AON

Better Outcomes by Design

2022 DC Pension Scheme and Financial Wellbeing Survey

Foreword

Benjamin Roe
Head of DC Consulting

I am delighted to introduce our 2022 DC pension scheme and financial wellbeing research.

The last two years have been challenging for everyone and, understandably, pension schemes have not always been at the forefront of people's minds. This does not diminish the importance of work being done by the custodians of the finances and future wellbeing of the millions saving for retirement through their workplace pensions, as well as the dedication of all those on the operational side who have ensured that the pension system continues to function.

I'd like to thank all those who took the time to participate in our defined contribution (DC) scheme survey. We received responses from those running DC pension schemes across a range of industry sectors, sizes and types, covering around half a million members and assets of over £35bn. This input gives us a great insight into the current priorities and challenges for DC pension schemes in the UK.

Our longer-term readers may be aware that we have been undertaking this research on a regular basis for nearly two decades. This allows us to identify differences year-on-year and to understand the direction of travel and trends over longer periods.

One such trend I have noted this year is the greater emphasis placed on pension outcomes. More respondents than ever selected providing a sufficient pot for members to retire with as their main driver in running their schemes. I also saw a growing recognition that monitoring and influencing outcomes is as important, if not more so, than measuring inputs across areas such as contribution take-up, communications and investment performance.

This is a really positive direction for DC pensions, as the management of schemes evolves to consider what members will receive in retirement. Whether this is enough and how we can help either by default or by nudging members into taking the right decisions.

I am pleased to be able to share within this report, insights from several subject matter experts within Aon's extensive DC team and wider retirement business. Each chapter also finishes with a short checklist of some practical actions that schemes can take to deliver better outcomes for employees and scheme sponsors.

Please feel free to contact me or any of our team to discuss areas of particular interest or challenges. At Aon, we are in the business of better decisions and our aim is to use our expertise, experience and tools to help support our clients to achieve their goals.

Note: some charts within this report may not total 100% due to rounding

Executive Summary

Strategy and Design

46%

of DC schemes now have a main aim to deliver **adequate retirement income**, compared to 29% two years ago.

Nearly half

of schemes (48%) are considering changing structure.

Learn more >

Contributions and Adequacy

Average default contribution rates steady

at around 6% company and 4% employee, but...

63%

don't know the projected outcome for a typical member. Although 22% say **they now know this in terms of the Retirement Living Standards.**

Learn more >

Investments

Four in ten

schemes now **assess all of their investment options against ESG criteria**, up from just one in ten two years ago.

90%

regularly monitor individual fund performance against benchmarks, but only 30% monitor performance overall as experienced by members.

Learn more >

Engagement and Wider Financial Wellbeing

61%

would like to spend **more time on communicating about pensions** with their employees.

44%

plan to provide targeted communications in next two years in addition to 38% currently doing this.

Learn more >

At Retirement

39%

signpost a selected IFA firm to members at retirement with a further 19% planning to do so in the next three years.

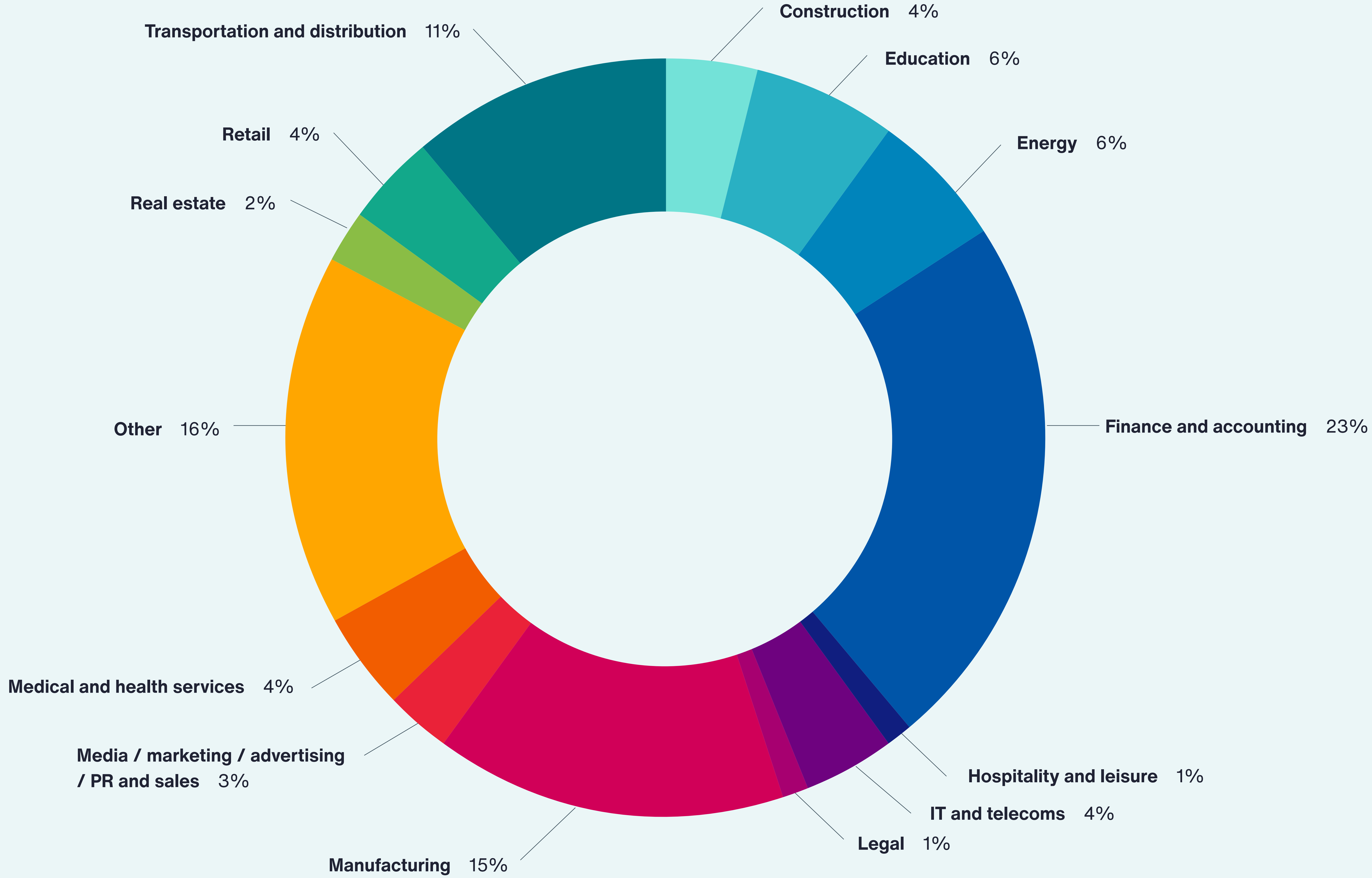
2/3rds

offer or plan to offer **a drawdown solution**, most use same provider as for accumulation.

Learn more >

Respondents

Responses from schemes holding over £35bn in assets for over half a million members across a range of sectors.



Strategy and Design

Headlines

- Five in ten DC schemes now have a main objective of delivering adequate retirement income, compared to three in ten two years ago.
- Around half of schemes are considering changing structure, for a range of reasons, including reducing their governance burden and costs, as well as expecting better outcomes for members from an alternative structure.
- Six in ten would like to spend more time on communicating about pensions with employees.

> "
> **Understanding employee demographics and how employees make decisions should influence DC plan design and implementation models, potentially to improve the resulting outcomes.**
>
> *Aon's Global Defined Contribution (DC) Point of View*

1

Member Outcomes Are Now the Key Driver for DC Pensions

We asked respondents what is driving their overall approach to defined contribution (DC) pensions.

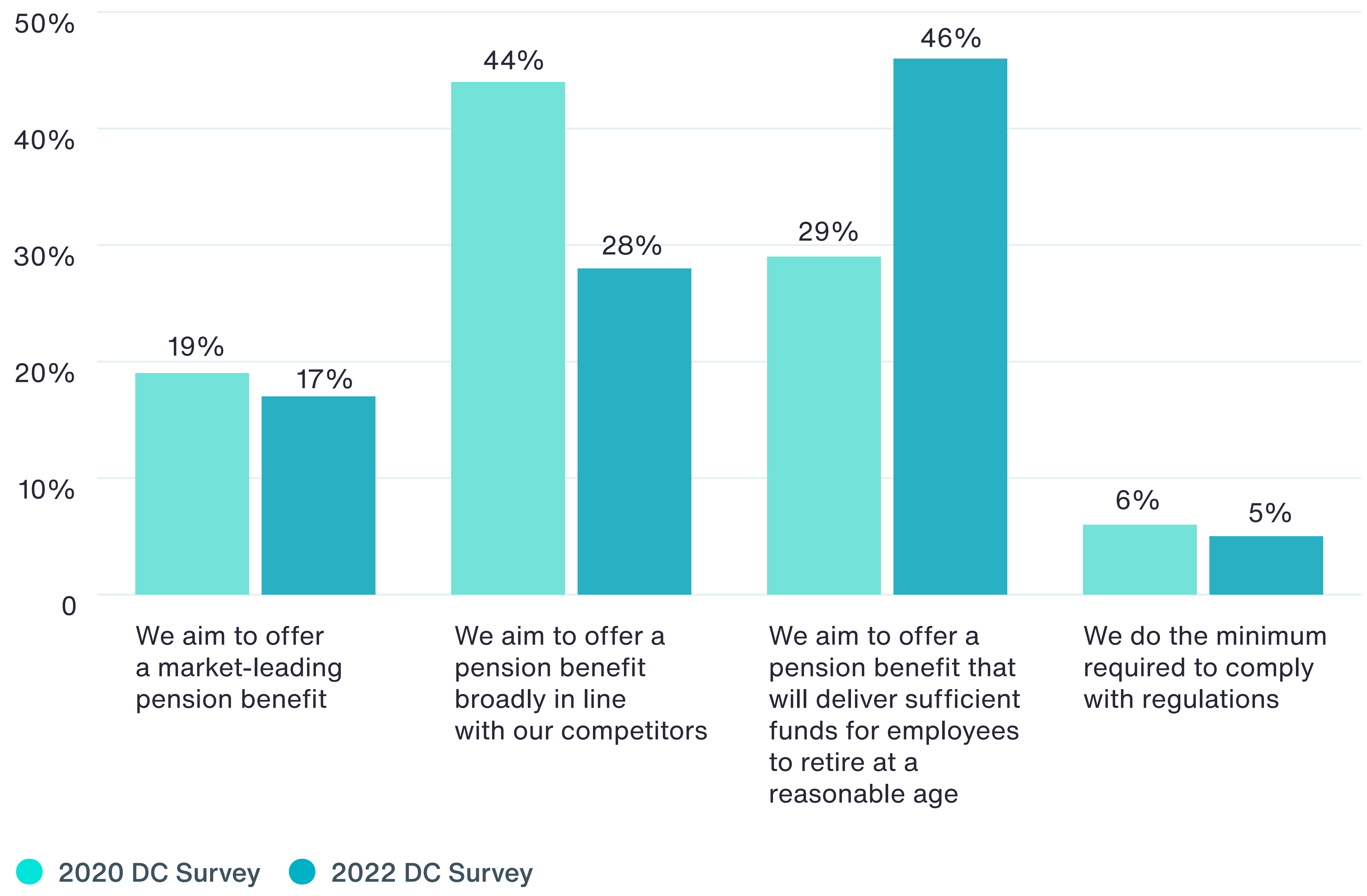
Our findings show that almost half the respondents (46%) have a primary focus on **providing good member outcomes**. Participants said that their approach to DC pensions is driven by delivering sufficient funds for employees to retire at a reasonable age. This was a significant increase from 29% in our 2020 survey.

