Society of Actuaries in Ireland

Global DC Markets Making retirement effortless

29th November 2016

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Global DC Markets
Making retirement effortless

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November 2016

Vanguard

Agenda

The emergence of a modern Defined Contribution (DC) scheme

DC Retirement themes

- Increasing saving
- Default options
- Pressure on fees
- Retirement income solutions

Conclusion – Universal DC Governance Lessons

The emergence of a modern DC plan

DB funding concerns mount-Is the DB vs. DC argument decided?

How to best blend DB and DC plan designs and features

- Shared responsibility between employer and employee
- Governance remains vital
- Use behavioural economics to improve employee outcomes
- Default assets to an appropriate and professionally managed glidepath
- Greater scrutiny of fees

But

- Retirement income solutions are a challenge

Saving more matters most

US: Auto enrolment increasing

- Average total contribution rate 9.5%
- 41% of plans employ auto-enrolment
- 97% defaulted to a Target Date Fund

UK: Auto enrolment phased in 2012 – 2017

- Estimated to increase savings by around £11 billion per year
- Current opt-out rate: around 9%

AUS: Superannuation made compulsory in 1992

- Mandatory contributions: currently 9.5%, long-term aim 12%

- Increase participation rates
- Increase contribution rates

Sources: How America Saves 2016, Vanguard; Dept for Work and Pensions 2013; SuperGuide www.superguide.com.au

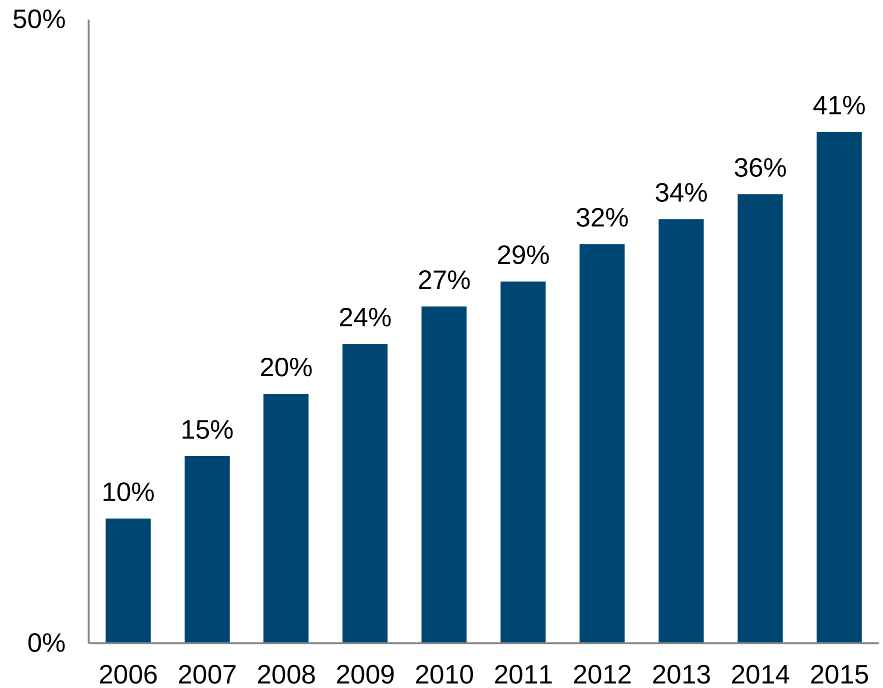
In the US, 4 in 10 plans have adopted automatic enrollment

Automatic enrollment designs

- 57% enroll at 3% or less
- 43% choose higher rates
- 70% have automatic deferral increases
- 99% have a balanced default strategy
  - – 97% have target-date funds
  - – 2% have traditional balanced fund

