in the hopes of owning a home. Unemployment amongst young people also presents a risk, however, these figures could be subject to improvement once more of Gen-Z start to leave the education system. Increased life expectancy alongside concerns about the sustainability of the State Pension could produce inadequate retirement outcomes, with young people needing to be prepared to save more for longer without the nSP to fall back on. Ultimately, the risks facing current young savers are interdisciplinary in nature and to ensure adequate retirement outcomes for Gen-Z a cross-policy approach would be vital.

Appendix Modelling Assumptions

Appendix: Modelling Assumptions

The modelling for this report considers the projection of an individual using the PPI's Suite of Pension Models, and a stochastic approach of economic assumptions. The economic scenarios are generated using the PPI's Economic Scenario Generator. The Models used are detailed below. Results are presented in 2023 earnings terms.

The pensions system

The pension system modelled is as currently legislated. The triple lock is assumed to be maintained. Individuals are assumed to be members of a Defined Contribution (DC) occupational pension scheme.

General assumptions

Investment returns are modelled stochastically with curves generated by the PPI's Economic Scenario Generator (ESG). 1,000 scenarios were produced providing values for equity returns, bond returns, cash returns, Consumer Prices Index (CPI) and earnings increases each year for each scenario.

Other economic assumptions

Other economic assumptions are taken from the OBR's Economic and Fiscal Outlook (for short-term assumptions) and Fiscal Sustainability Report (for long-term assumptions).

Asset allocation

Unless otherwise specified, asset distributions are assumed to be 56.7% invested in equities, 33.3% invested in bonds and 10% in cash, such that the median return is 5.8%. These assumptions are consistent with those used across the PPI Modelling Suite and are the result of consultation with the PPI's Modelling Review Board, which consists of a number of experts in the field of financial modelling.

Fund charges are assumed to be 0.75% for existing workplace DC schemes, and 0.5% for other DC/master trust schemes set up for automatic enrolment.

Earnings growth and other economic assumptions are taken in line with OBR assumptions, derived from their 2019 long-term economic determinants. The earnings band for automatic enrolment contributions and minimum salary assumption are assumed to grow with average earnings.

The Economic Scenario Generator (ESG)

The PPI's ESG is used to produce randomly generated future economic scenarios based upon historical returns and an assumption of the median/long-term rates of return. It was developed by the financial mathematics department at King's College London. It is used to test how the distribution of outcomes is influenced by the uncertainty of future economic assumptions.

[94] Average charges for trust-based schemes are 0.71% and for contract-based schemes 0.95%, DWP (2012), and a 0.75% charge cap will be introduced for any DC default funds being used for automatic enrolment from April 2015 onwards.
[95] Equivalent Annual Management Charge for multi-employer/Master trust schemes such as Legal and General's Worksave, NEST and The People's Pension.
[96] OBR (2023)

Key results

The Model generates projected future inflation rates, and earnings growth

- **Inflation rates**
  - Future CPI increases and earnings inflation rates
- **Investment returns**
  - Returns are produced for the major asset classes of equity, cash and gilts

This produces nominal returns which can be combined to produce investment returns for a more complex portfolio.

Application of output

The output of the ESG is a number of economic scenarios which are employed by the PPI's other models to analyse the distribution of impacts on a stochastic economic basis.

Key data sources

The specification of the model is based upon historical information to determine a base volatility and future assumptions to determine a median future return:

- **Historical returns:** Historical yields and returns, as well as inflation measures, are used to determine the key attributes for the projected rates.
- **Future returns:** Future returns are generally taken from the OBR Economic and Fiscal Outlook (EFO) to ensure consistency with other assumptions used in the Model for which the economic scenarios are being generated. Volatility can also be scaled against historical levels.

Summary of modelling approach

The six identified risk factors modelled are:

G Nominal GDP

P CPI

W Average weekly earnings

Y1 Long-term yields

Ys Money market yields

S Stock returns

Using these variables, a six-dimensional process, x_t is defined.

$$x_t = \begin{bmatrix} \ln G_t - \ln G_{t-12} \\ \ln(P_t - \ln P_{t-12} + 0.02) \\ \ln W_t - \ln W_{t-12} \\ \ln\left(e^{Y_t^l} - 1\right) \\ \ln\left(e^{Y_t^s} - 1\right) \\ \ln S_t \end{bmatrix}$$

Where t denotes time in months.

The development of the vector x_t is modelled by the first order stochastic difference equation:

$$\Delta x_t = Ax_{t-1} + a + \varepsilon_t$$

Where A is a 6 by 6 matrix, a is a six-dimensional vector and ε_t are independent multivariate Gaussian random variables with zero mean. The matrix A and the covariance matrix of the ⍰_t were determined by calibrating against the historical data. The coefficients of a were then selected to match the long-term economic assumptions.

It follows that the values of x_t will have a multivariate normal distribution. Simulated investment returns will, however, be non-Gaussian partly because of the nonlinear transformations above. Moreover, the yields are nonlinearly related to bond investments.