We have also seen a move away from respondents basing their strategy solely on competitor benchmarking. In 2020, 44% of respondents said this was leading their approach to DC, compared to just 28% in 2022.

46%

of schemes have a primary focus on providing good member outcomes

What is Driving Your Overall Approach to DC Pensions?



Aon's Expert View

Overall, I think these findings are positive as they show schemes are taking a more forward-looking approach to pensions. While it will always be important from a recruitment and retention perspective to benchmark pension offerings against peers, taking the long-term view on delivering adequate outcomes that enable people to retire at an appropriate time is vital from a business perspective.

With ever greater proportions of employees' retirement income coming from DC plans, it seems that companies and schemes are reflecting far more on how they can best design their pension plans and offer support to help their employees to achieve a reasonable retirement.

John Foster
Partner, DC Consulting

What Objectives Do You Have for Your DC Scheme?

3/4

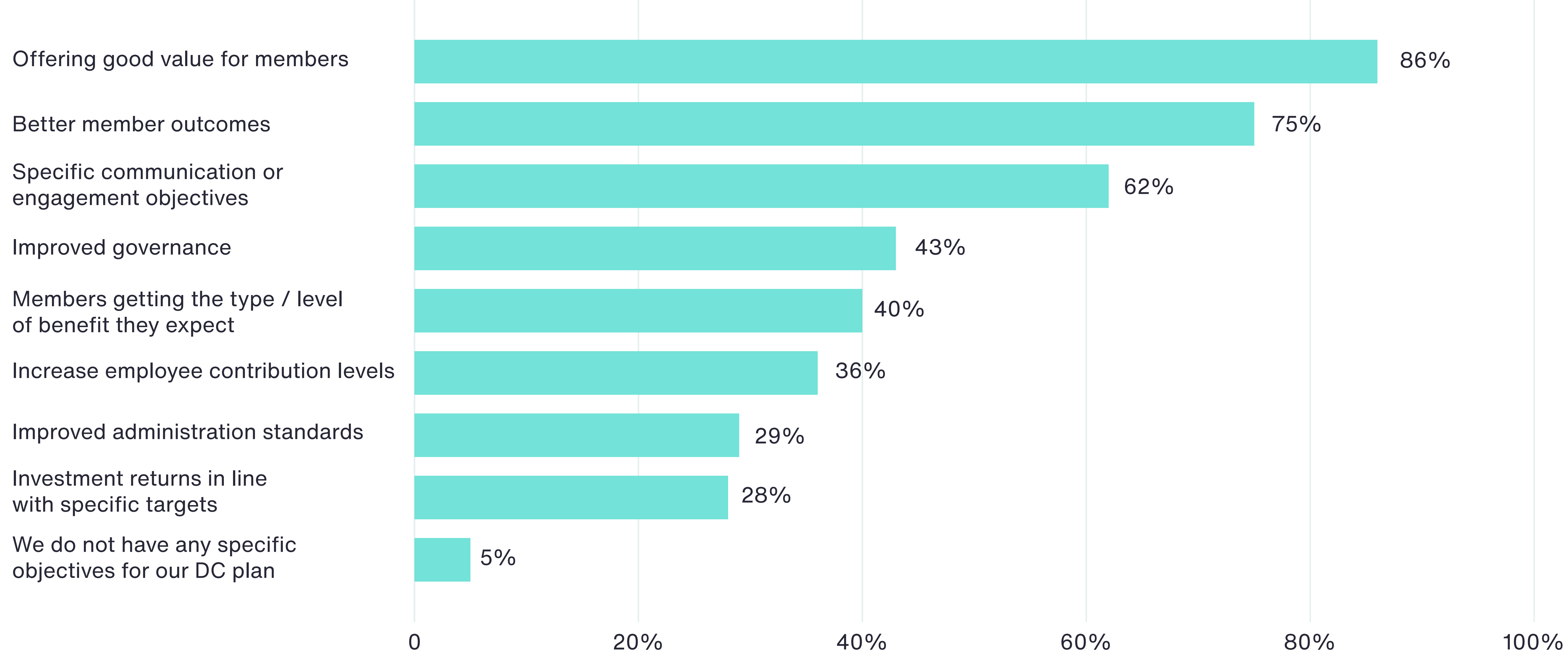
of schemes say improving member outcomes is an objective

Just over 1/3

of schemes target increasing employee contributions

Objective setting is crucial for any DC scheme. It sets the direction for future planning and prioritisation, as well as helping to shape key activities such as investment strategy. This year, **three-quarters of respondents told us that improving member outcomes is a major focus.**

On the surface, this is a really positive figure, but our findings show that schemes may not be backing up their ambition with sufficient action. Improving member outcomes can only be achieved through increasing contributions, improving investment returns after charges, and helping members make sensible retirement choices. However, only 36% of respondents said that increasing employee contribution levels is on their list of objectives, and just 28% said they were focusing on making sure their investment returns were hitting specified targets. This suggests that some of the drivers of better member outcomes should be higher on schemes' priority lists.



A Framework for Value for Money

86% of schemes said that offering good value for members is one of their key objectives. However, it can be difficult to define what 'good value' means.

We are seeing increased attention both from the Financial Conduct Authority (FCA) and The Pensions Regulator (TPR) on defining and measuring value.

The FCA and TPR's joint discussion paper *Driving Value for Money in Defined Contribution Pensions* is a starting point for an industry-wide standardised assessment framework that is focused on core elements of value for money: investment performance, scheme oversight (including data quality and communications), costs and charges.

Trust-based schemes with less than £100m in assets now have to undertake a prescribed value assessment to understand if members would be better off in an alternative arrangement. Following recent consultation, we expect that requirements will similarly increase for larger trust-based and other types of workplace pension schemes. We have seen best practice develop significantly in this area and have developed our framework to help trustees and employers understand whether their pension scheme measures up.

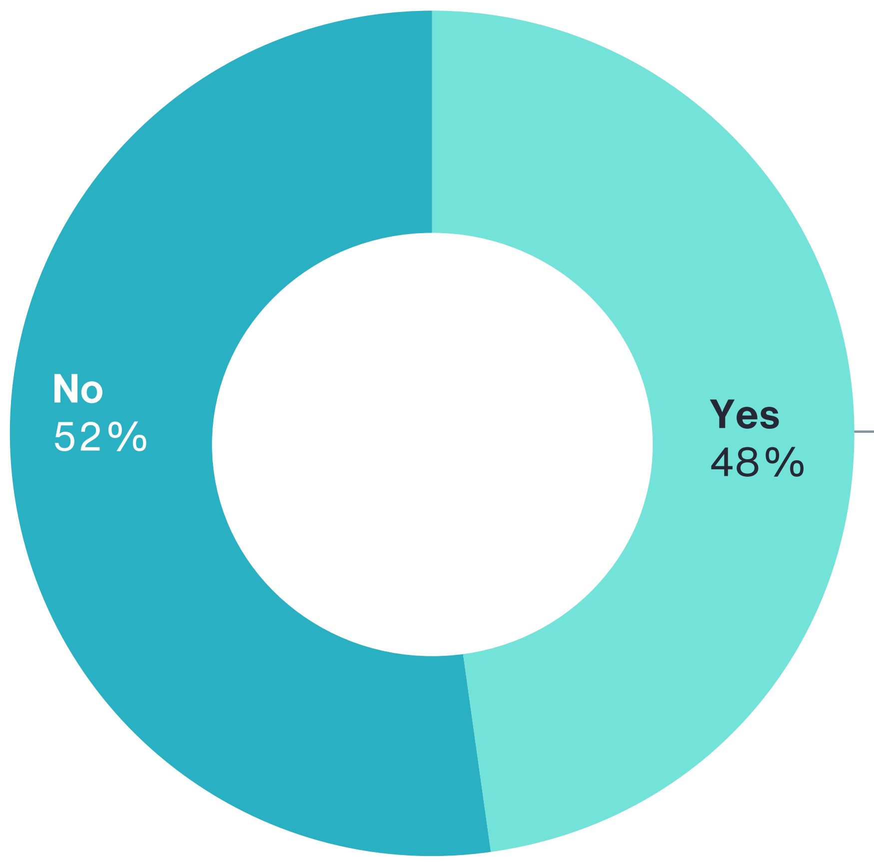
1 A Change of Structure?