Two-thirds new plan entrants in 2015 were in plans with automatic enrollment

Automatic enrollment adoption grows

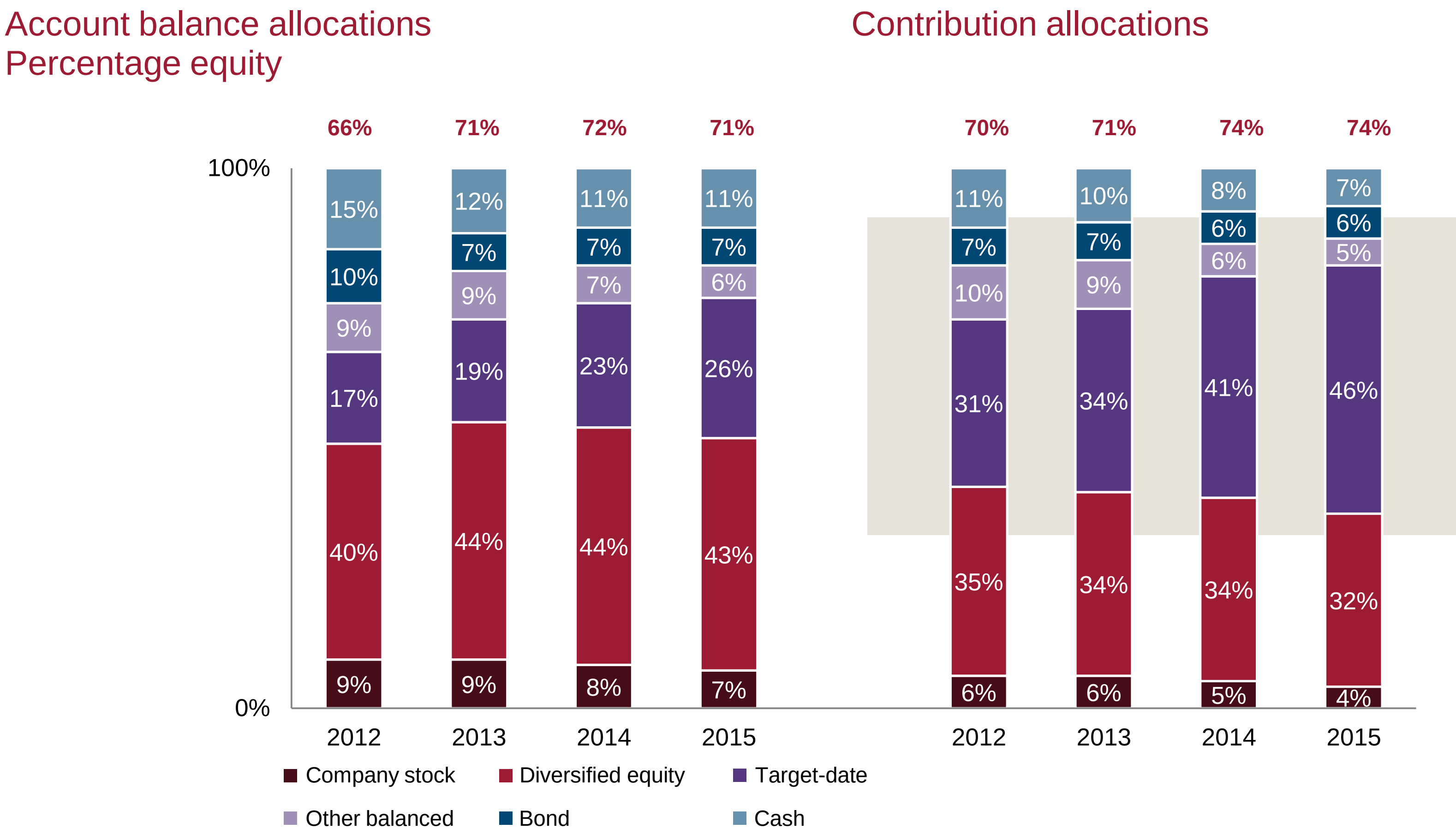


Source: *How America Saves 2016,* Vanguard.

Default options

- Will simpler defaults drive member engagement on saving more?
- The rise of automatic plan features at the kick-off and accumulation stage:
  - Automatic enrolment
  - Target-date funds, managed accounts or lifestyling
  - Menu tiering
  - Growth of indexing
  - Professionally managed allocations
  - Re-enrolment

