
Shantel Okello


Lauren Wilkinson

10 more years of DC

Pensions Age sits down with the authors of the Pensions Policy Institute's latest _DC Future Book_, Shantel Okello and Lauren Wilkinson, to discuss the progress made in the industry over the past decade, and the challenges still to come

This year's future book comes almost a decade after the launch of the inaugural 2015 edition of the _DC Future Book_. Can you tell us a bit about how the landscape has changed in the 10 years since the launch?

Shantel Okello: There have been many changes within the pensions industry landscape, and I think the most significant one is the introduction of automatic enrolment in 2012 *[and growth in participation seen since]*, because of the way it's brought millions of savers into retirement planning that wouldn't have done so otherwise.

Another big one was the introduction of the freedom and choice, as that marked a real shift in the way in which people can access their DC savings and gave them much more flexibility.

But the overarching change has definitely been the shift in responsibility of risk from employers to individuals.

That shift has also presented some challenges for the industry, and this year's future book also has a focus on the what the next 10 years may hold, particularly given that move towards DC. So, with so many challenges on the horizon, what challenges do you think are most pressing for the industry to address?

Okello: The adequacy of contributions is a major one. I think that is a very persistent issue and currently contribution rates are nowhere near enough to ensure adequate standards of living in retirement.

Another issue though is the number of employees that are actually found ineligible for automatic enrolment as well. That is a major issue, and it highlights the gaps that we have in the current system – so it's definitely up to the government to make sure that people aren't being left behind.

Lauren Wilkinson: Yes, that was a very stark finding, as we've seen the number of ineligible workers overtaking the number of eligible people for the first time.

One thing to flag is that there are some people within that 11.2 million ineligible workers who will have been counted multiple times because they've been shifting around jobs quite a lot.

So, I think the real concern over the next decade is which groups are overrepresented in that ineligible group. Under-pensioned groups – including women, people from minority ethnic backgrounds, people with disabilities, carers, and people in non-traditional employment, so multiple job holders and the self-employed – are much more likely to be overrepresented in that ineligible group, which is really concerning in terms of the impact that could have on existing inequalities.

Do you think these are issues that we can expect to see addressed in the government's upcoming pensions review?

Wilkinson: Potentially, I think particularly in the second phase of the review where we're looking at adequacy – I think that these are all questions that will need to be fed into the review at that stage.

The first part of the review will be focusing on pension investments though, amid the broader push to encourage greater pension investment in the UK. This is another area that the _DC Future Book_ looks at in depth, suggesting that the move towards private markets will need to be handled carefully to ensure that schemes still put the needs of their members at the forefront. Can you tell us a bit more about these concerns and any specific measures you'd like to see from the government?

Wilkinson: Even before the current focus with the Mansion House Compact and the current investment review, we have been seeing DC schemes tentatively exploring alternative asset classes a bit more beyond that sort of traditional equity bond split.

That's a trend we've been highlighting in the *Future Book* for quite a few years now, but I think we've really started to see an increased focus recently.

There have been some structural and governance barriers that have meant progress was quite slow, but the daily pricing issue, which was quoted for a long time as a reason for DC schemes not investing, has largely been dealt with.

And as we see scale in the DC market grow, I think we'll see some of the other challenges reducing as well – so I think we can expect to see allocation to alternatives and private markets growing over the next decade.

But it's unclear at the moment how much of that will be going into the UK economy specifically, which seems to be the government's main driver.

And while there are societal benefits to stimulating the UK economy, for schemes, there really needs to be a strong case for why it's in their members' best interests before they start making changes to investment strategy.

If not, I think we're really going to see a growing tension between fiduciary duty

to members and the external pressures coming in from the government around UK productive finance.

One of the other issues is on the supply side, as there are concerns around whether there's currently enough in terms of quality UK productive finance investment opportunities.

If we start to see a rapid shift of schemes channelling funds into this, there is a risk there would be a potential herding effect, and it could have quite a detrimental impact on asset prices and returns.

We don't yet know what exact approach is going to be taken by the government, but we may see lighter touch measures explored first, such as disclosure requirements.

Even that could prompt less innovation in asset allocation though, if schemes tend towards the average allocation they're seeing among other schemes.

There's also the potential that could have the opposite effect on UK investment compared to what the government is intending, because if we start to see that schemes that are a bit overweight in UK investments are underperforming, then we'll see less schemes investing in UK assets.

It's a difficult one and it needs to be approached very carefully.

Do you think there is any risk that the focus on productive finance could distract from recent progress made on the push towards net zero?

Wilkinson: Potentially, we've seen ESG considerations really growing massively in importance in recent years, and again, that's something we're tracked in the *DC Future Book.*

But the increase in these ESG regulatory requirements has led to a bit of fatigue in terms of ever-growing disclosure requirements to be met.

We don't know what the government's approach is going to be on productive finance, but if we do see disclosure requirements, that could mean less time spent on ESG considerations.

We are quite far down the ESG-path though, and I think a lot of schemes, particularly larger DC schemes, have already thoroughly incorporated these considerations into their approach and into their processes, so hopefully we wouldn't see too much in terms of backsliding on these issues.

There's also the potential for productive finance assets to support the ESG objective, so I don't think they necessarily have to be in conflict, but they'll likely require a fair bit of work from schemes.

Given some of the adequacy issues raised in the report do you think it's the right approach for the pension investment review to tackle investments first, or do you think contribution rates should be tackled in tandem or sooner?

Wilkinson: Obviously I think that investment returns are an important part of the puzzle, and so I completely understand why we're focusing on that.

But I don't think they will solve the problem. We've got a lot of people that are sleepwalking towards very poor retirement outcomes and even with the best investment returns in the world, they won't be able to achieve positive outcomes without also increasing those contribution rates.

Okello: I agree. I think they both need to work simultaneously, and we want to ensure we don't overemphasise one or neglect the other.

Focusing on investment and performance can have a great impact as well, and even if it's just through active management or incorporating alternative assets, it is important to try our best to maximise those returns.

But again, I think the foundation and the building block is increasing those contributions.

Written by Sophie Smith