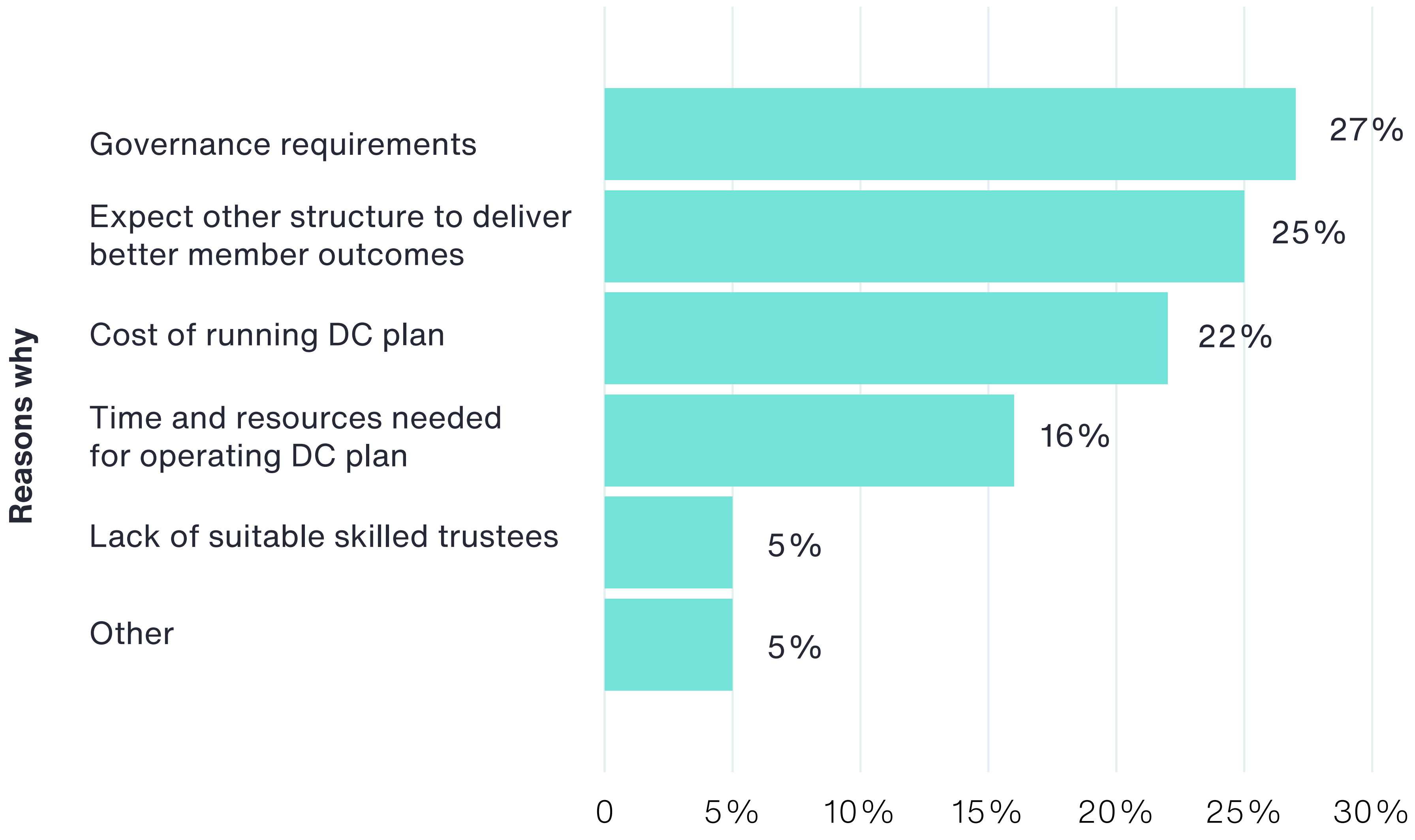
We asked participants if they were considering a change to the structure of their DC scheme, such as moving to a master trust or Group Personal Pension ("GPP").

More schemes than ever are considering a change to the structure of their pension scheme. In our 2022 findings, 48% of schemes said that they are now thinking about making a move to a master trust or other option such as Group Personal Pension or bundled provider own trust.

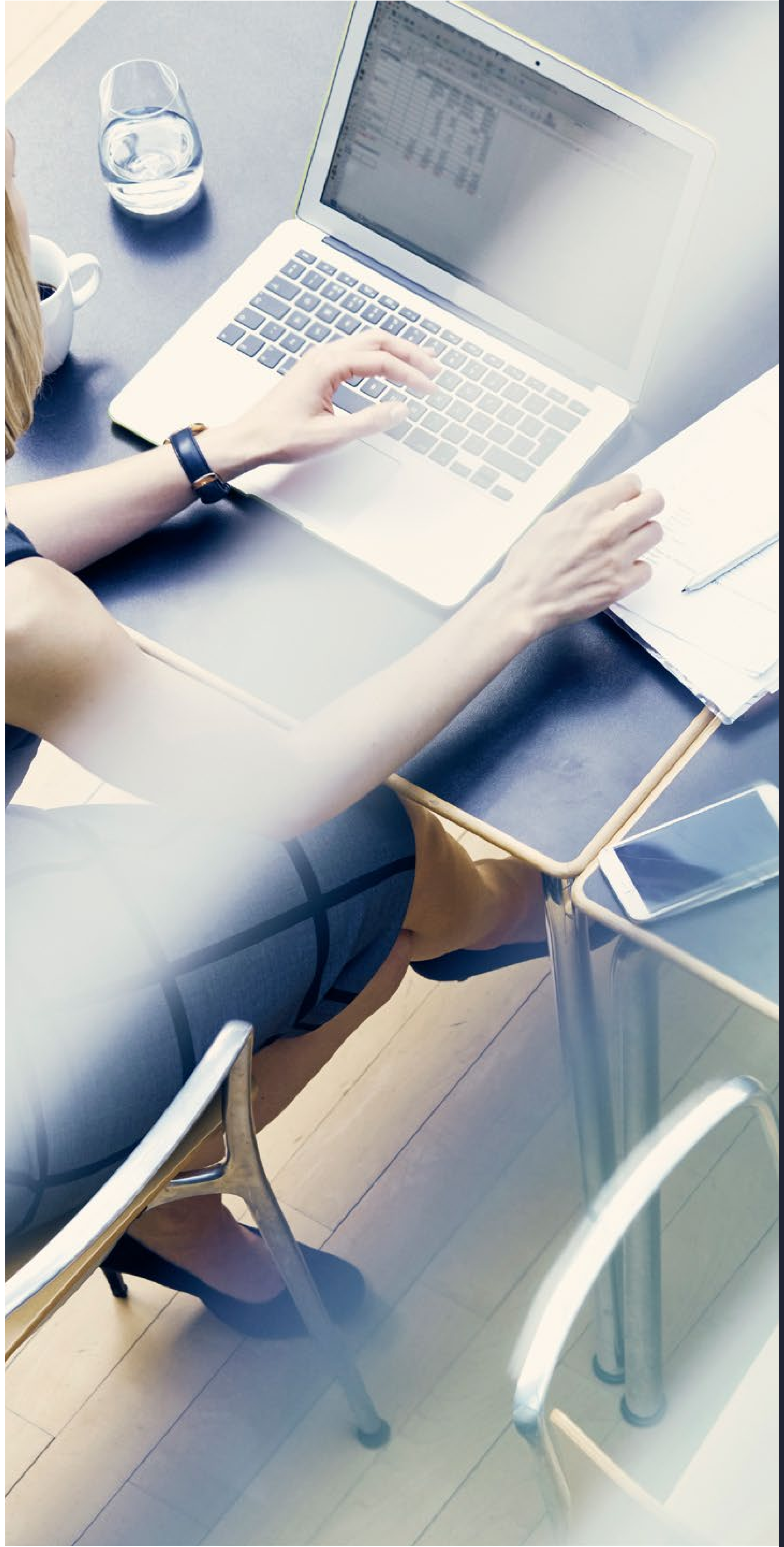
48%
of schemes plan to change structure

Considering Moving Structure





Many of the reasons cited for planning a change are related to expected benefits for the sponsor, such as reducing the burden of managing governance requirements (27%) or reducing the cost of running a DC scheme in its current structure (22%). However, one in four (25%) are considering this because they expect a different structure to deliver better member outcomes. As we saw earlier in this section, this final point is in line with many respondents' broader objective to improve outcomes. In reality, a change of structure can potentially help achieve progress across several objectives.



Aon’s Expert View

I am seeing employers and trustees considering a move to the Aon MasterTrust for a range of different and often complementary reasons. It can make pensions easier to run and reduce costs, as well as providing access to more modern investment approaches, improved member communications and holistic financial support. In some cases, schemes have started off looking for a post-retirement solution for members wishing to use flexible drawdown and have subsequently concluded that it would benefit members to use the same solution pre-retirement.

Jenny Swift
Aon MasterTrust

Will Consolidating Reduce Member Costs and Improve Returns?

Research from the Pensions Policy Institute (PPI), *What can other countries teach the UK about measuring Value for Money in pension schemes?* shows that scale can certainly make a difference, but above a certain point, there may be diminishing returns.

- Schemes in the Netherlands have found that, while there is **a positive impact from lower costs and higher returns in large funds**, this starts to recede once scheme size goes above £0.5bn.
- Experience from the US shows that the biggest gains in value for money are available by moving from a small scheme to a larger structure. The investment fees paid by scheme members could fall by half as size increases.
- In the UK, larger funds have increased the opportunity to improve diversity in their investment strategies and achieve potentially higher returns by accessing illiquid, unlisted or direct investment. However, illiquid investments are not a homogeneous group and can mean higher charges. We consider this topic in chapter three — DC Investments.

Are Schemes Spending Time on the Right Things?

We have already seen that governance requirements and the time and resources needed to run a DC scheme are concerns for our respondents. There was further evidence of those strains when we asked participants about the time they spend on different aspects of scheme management.

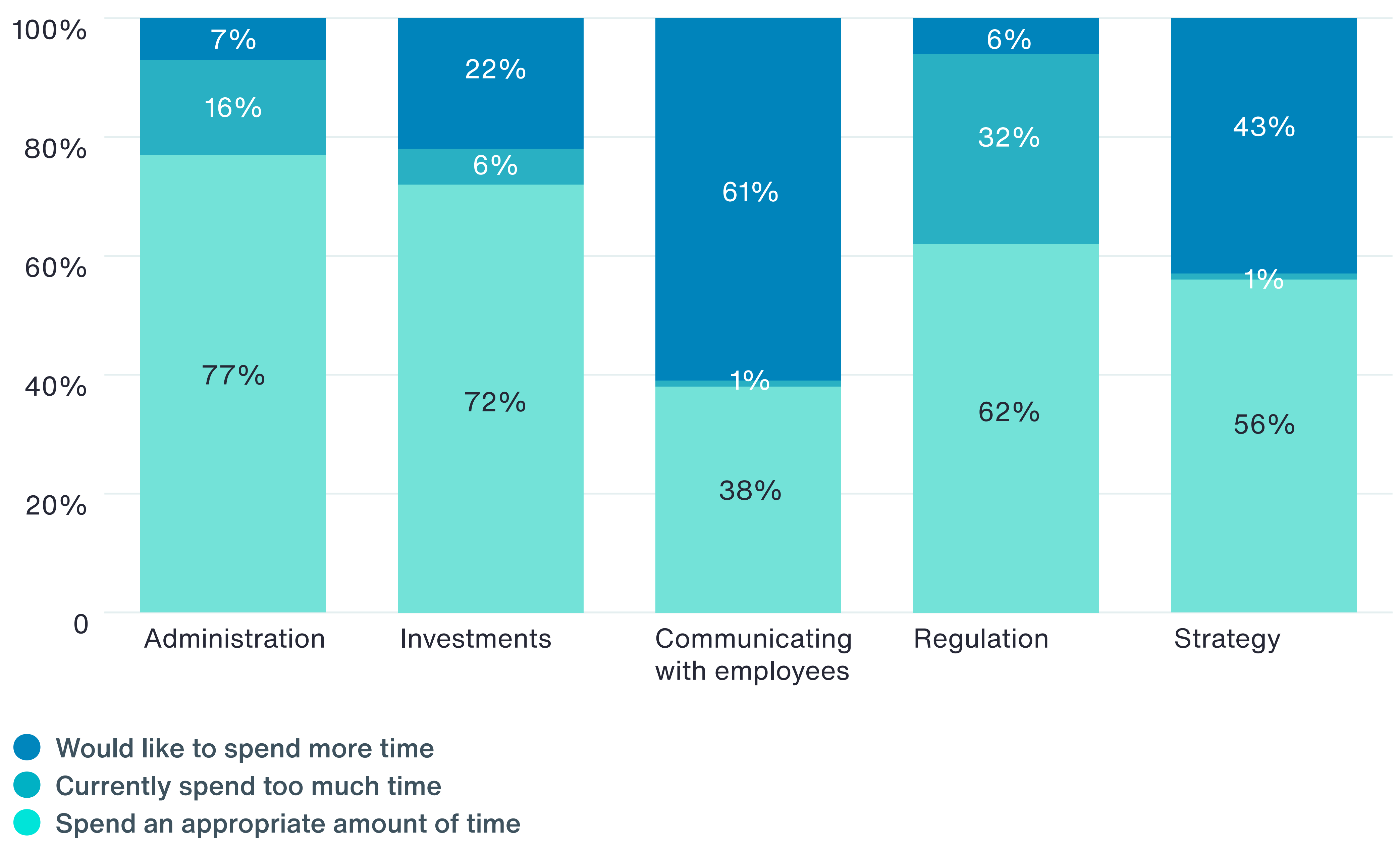
One of the most striking findings this year is the extent of respondents' frustration with the time they spend on regulation. One in three (32%) said they feel they are spending too long on it — about double the number who reported this in our 2020 research.