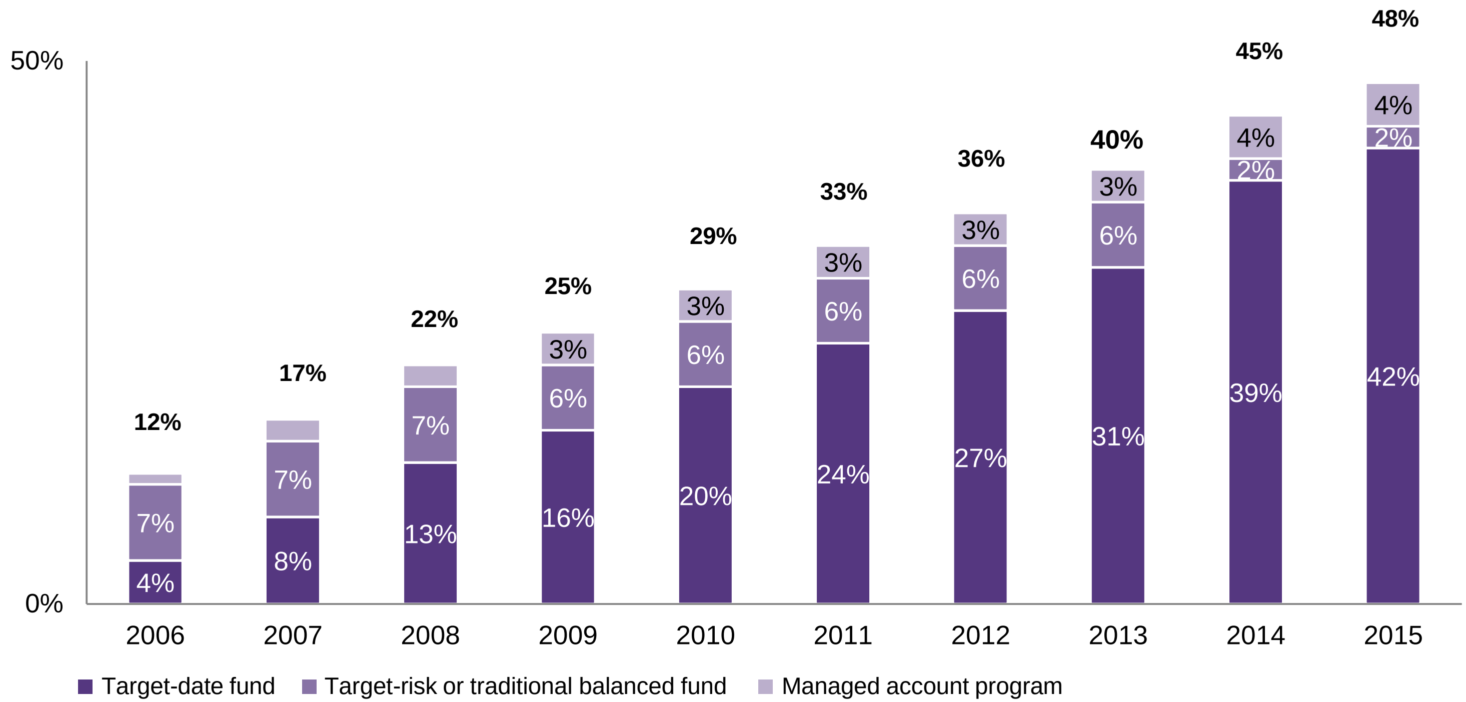
US-Overall allocations steady



Source: *How America Saves 2016*, Vanguard.

US-Professionally managed allocations

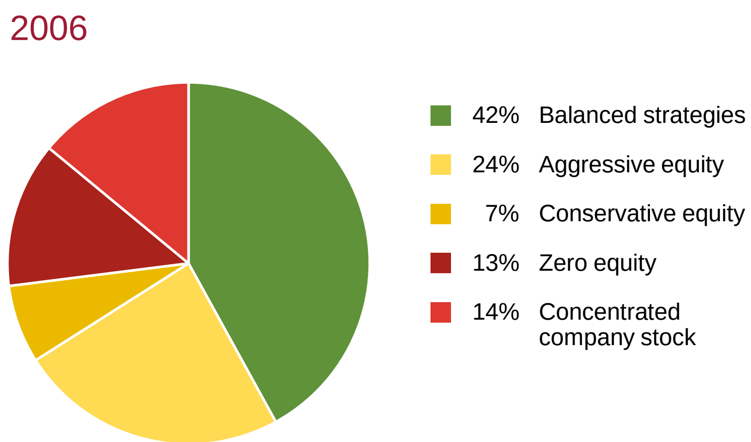
Percentage of participants with professionally managed allocations – we predict 68% in 2020

