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INVESCO RETIREMENT SERIES – PART 4

Spotlight on Labour's Pension Schemes Bill

Will it pave the way towards better retirement outcomes?

Introduction

To the surprise of some, within the first few lines of the King's Speech – the first such speech under a Labour government in 14 years – reference was made to proposed legislation to "strengthen... pension investment".

Mary Cahani
Head of Defined Contribution (DC) Client Engagement

The Pension Schemes Bill will aim to enhance pension investment and stimulate economic growth. Notable elements of the proposed Bill include facilitating the automatic consolidation of small Defined Contribution (DC) pension pots, establishing a value-for-money framework for trust-based DC schemes, and mandating trustees of occupational DC schemes to offer retirement-income solutions to members. The overarching objective is to enhance the outcomes for members.

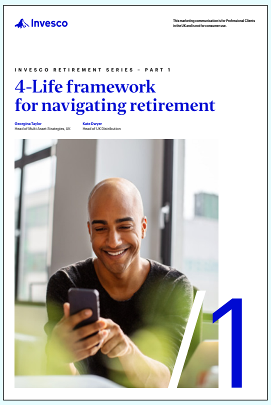
In this, the fourth paper in our Retirement Series, we will be discussing the Bill with two of our experts – Georgina Taylor, Head of Multi-Asset Strategies in the UK, and Michael O'Shea, Director, Government Relations and Public Policy – to understand what the Bill means from a policy perspective and explore how these policies can be translated into investment objectives to improve member outcomes.

Please see our Retirement Series

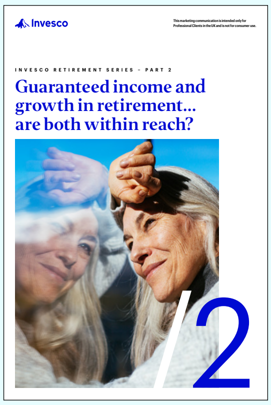
In the previous papers in our Retirement Series we introduce the 4-Life decision making framework, explore the opportunities for combining a guaranteed income with investment growth and provide an analysis of the Retirement Income Advice Review.

You can read the papers here:

Part 1



Part 2



Part 3

Policy perspective

Michael O'Shea
Director, Government Relations and Public Policy

Q: Firstly Michael, how important is the King's Speech – are these now solid commitments to change across the pensions industry?
The King's Speech heralds the State Opening of Parliament and sets out the legislative agenda that the government intends to pursue over the course of the parliamentary session, which typically lasts one year. It took on even greater prominence for Labour, as it was the first sovereign's speech given under a Labour government since 2009.

The King's Speech set out Labour's plans to deliver on many of its manifesto pledges within its first year of government. It is extremely ambitious; passing 40 pieces of legislation in one parliamentary session would be a massive achievement even with a large majority in the House of Commons.

However, given its prominence in the King's Speech and its importance to the delivery of Labour's economic growth 'mission', the Pension Schemes Bill is expected to be a priority piece of legislation which should pass without too much challenge, although parliamentarians will have an opportunity to amend the Bill in the usual way as the parliamentary process is taken forward.

Labour sees pensions reform as a priority policy – and financial – enabler for its programme for government

Q: The King's Speech included details of the Pension Schemes Bill. What elements do you believe are most important for Trustees to focus on?
To my mind, the proposed Pensions Schemes Bill – which the government is still to publish – will include four key elements for Trustees to consider.

- First, Labour continues the theme of the previous government regarding pension consolidation – both DB and DC – where it is clearly in the best interest of pension savers and retirees. This will encourage the establishment of DB superfunds, as well as consolidation of deferred small pension pots.
- The second key element, which relates in part to consolidation, foresees the development of a 'Value for Money' framework for trust-based DC schemes. This also represents a continuation of work undertaken by the previous government, as well as The Pensions Regulator (TPR) and the Financial Conduct Authority (FCA), and it is expected that underperforming schemes will be required to consolidate where doing so would demonstrably improve outcomes for members.
- Third, the forthcoming Pension Schemes Bill is expected to include provisions requiring pension schemes to offer decumulation solutions for those who have reached retirement age and choose to access their benefits, with the aim of providing retires with greater flexibility and security in retirement, while ensuring more funds are invested for longer.
- Lastly, the Labour Party – both in opposition and now in government – has talked at great length about using pension savings more productively in the UK in support of its primary 'mission' to deliver economic growth. While, to date, Labour's rhetoric in this regard has been short on detail, the government has made clear that pension schemes should "play a more significant role" in supporting the UK economy.

Q: Why do you think the new government chose to include details on pensions reform in the King's Speech?
It is becoming increasingly clear that, given the prominence of the proposed pensions legislation in the King's Speech, Labour sees pensions reform as a priority policy – and financial – enabler for its programme for government. Alongside the establishment of the National Wealth Fund and Great British Energy, the government views encouraging pensions to invest more productively in UK assets as central to the realisation of its economic growth objective.