There is a range of new regulation on the horizon in 2022. This includes TPR's Single Code of Practice, proposed changes to illiquid investments and charges caps, continued scrutiny of ESG and stewardship, as well as other factors such as the ongoing pensions dashboard, so this concern is unlikely to reduce.

This could also be a driving force for respondents' plans to change their scheme structure and reduce governance time. Increasing delegation to a master trust or GPP provider could free up time and resources for those running schemes, enabling them to devote more to activities where they can deliver enhanced value to members, such as communications and strategy.

The lack of time spent on communicating with scheme members continues to be a concern for respondents. In 2020, 65% said that they would like to spend more time on this aspect of pensions. In this year's findings, that has remained fairly consistent at 61%. We explore this further in chapter four of this report

Evaluate How You Are Spending Your Time in the Following Areas



Actions Checklist

Strategy and Design

- Review whether your objectives are focused on the right areas to deliver your overall strategy and how you assess progress.
- Consider whether a different scheme structure could improve outcomes for members.
- Could delegation help focus time on areas where it would add most benefit?

2

Contributions and Adequacy

Headlines

- Average default contribution rates are relatively unchanged, at around 6% from company and 4% from employee.
- Half of schemes have more than one contribution structure in place.
- 63% do not know the expected outcome for a typical member at retirement.

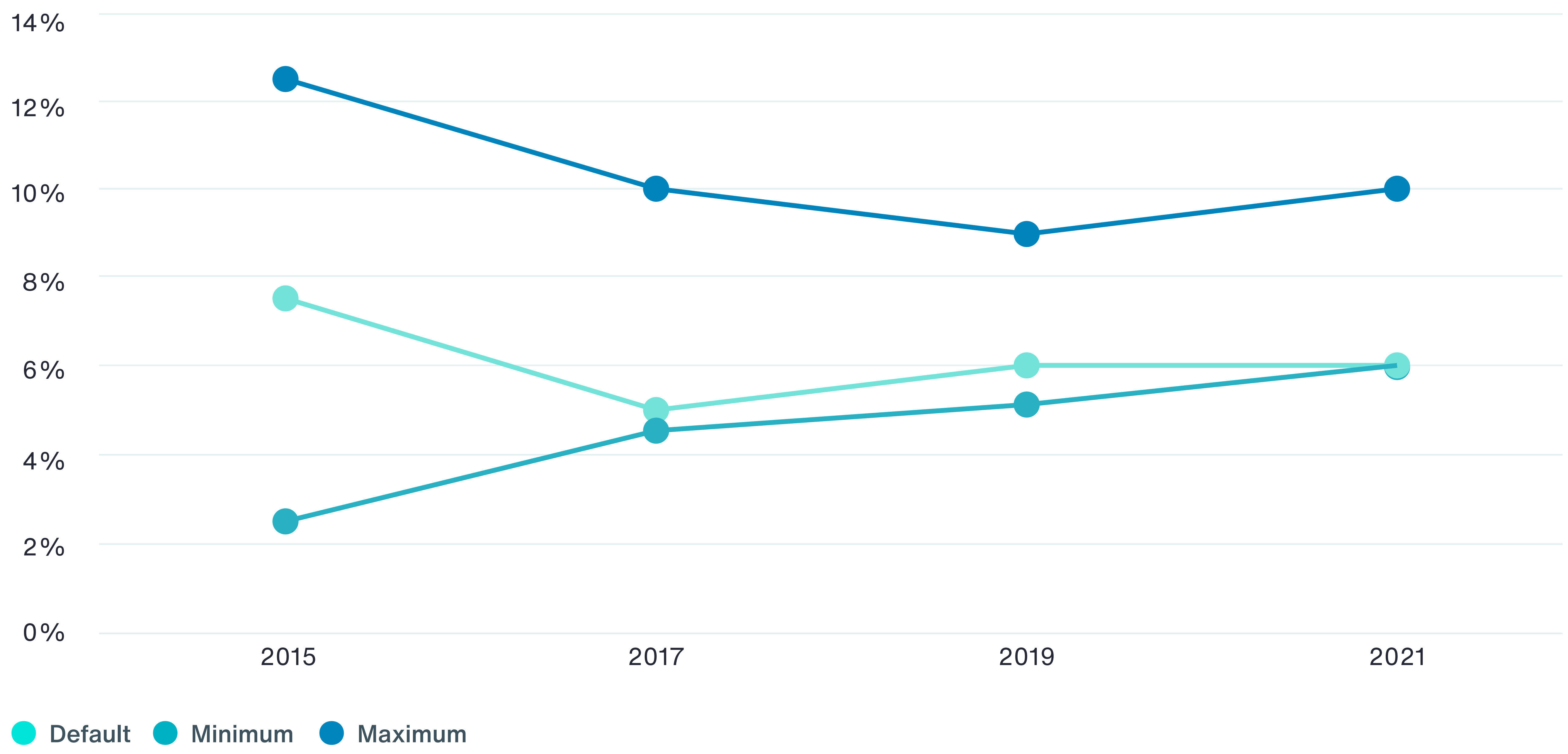
How Much is Being Paid Into DC Pensions?

Making adequate and regular contributions is one of the key pillars of good member outcomes in DC schemes. It is positive to see that, despite the financial pressures of the COVID-19 pandemic on employers and employees alike, contribution rates have remained stable over the last two years.

The average default pension contribution from employers has remained at 6% and at 4% for employees. This shows that most employers structure their own pension contributions at a level above the minimum statutory requirement, and that they are prepared to contribute a bigger share of the overall minimum level than they require from employees. However, there is significant variation, as can be seen from the box charts on the next page. This variation is particularly apparent across industry sectors, with the energy sector offering the highest average starting company contributions — at a rate more than double that of the lowest level across all sectors.

Considering trends over recent years, our results show that contribution design has stabilised now that the phased increases driven by auto-enrolment legislation are complete. While COVID-19 will continue to put pressure on some business sectors in the short term, the longer-term question will be whether employer and employee contribution rates are sufficient to deliver adequate member outcomes.

Median Company Contributions Over Time



Average default contribution rates

6% company

4% employee

What Are the Minimum, Default and Maximum Pension Contribution Rates for a New Joiner to Your Plan?

The range of minimum and maximum contributions on offer from employers with a matching contribution structure has remained broadly consistent with our 2020 research. The minimum levels of contributions are generally close to the default level, i.e. employees are automatically enrolled at the lowest contribution option. However, it can be seen from the charts, that many employers offer a substantially higher company contribution if employees contribute more — the median company contribution level increasing from a default of 6% to a 10% maximum.

Aon's Expert View

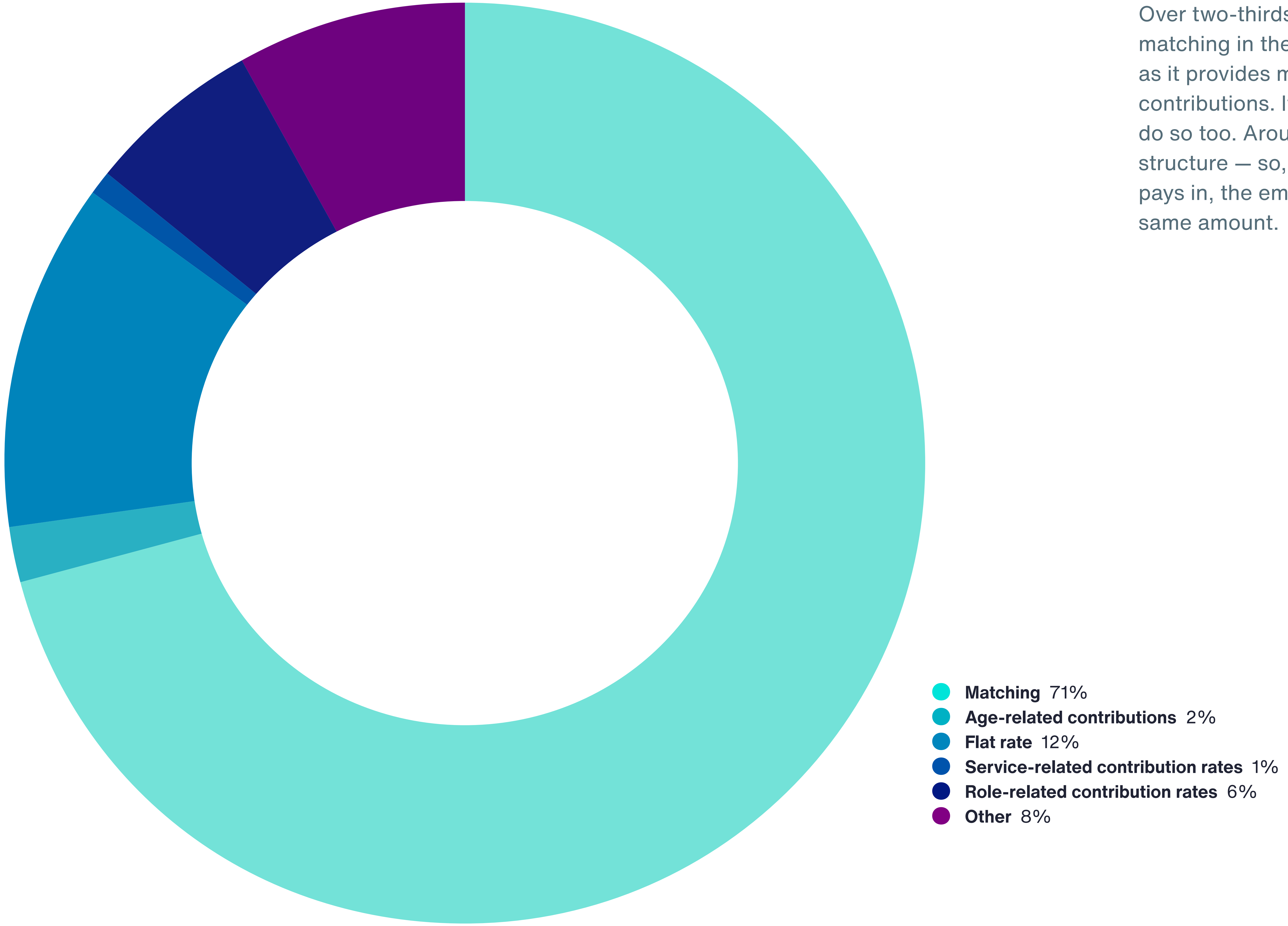
Auto-enrolment has shown that we can harness the power of inertia to improve pension outcomes. I think we can take this further, for example by defaulting members at a higher matching contribution rate, rather than at the minimum rate, and then allowing them to choose to opt down rather than up.