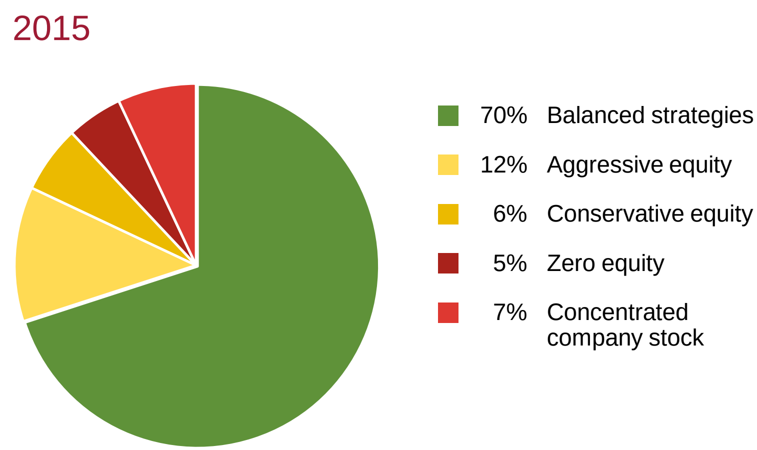


Source: *How America Saves 2016*, Vanguard.

US-Portfolio construction has improved

Percentage of participants





Source: *How America Saves 2016*, Vanguard.

Pressure on fees

Sources of pressure

- Regulatory scrutiny
  - US DOL mandate of fee disclosures
  - Fee cap in the UK
- Administrative economies of scale and market forces
- Transparency increasing buying power
  - Ability to identify the cost of individual components
  - Bundled versus unbundled
- Demand for passive investment strategies greater in DC than in DB
- Master Trusts-who benefits from the scale?

Retirement income phase

Global themes

- Shift in emphasis from accumulation to drawdown
- Need for appropriate drawdown products

US – 'Drawdown 1.0' – the first iteration of retirement income solutions

Australia – still early stages, but change in policy framing

UK – end of annuitisation – more options and more decisions for members

US experience

US policy

- ‘Lifetime income’ initiatives:
  - Include income estimates on statements
  - Introduce annuities within target date funds (TDFs)
  - Remove tax impediments for longevity insurance
  - Encourage annuitisation
- Some states looking to mandate enrolment

Market practice

- Behavioral economic theory drives plan design
- Education and web tools on drawdown and annuity options
- Advised drawdown services, eg Vanguard and Financial Engines
- Annuity options generally excluded from plan

Lessons from US

- The need for education
- Choice architecture-unbundling
- Fee disclosures help

Australian experience

Australian policy

- Financial System Inquiry proposed
  - Restate government objective to the provision of incomes in retirement
  - Remove regulatory obstacles to encourage product development of retirement income products
  - All superannuation funds adopt a comprehensive retirement income product (in which annuities may play a role)
  - Relies on behavioural finance concept of streamlined choice
- Contribution caps for high earners

Market practice

- Use financial advisers to establish an account-based withdrawal programme (currently without annuitisation)
- Annuity market has shrunk over the years

Lessons from Australia

- Role for annuities persists
- Regulatory framework to allow appropriate product development
- Choice architecture via Master Trusts

UK experience

UK policy

- Limiting the tax benefits of pensions:
  - Containing the ‘tax loss’ to the Exchequer
  - Lifetime pensions savings limit
  - Cap on tax relief for high earners
- Compulsory auto-enrolment
- Pensions freedom at retirement

Market practice

- Prevalence of lifestyling default models
- No clear solutions at retirement-how to achieve flexibility

Lessons from UK

- Growing DC plans require greater scrutiny
- How to achieve member outcomes and value for money

Global DC Best Practices

Focus on member engagement to push for saving more

- Auto enrolment is increasing participation rates, but not high enough
- Next step is to escalate contribution rates
- Complexity overwhelms and paralyzes members
- Simplicity helps member engagement

Focus on DC governance and scheme design

- Scheme features need to encourage good decisions
- Corporate sponsors must lead on open architecture and transparency

Scrutinise fees

- Pressure to minimise costs demonstrate value for money
- Bundled vs. unbundled

Retirement income is now a focus

- No consensus on product approach and member behaviours
- Regulatory environment expected to evolve rapidly

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