While arguably the Pensions Bill will address issues on which there is general agreement, for example around consolidation and the provision of decumulation solutions, many more challenging issues, such as in relation to contribution rates and tax treatment, will likely be captured as part of the longer-term pensions review.

Q: Are there any other areas that are also important to consider alongside those referenced in the King's Speech?
Trustees should note that Labour's ambitions for pensions reform are not limited to the contents of the eventual Pensions Schemes Bill. The government has also announced a pensions review which will serve partly in support of the Bill but will also focus on enhancing the pensions landscape more broadly, though details remain scarce at this stage.

Of course, Trustees will want to remain close to other initiatives relevant to pensions that are expected to be taken forward in due course. I mentioned earlier, for example, the work of the TPR and FCA, alongside the Department for Work and Pensions (DWP), on the Value for Money framework undertaken under the previous government. The FCA had been expected to consult on detailed rules for DC workplace pensions but was no doubt waylaid by the announcement of the snap election. Whether the FCA will proceed as previously planned remains to be confirmed.

In addition, the work that the FCA has been undertaking on clarifying the Advice Guidance Boundary as a means to closing the advice gap will certainly be relevant to pension schemes required to provide decumulation solutions. The so-called 'Targeted Support' model – where firms would be able to suggest products or solutions based on target market profiles – potentially offers a route to bridging the gap between accumulation and the receipt of pension benefits.

Q: How is the value for money framework being defined?
Broadly, the Labour government has talked about introducing a "standardised test" that trust-based DC schemes will need to meet in order to demonstrate that they are delivering value to pension savers. This will include a focus on scheme governance and performance, supported through consolidation and increased investment in "productive assets".

The government has also suggested that the 'Value for Money' framework, once implemented, could boost the pension pot of an average earner who saves over their lifetime in a defined contribution scheme by over £11,000.

To achieve this objective, the DWP, TPR, and the FCA recently outlined their intention to implement a joint 'Value for Money' framework for workplace DC schemes. As proposed, the joint framework would require scheme providers and trustees to deliver greater transparency to members on metrics including investment performance and service quality, as well as costs and charges, with such metrics made public and rated relative to other schemes.

The idea is that poorly performing schemes would be required to take remedial action to improve the value which is being delivered to members. If this cannot be achieved, underperforming schemes would ultimately be required to transfer members to better performing peers. The FCA has stated that the framework "should lead to better value pensions, without savers themselves having to take action."

Investment perspective

Georgina Taylor
Head of Multi-Asset Strategies, UK

Q: Georgina, who needs to take responsibility for implementing the initiatives highlighted in the King's Speech?
The changes announced in The King's Speech throw a spotlight on the need to put a new pensions infrastructure in place to improve scheme member outcomes. In our view it also emphasises how the entire pensions industry, regardless of where an organisation is in the pension supply chain, needs to take responsibility for effecting change. This spans availability of appropriate products for both accumulation and decumulation and Trustee understanding of the outcomes of those products, member education in collaboration with Trustee boards and Investment Committees and ease of pensions access through digital platforms. It also involves collaborating on regulatory change to ensure change drives better outcomes for members.

Q: Is there a difference between assessing value for money in the accumulation versus decumulation phase of retirement?
We believe there is a stark difference between effectively assessing value for money in the accumulation phase of retirement planning versus decumulation. The spotlight is first being thrown on value for money in accumulation, but decumulation will soon be in focus.

Net performance through combining investment performance with costs and fees takes the traditional path to assessing value for money. During the saving phase, the longer timeframe over which savings are invested should allow for market risk premiums to be realised, contributing positively to retirement portfolios. Product selection during this phase should be a blend of active, passive, and private market investments to ensure investments are well diversified from both a performance and fee perspective. Given the long-term investment horizon for the savings part of the retirement journey, measuring value for money relative to a benchmark is appropriate.

For the post-retirement phase measuring value for money is more complicated. Products and pension scheme solutions should be delivering specific outcomes for scheme members rather than measuring success relative to a comparator benchmark. On retirement a proportion of scheme members will immediately start taking an income from their pension pots. As soon as a pension pot is being depleted, it is imperative that products are designed to deliver income rather than simply a total return over the longer term. The risk is that quantitative measures will be overly relied on to provide evidence of value for money post-retirement which may fail to capture the key elements of success in decumulation.

Q: With a move by schemes to explore offering a post-retirement default strategy what are the first steps for schemes in your view?
Building a post-retirement strategy is not an easy task. In accumulation the investment objectives are far more similar across scheme members – to deliver good long term returns to ensure as large a pension pot as possible on retirement.

Post-retirement looks and feels very different for different people. There needs to be a degree of flexibility embedded within the strategy. Factors that Trustees may need to consider are:

- The role that Investment Pathways play in providing a decumulation solution
- How to group individuals based on personal preferences
- How to design strategies where individuals do not have to commit to one pathway on retirement without flexibility to change path
- How to help individuals change their pension plan if their circumstances change – for example they return to part time work
- How to embed flexibility to allow members to purchase guaranteed income products later in their retirement journey

It is important for schemes to look at a broad range of investment options but through a lens that is very different to the one used for building an accumulation strategy. This is a new area for pension fund Trustees, and it requires a new and different approach. To be able to show value for money in accumulation and decumulation Trustees will have to show why they have a differentiated strategy for the two different phases of a scheme members retirement journey.