I am also seeing schemes increasingly interested in automatically increasing employee contribution rates each year in line with pay rises, but again allowing employees to opt down if they choose.

Both of these approaches take the onus off the individual to make a choice proactively and can be very successful in improving pension outcomes.

Claire Magudia
Senior Consultant DC Consulting

2 What Best Describes Your Contribution Structure?



Over two-thirds of respondents (71%) offer contribution matching in their schemes. This is a compelling model as it provides members with a clear incentive to increase contributions. If they pay in more, their employer will do so too. Around one in eight (12%) offers a flat rate structure — so, no matter how much the employee pays in, the employer continues to contribute the same amount.

Over ⅔
of schemes offer contribution matching

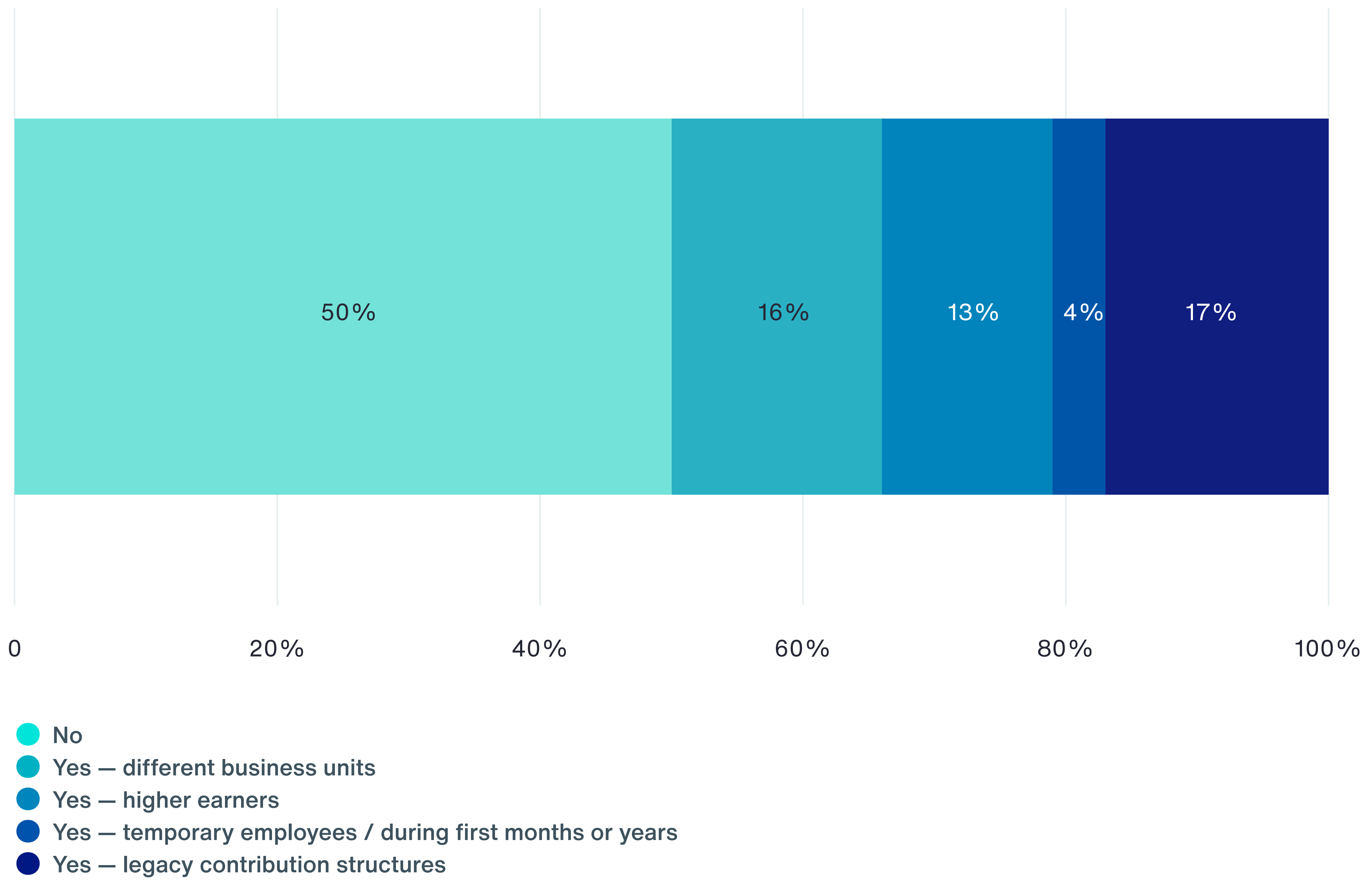
2

Not All Pension Offerings Are Equal

Around 50% of our respondents offer more than one contribution structure within their organisation. The main drivers for this are different approaches between business areas (16%), the effect of legacy schemes (17%), and contributions that change with seniority (13%).

While many of these differences may be historical, caused by mergers and acquisitions or the way that a business has evolved, they can pose a risk. As focus intensifies on building inclusive, equal workforces, unequal pension arrangements will become increasingly unacceptable and could expose employers to potential negative publicity or pressure from investors.

Do You Provide Different Contribution Structures for Different Groups?

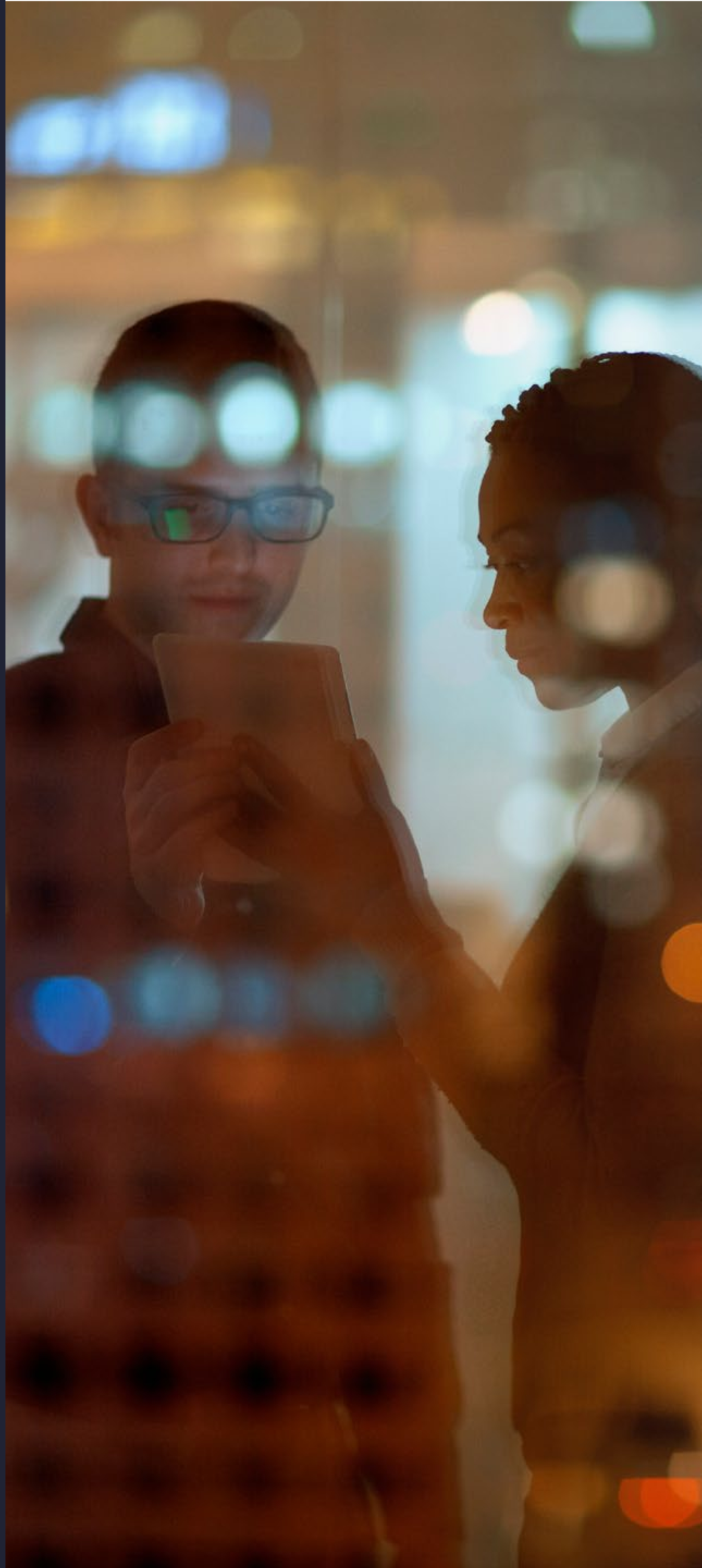


- The latest annual pay guidelines for FTSE350 companies from the Investment Association (the trade body and industry voice for UK investment managers) state that pension contributions for executive directors should be aligned with those available to the majority of the company's workforce.
- The IA will 'Red Top' (the highest level of warning issued by its Institutional Voting Information Service) any new remuneration policy that does not explicitly state that any appointed executive director will have their pension contribution set in line with the majority of the workforce, or if there is not a credible action plan to align pension contributions for incumbent directors with those of employees by the end of 2022.

Aon's Expert View

Over the last few years, I have seen a number of clients look to address disparities between pension contributions for higher earners and their wider employee population. This can be an emotive topic, especially for the individuals affected. I've found that the best approach starts with agreeing the overall objective and rationale for any change, then moves on to look at the potential impact on individuals and considers ways to provide them with the appropriate support.

Claire Morland
Partner, Head of Executive Compensation Europe



2

How Much is Likely to be Paid Out From DC Pensions?

We saw in chapter one that improving member outcomes is a key objective for three-quarters of schemes. To improve outcomes for members, schemes need to be able to consider how much is being paid into their current arrangements and be able to benchmark this with their peers. However, this alone does not complete the picture. Without knowledge of the likely outcomes for members, it is not possible to measure improvements or to have a clear view of the age at which members are likely to have adequate savings to be able to afford to retire — if they can at all.

This year's research shows that many respondents have more to do in this area, with just under four in ten (37%) having visibility of expected member outcomes from their pension plan.