The first and third components of x_t give the annual growth rates of GDP and wages, respectively. The fourth and fifth components are transformed yields. The transformation applied ensures that the yields are always positive in simulations. Similarly, the second component gives a transformed growth rate of CPI. In this case, the transformation applied ensures that inflation never drops below -2% in the simulations. This figure was selected to be twice the maximum rate of deflation ever found in the historical data.

PPI Aggregate Model

Overview of Aggregate Modelling of Private Pensions

The PPI Aggregate Model links changes in the UK population, the labour market and economic assumptions to project forward private (and State) pension savings. Population projections are taken from 2016-based figures published by the ONS.

Current distributions of individuals across pension scheme types are taken from the Lifetime Labour Market Database (LLMDB), a panel dataset of 1% of UK National Insurance records. The workforce data includes numbers of individuals and average earnings split by age, gender and earnings band. The data are further split between public and private sector contracted-out schemes and those who are contracted-in to the State Second Pension (S2P).

Initial Conditions

In the base year of projection (2010), individuals with private sector pension arrangements are split between public and private Defined Benefit (DB) schemes and workplace Defined Contribution (DC) schemes. 17.5% of working individuals are assumed to be members of DC workplace pensions and 32.1% of individuals are assumed to be members of DB workplace schemes. 73.2% of those in DB schemes are assumed to work within the public sector, leaving 8.6% of the workforce in private sector workplace DB schemes.

The workforce not initially enrolled in public sector DB, private sector DB or private sector workplace DC, are considered as the eligible population for automatic enrolment. This includes individuals not in workplace pension schemes who contribute to personal pensions.

Stocks of existing assets for DB schemes and workplace DC schemes are split across cohorts by contribution levels. Initial stocks of workplace DB assets were assumed to be £890 billion in the base year. It was assumed that the stocks of DC assets in 2010 were £275 billion.

Movement of individuals between schemes due to decline in DB schemes

The proportion of individuals in each scheme is not stable over time: the proportion of the total workforce who are enrolled in a private sector DB scheme is assumed to decline by 80% between 2010 and 2030 and these individuals are moved into the existing DC workplace schemes.

[97] Data from LLMDB 2010-11
[98] ONS (2013)
[99] Average proportion of males and females employed in public sector COSR schemes according to LLMDB 2010-11
[100] TPR (2012) The Purple Book Chapter 4 Table 4.1 Assets discounted to the base year.
[101] Workplace DC assets taken from ONS (2012) Table 3, adjusted for decumulated assets.

Movement of individuals between schemes post automatic enrolment

From 2012, employees in the private sector without workplace DC provision are placed in a scheme to represent automatic enrolment, which is split further into master trust schemes and other DC schemes, assuming 80% are automatically enrolled into master trusts and the remaining into other DC schemes. Individuals are enrolled in proportion to the likely number of employees becoming eligible each year due to staging of their employers. Similarly, during the staging period, employees in existing DC schemes who become eligible for automatic enrolment either remain in the existing scheme or are moved to a new automatic enrolment workplace DC scheme (again split into master trusts and other DC schemes in the same proportions as mentioned above). It is assumed that 80% of existing members remain in their current scheme, and 20% are expected to move to the new automatic enrolment scheme. New members to DC schemes who have an employer with an existing scheme either join the new automatic enrolment scheme (80%) or join an existing DC scheme (20%).

Overall, after 2012 the private sector workforce is assumed to contribute to either private sector DB pension schemes, DC schemes which were existing prior to automatic enrolment, DC schemes which were set up for automatic enrolment, or DC schemes set up for those that are eligible for automatic enrolment that did not contribute before the implementation of automatic enrolment. It is assumed that 14% of the workforce change jobs from year to year, which causes individuals to shift from existing DC schemes into new DC automatic enrolment schemes over time.

Contributions

Contributions are taken as a percentage of total earnings for employer-provided schemes (both existing schemes and those set up after automatic enrolment) and are taken across band earnings for individuals automatically enrolled who previously were not saving. The earnings band is taken to be £6,240 to £50,270 with an earnings trigger of £10,000 (all in 2023/24 terms).

When automatically enrolled, individuals and their employers are assumed to contribute at the minimum levels required under automatic enrolment legislation (phased in from a combined contribution of 2% of band earnings in 2012, rising to 8% of band earnings in 2019 in accordance with existing regulations) unless otherwise stated.

Limitations of analysis

Care should be taken when interpreting the modelling results used in this report. In particular, individuals are not considered to change their behaviour in response to investment performance. For example, if investments are performing poorly, an individual may choose to decrease their withdrawal rate and vice versa.

Monte Carlo simulation can be a powerful tool when trying to gain an understanding of the distribution of possible future outcomes. However, in common with other projection techniques, it is highly dependent on the assumptions made about the future. In this case, the choice of distribution and parameters of the underlying variables, the investment returns of equities, gilts and cash are important to the results.

[102] Average annual workforce churn. DWP (2010) p49

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