Q: What are the key elements to differentiate between pre and post-retirement strategies?
Pre-retirement strategies can be anchored around long-term returns often driven by capital market assumptions. Historic correlation analysis will derive a suitable allocation across asset classes, managing risk with return potential. The level of contributions by members is also key to the success of accumulation strategies therefore education on the benefit to members of adding to contributions should form a part of the overall accumulation strategy of the Scheme Trustees.

Post-retirement strategies need to look and feel different. The outcomes for members are more complicated because they cannot be treated as one homogeneous group. The personal aspect of post retirement planning is a key consideration for Trustees alongside investment risks such as lifestyle, sequencing and longevity risk.

To address lifestyle, sequencing and longevity risk we believe there must be a very clear distinction between income and growth strategies. This very simply means that if a member requires an income, they should draw that income from the part of their pension pot that is invested in strategies that are built to deliver income and limit downside capital risk. Alongside these income strategies can sit a growth strategy that future proofs the pension pot and gives members flexibility over the longer term. The feedback loop between these two components of the pension portfolio is important – the more exposure to income, the more risk can be taken in the growth strategy so that the overall risk of the pension pot remains consistent.

To address the personal aspect of retirement planning we believe building default personas, underpinned by different allocations to growth and income strategies to deliver both the income and long-term flexibility components that members need for their individual circumstances, is key to driving member engagement and keeping members invested to and through retirement.

Q: Are there other regulatory changes that will help with the measures laid out in the King's Speech?
The announcements made in the King's speech are directly impacted by the conclusions of the Advice Guidance boundary review by the FCA. If pension schemes offer a decumulation strategy in the future they need to work within the Advice-Guidance boundary and not be seen to be advising scheme members to invest in a particular decumulation strategy.

The Advice Guidance boundary review is looking at introducing targeted support which would allow more freedom to guide individuals to certain investment options based on their own personal circumstances. This would allow far more freedom for scheme Trustees and Master trusts to guide members to the most suitable decumulation strategy for them and arguably deliver better outcomes for members.

Q: Investing in UK growth – a good or bad strategy?
Directing investment allocations for pension schemes on the face of it is a sub optimal way to deliver the best outcomes for scheme members. Allowing trustee boards and investment committees to dictate the most appropriate asset allocation at any point in time should achieve the best outcomes, both in terms of meeting the scheme's objectives and ensuring alignment of board decision making with member outcomes.

However, while we agree with this sentiment and as investors would always want the freedom to allocate where appropriate at any point in the economic and market cycle, in the spirit of flexibility we want to put forward some thoughts. Firstly UK allocations could be re-thought, for example reallocating some of the existing UK equity exposure towards specific targeted growth opportunities in the UK economy. If incentives are in place this could boost returns over the longer run for scheme members. Secondly engagement of scheme members could potentially be boosted by being able to 'see' the returns on their pension investments. Showing how pension investments can help boost growth domestically could, if done correctly, increase pension engagement levels which ultimately will improve member outcomes through increased contributions and interest in pension investments.

To address lifestyle, sequencing and longevity risk we believe there must be a very clear distinction between income and growth strategies.

Summary

In conclusion, the Bill's significance within the King's Speech indicates that it is likely to be a priority piece of legislation for the government.

This underscores the government's commitment to bringing about meaningful change in the pensions industry with the aim to enhance pension investment and promote economic growth by incorporating several key elements: pension consolidation, establishing a value-for-money framework for trust-based DC schemes, mandating retirement-income solutions for members, and stressing the role of pension savings in supporting the UK economy.

There is clearly a need for industry collaboration to enable innovation and evolution of the DC schemes' strategies to ensure that members are able to benefit through improved outcomes.

Mary Cahani
Head of Defined Contribution (DC) Client Engagement

What is Invesco doing to help address the measures announced?

The Invesco approach involves fostering a collaborative relationship with DC pension scheme stakeholders to analyse the role of different types of investments during the accumulation stage of the members' journey and enable access to various investment strategies across alternative or public assets through a value-add approach. An important focus is placed on aligning with the scheme's Responsible Investing policies while aiming to improve member outcomes during the growth stage of the member journey.

When looking to develop a comprehensive retirement planning strategy, our aim is to introduce the 4-Life Framework, which provides a well-rounded approach to planning for life after retirement. This framework focuses on personalization by incorporating Personas into pension schemes. Moreover, we are committed to providing balanced solutions that consider the holistic risk profile, balancing income, growth, and risk factors. In addition, we are working on launching innovative products, including global real estate and income products, to facilitate both the accumulation and distribution phases of retirement planning.

Investment risks

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and you may not get back the full amount invested. Over time, inflation may erode the value of investments.

Important information

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