It is encouraging to see that 22% of respondents say they assess outcomes in terms of the Pensions and Lifetime Savings Association's Retirement Living Standards. Launched in Oct 2019, this measure of adequacy seems to have quickly replaced the 'replacement ratio' of pension to pre-retirement income measure that was traditionally used by pension schemes. Trustees are most likely to refer to the Standards, with 28% saying they do this, compared to 18% of non-trustee respondents.

Do You Know the Expected Outcome for a Lifetime Member of Your Pension Plan?

63% of respondents do not know expected outcomes

22% use Retirement Living Standards to assess outcomes

- **Yes – in terms of the PLSA Retirement Living Standards** 22%
- **Yes – in terms of replacement ratio of retirement income to pre-retirement earnings** 8%
- **Other** 8%
- **Do not know** 63%

What Are the Retirement Living Standards?

These are a set of 'rule of thumb' measures, that identify how much money is needed by members to achieve a minimum, moderate or comfortable standard of living in retirement.
The standards are based on independent research carried out by Loughborough University on behalf of the Pensions and Lifetime Savings Association to determine the cost of three different *baskets* of goods and services, established by what the public considers realistic and relevant expectations for retirement living.

2 Are Members On Track for Retirement?

Similarly to those running pensions, just under one in five respondents (19%) say that the sponsoring employer has considered pension outcomes in relation to its future workforce planning.

Our 2021 employee research — *Keeping on track in challenging times*, found that one in three individuals now expect to work to age 70 or beyond, and one in four think they may never be able to afford to retire. This could present significant challenges for many organisations, meaning it is vital they understand the position for their own workforce, using tools such as Aon's DC Analytics to measure the proportion on track for an adequate retirement at different ages.

Without an understanding of likely outcomes, whether relating to the Retirement Living Standards or an alternative target, both members and sponsoring employers potentially suffer. If individuals do not know how much they need to save to retire and cannot tell whether they are on track to achieve that figure, they will have little control over when and how they can retire.

Pension outcomes are an important check to help employers predict when employees will leave work, and what that might mean in terms of future skills and talent needs as well as employment costs.

Just

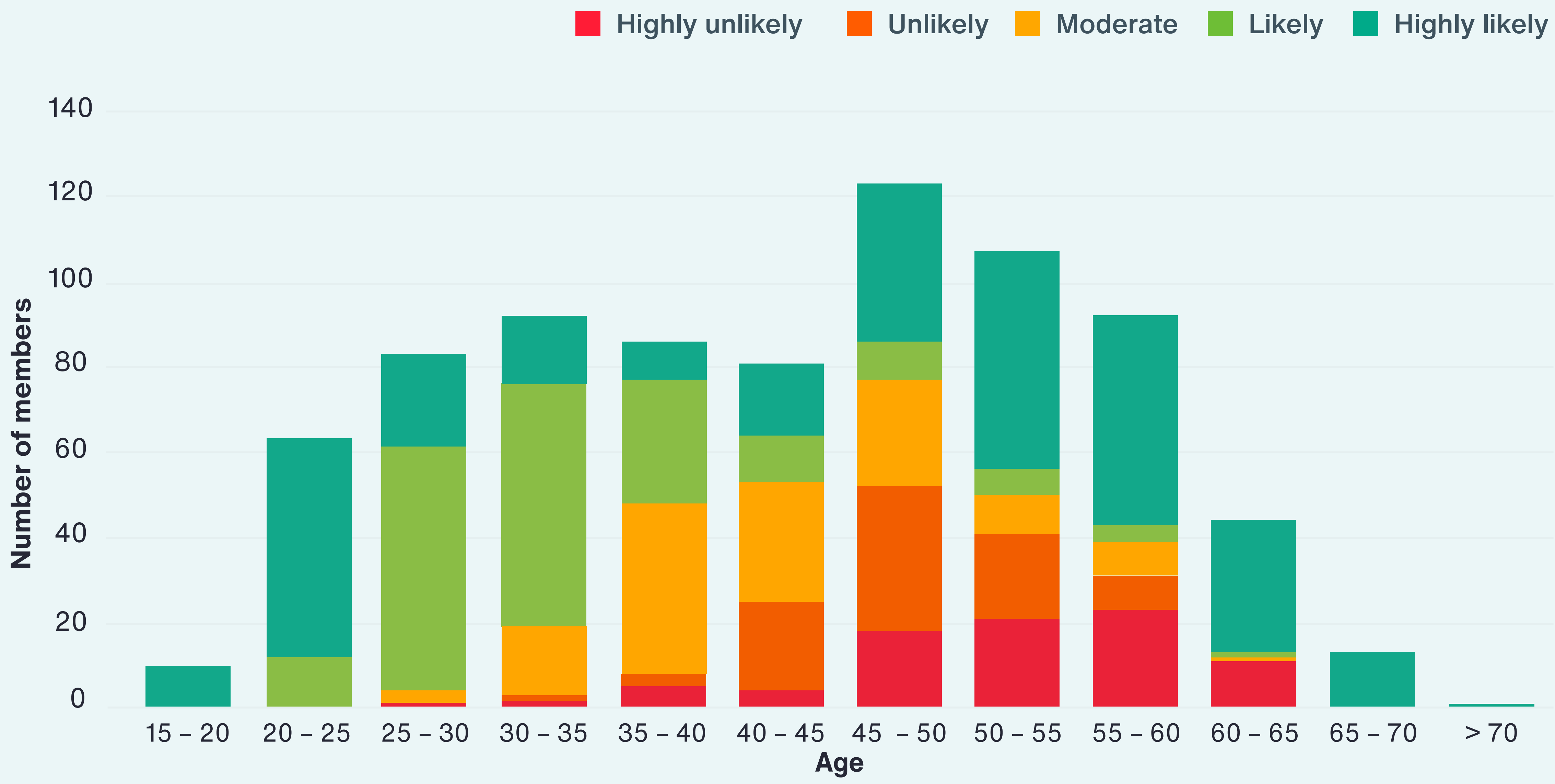
19%

of respondents say that the sponsoring employer has considered pension outcomes in relation to its future workforce planning

Understanding Whether Members are On Track

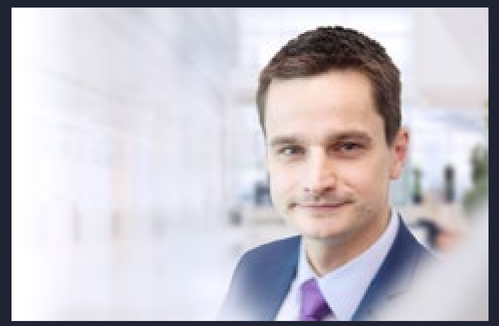
Aon's DC Analytics is a tool to help understand whether pension scheme members are on track for retirement. It works by assigning a retirement target starting with the Retirement Living Standards figures and proportioning these on a member's expected salary at retirement. It then considers estimated State Pension and other pensioned employment periods, allows for future returns and how the pension will be accessed, to produce a summary of whether a member is on track.

Number of Members by Age



Aon's Expert View

Perhaps the most important thing I do in my role is to help employers and pension schemes understand whether their employees are on target for an adequate pension in retirement. Using our analytics tool, we can compare within a scheme the likely outcomes across different job roles, locations, ages and sometimes by gender or other measures. That way we can understand if any groups are falling behind as well as understanding the overall picture. This gives a foundation to enable better informed decisions across all aspects of DC pensions, including contribution design, targeted communications, or changes to the investment approach.



Steven Leigh
Associate Partner, DC Consulting

Actions Checklist

Contribution and Adequacy

- Review contribution structures for consistency, especially in legacy arrangements.
- Make the most of matching structures to drive employee engagement.
- Understand and monitor changes in projected member outcomes to inform better decision-making on smart design as well as smart engagement (see chapter four for more on smart engagement).

3

Investments

Headlines

- There is a continued trend away from targeting annuity purchase at retirement in default investment approaches.
- 90% of schemes monitor investment performance of individual funds against benchmarks, but only 30% monitor overall aggregate performance experienced by a member in the default option.
- 40% of schemes now assess all their investment options against ESG criteria, up from just 10% two years ago.

3

Smart Investment Design

Along with contribution design, the investment returns achieved after charges are a critical factor in delivering the best possible outcomes for members. For most members, the default investment option used by a company pension plan plays a key role.

The optimum default investment option for pension scheme members needs to get the right balance of target returns versus risks, as well as aiming to be appropriate for the way in which members will access their DC pension savings in retirement.

Most schemes are now **targeting drawdown** as an end goal

Just **1 in 8** schemes still target annuity purchase

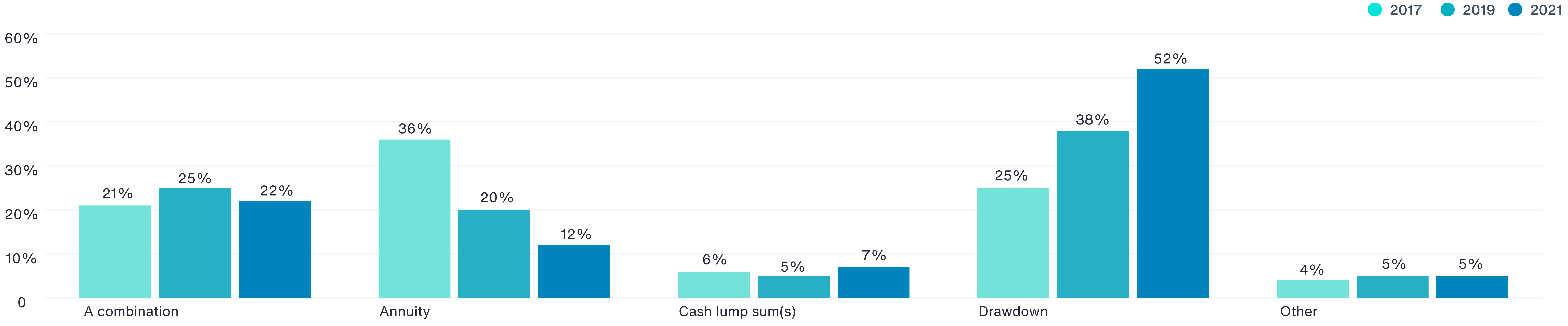
Since the introduction of pension freedoms in 2015, schemes have had to consider the different ways members use their pot once they reach retirement and then design their scheme's default strategies to meet members' needs.

Our DC survey results reflect this change, with a clear trend away from targeting an annuity as a member's end goal, towards using drawdown instead. In 2017, 36% of schemes were still targeting annuities for members, compared to around 12% today.

More than half of schemes (52%) are now targeting drawdown — around double the number that were doing so in 2017.

We have seen from previous research such as the 2021 employee survey — *Keeping on track in challenging times*, that members rely heavily on their scheme to manage investments on their behalf. For example, even during the unprecedented volatility in markets at the beginning of the COVID-19 pandemic, only 7% of members checked to see how their pension investments had been affected.

Target of Default Investment Option



Better Outcomes by Design | Investments

The Cash Question

Financial Conduct Authority figures show that the majority of retiring DC scheme members currently withdraw their full pot in cash. Between October 2020 and March 2021, 55% of those accessing their pension for the first time took this approach.[1] By comparison, 30% opted for drawdown.

But if cash is so popular with members, why aren't schemes targeting it in their default investment strategy? According to our research, less than 10% of respondents target cash.

While it might be tempting for schemes to reflect current member behaviour, this is less likely to be representative of longer-term trends. Current experience is being driven by large numbers of small pots (9 out of 10 full withdrawals were funds of less than £30,000), including those who have been auto-enrolled into a DC plan for the first time over the last 10 years and those who may have significant income from defined benefit pensions. Over the next decade, that balance will shift. When DC pots represent a more substantial proportion of members' retirement savings, it is less likely they will be withdrawn in full in cash.

[1] https://www.fca.org.uk/data/retirement-income-market-data-2020-21a

Aon Expert View

In my experience, many DC members don't understand the risks involved with choosing cash investments while saving for retirement and why this could ultimately undermine them achieving a good outcome. The two big risks here are inflation and opportunity.

- **Inflation risk** — if members' savings are held in a cash fund, they will have no protection against inflation, (which is very much a current issue at the time of writing), so this will erode the value of their pension pot in real terms.
- **Opportunity risk** — this is where members lose out on the benefit of investment growth on their funds by taking too little investment risk. For younger members, this could be choosing cash or other perceived 'low risk' funds and not appreciating the potential lost returns over what could be several decades to retirement. Older members may be in a lifestyle or target date fund which automatically switches them away from growth assets, but then retire later than planned. If a significant proportion of their pension savings are invested in cash funds, they could lose out on valuable investment returns.

Faith Amadasun
DC Investment Consultant

3

Making the Connection Between Investment Performance and Retirement Outcomes

93%

of schemes monitor the individual investment funds against their benchmark

Only ⅓

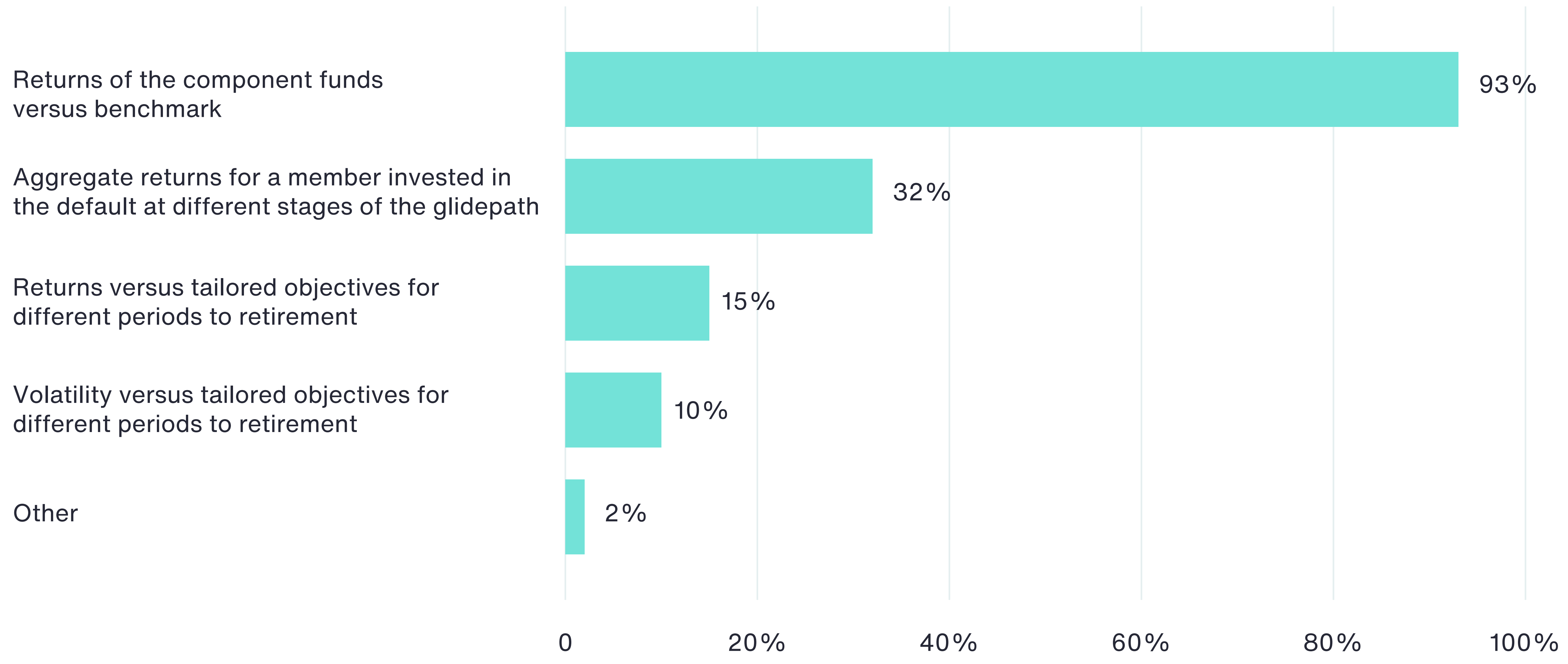
of schemes consider the aggregate returns in the default investment option

Most schemes (93%) monitor the performance of individual investment funds against their benchmark, but only a third (32%) consider the aggregate returns experienced by members invested in the default investment option.

While monitoring performance against benchmarks is an appropriate way of checking that an underlying fund is meeting its objective, this approach can miss the bigger picture of whether the default strategy is really delivering for members. In most instances, the default is made up of a number of underlying funds, so it is important to also monitor the overall aggregate returns experienced by members.

We also found that most schemes do not monitor investment performance against their own return or volatility targets. Setting scheme specific targets for the aggregate default investment option allows those running schemes to understand how their default investment is performing in relation to delivering a good outcome for their members. For example, if your default option has returned four percent per year above inflation for a member who is 20 years from retirement and two percent per year above inflation for a member three years from retirement — is this enough? Or is this too low to give them the retirement outcomes they need?

How Do You Monitor the Performance of Your Default Investment Option?



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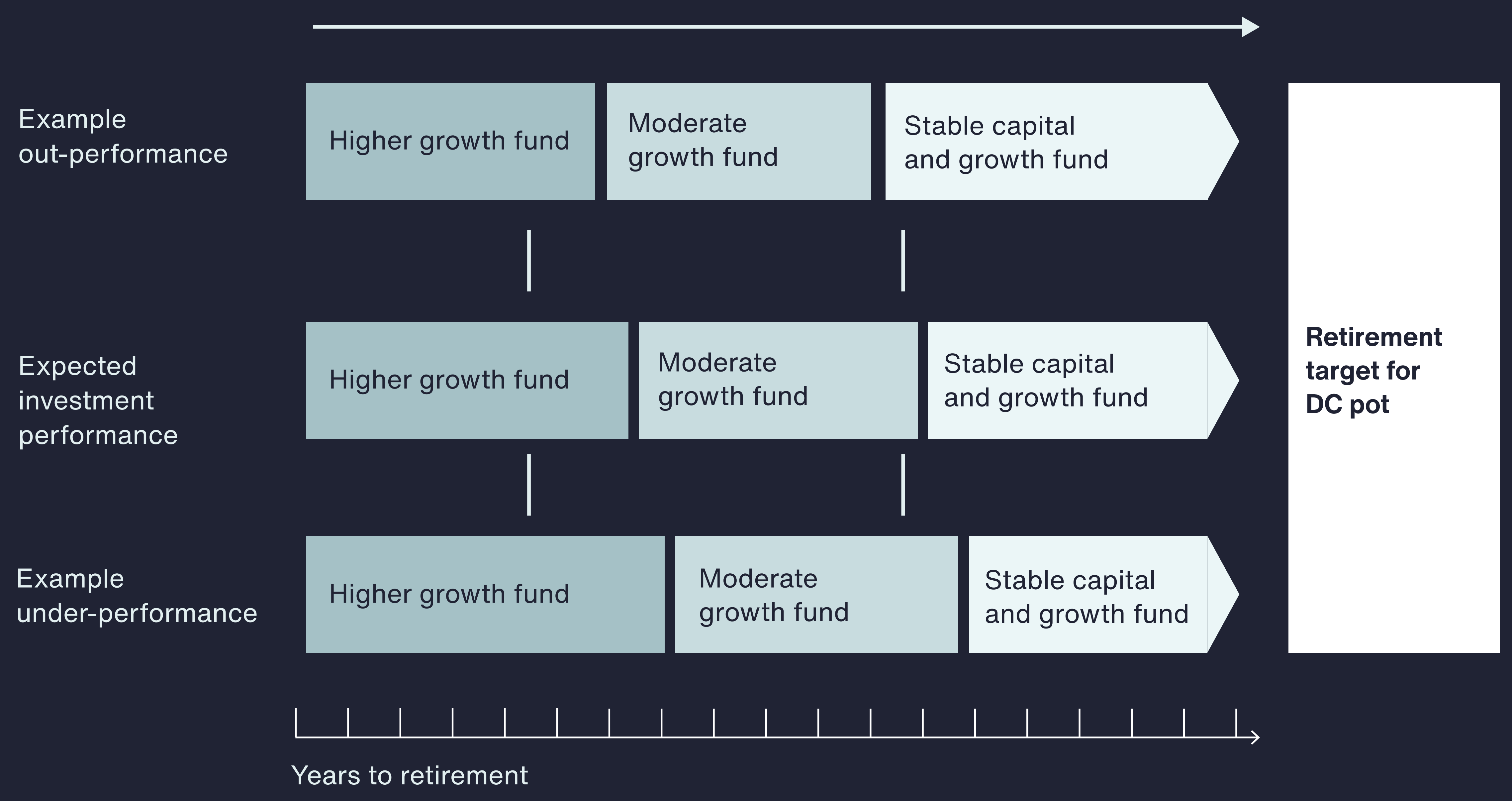
Aon's Expert View

The Aon MasterTrust uses tailored return objectives and aggregate investment performance information to inform decisions on the investment glidepath under our innovative **Target Driven Investment approach**. Ultimately this means we can lock in gains if we are ahead of expectations by switching assets into more defensive funds earlier. Alternatively, we can maintain the allocation to funds with a higher growth potential for longer if it is necessary to avoid locking in losses from badly performing markets. Reflecting strong equity market performance in recent years, we've been able to lock in some of those gains and reduce investment risk ahead of plan for members approaching retirement to improve certainty of retirement outcomes.

Jo Sharples
CIO, DC Solutions

How a Target Driven Investment Approach Works



3 Monitoring Against Benchmarks Can Miss the Bigger Picture

In the first quarter of 2020, stock markets were exceptionally volatile as a result of the COVID-19 pandemic. In a few days, while a passive equity fund might have lost as much as 20% of its value — it could still have met its investment objective of tracking the index that it follows. However, from a members' perspective, this fall could have had a significant impact on their retirement outcome. This would not have been evident just from measuring the fund performance against its benchmark.

This is why it is important that schemes consider their investment returns in the context of aggregate long-term targets to understand how the underlying investment performance will impact the delivery of adequate member outcomes, particularly for those invested in the default investment option.

3

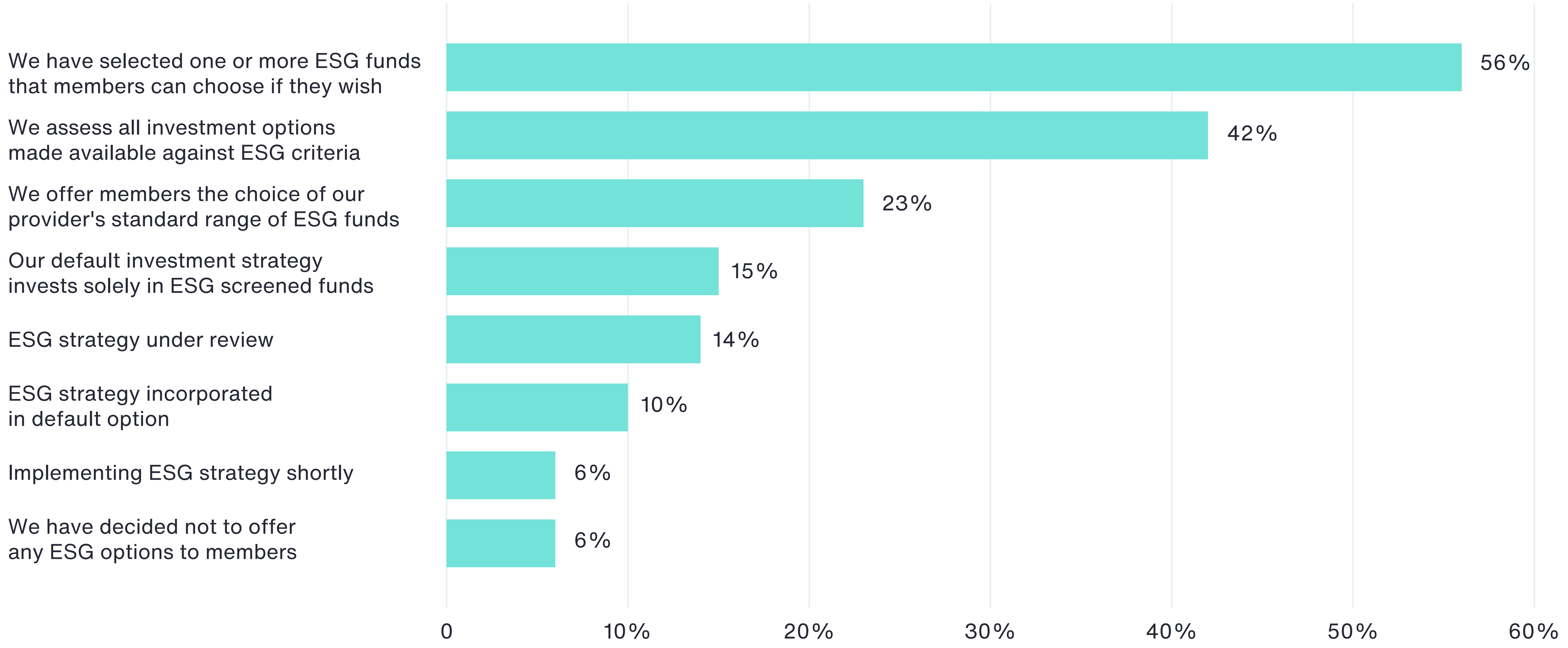
A Wide Range of Approaches to Responsible Investing

Environmental, Social and Governance (ESG) factors are one of the highest profile investment trends — and not just in the world of pensions. From wildfires and flooding, to the 2021 COP26 summit in Glasgow, it has been impossible to ignore the imperative to address climate change and the wider social impact of investment practices.

However, at DC pension scheme level, our findings show there is still a wide variation in schemes' approaches to ESG. The Pensions Regulator now requires all schemes to document how they address ESG factors — but moving beyond just fulfilling regulatory compliance, and instead genuinely embedding ESG in investment design, is still a work in progress.

We asked respondents to confirm the approaches they take on offering investments in line with ESG criteria.

What is Your Approach to Responsible / Environmental, Social and Governance (ESG) Investment?



42%

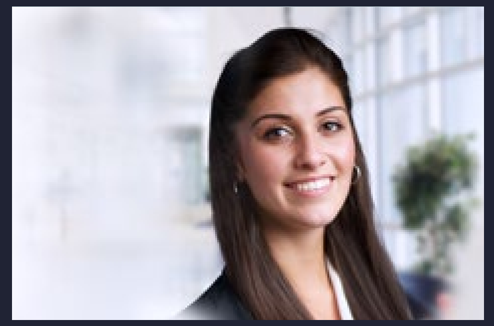
of schemes monitor all investment options against ESG criteria

Over half of schemes (56%) have selected one or more ESG specific investment options that members can choose and 42% of schemes monitor all the investment options offered against ESG criteria.

Some schemes take the initiative on behalf of members, with 15% choosing to use only ESG-screened funds in their default option and a further 10% incorporating a different form of ESG strategy as part of the default option on behalf of members. This is important as many members do not feel comfortable making their own investment selections.

Aon’s Expert View

I firmly believe that unless ESG considerations are incorporated into default strategies, they will not reach the majority of members. As public opinion — and many members’ views — on responsible investing become more high profile, and greater reporting is required from schemes on this topic, some may face difficult questions in the future. This is particularly the case if their responsible investment approach is not aligned with what members might reasonably expect or the CSR policy of the sponsoring employer.



Kath Patel
DC Consultant and Head of DC Responsible Investment

3 COP26: Three Reasons Why Schemes Need to Address Climate Change

The November 2021 COP26 conference hoped to achieve greater commitment on climate change globally. While there was a noticeable shift in momentum, appetite for bolder action (particularly in the short term) was limited. But time is running out and finance, including pensions, has a critical role to play.

- According to OECD estimates, globally, public and private investors need to allocate $5tn each year to address climate change by 2030. That is an eight-fold increase on the current allocation by institutional and retail investors.
- Investors must support emerging economies' response to climate change, as well as backing new climate technologies and nature-based solutions. Steeper emissions reductions are still urgently needed.
- As well as challenges, there are investment opportunities — but speed is essential. Delaying collective agreement makes future climate action more complex, costly and riskier to resolve, with catastrophic consequences for ecosystems and humanity.

Feeling the Heat

COP26 predicted rises in global temperatures above pre-industrial levels

1.5°C increase → **2.1°C increase** → **2.4°C increase** → **2.7°C increase**

1.5°C increase: Aim to cap temperature increase by 2100 to limit the impact of climate change.

2.1°C increase: If all long- and short-term targets, pledges and more ambitious nationally determined contributions (NDCs) from COP26 are implemented.

2.4°C increase: If all 2030 targets and NDCs are implemented.

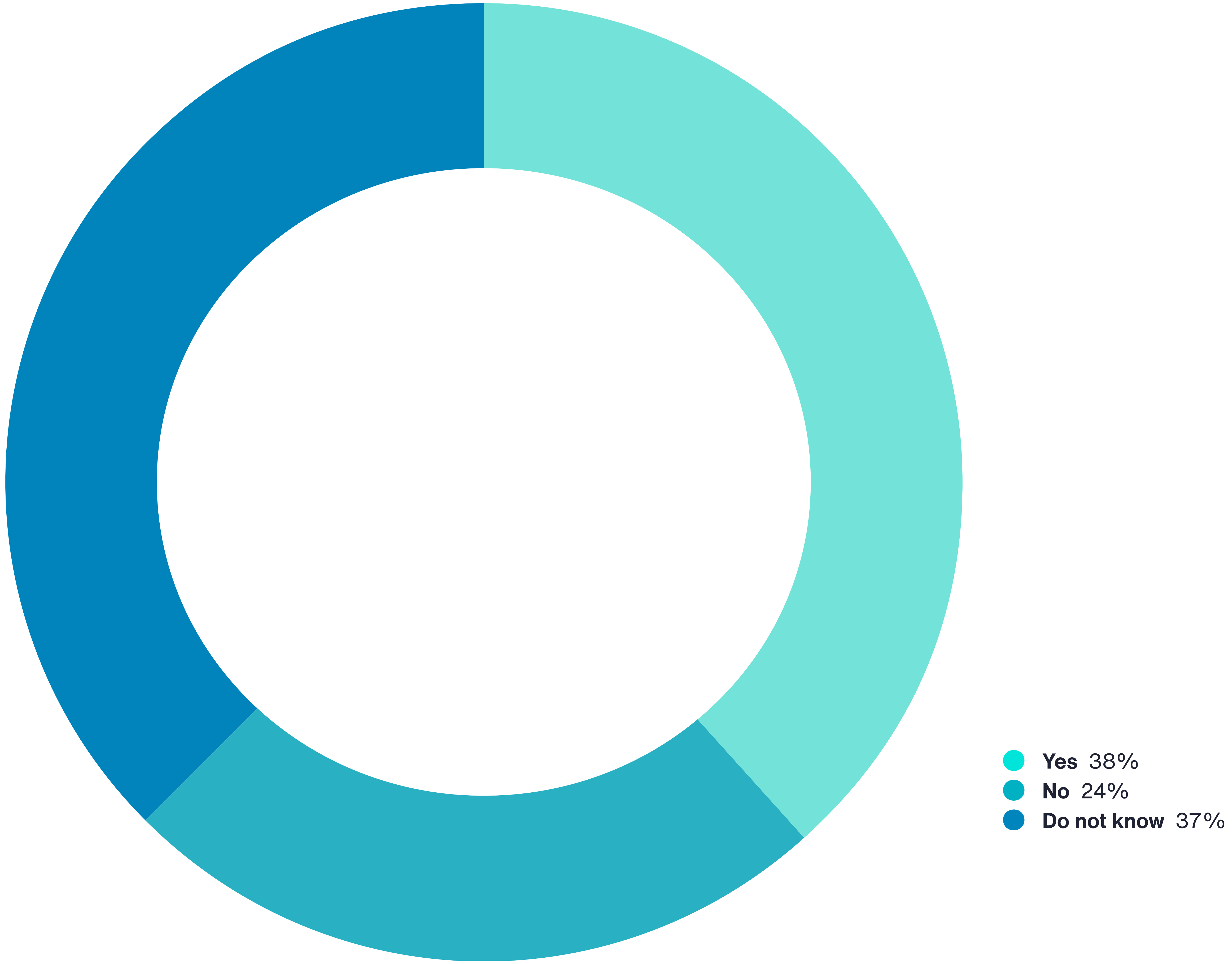
2.7°C increase: If there is no change to the current policies and action.

Industry Expert View

"Institutional investors have a huge part to play within addressing climate change. From an Institutional Investor perspective, it's getting to managing risks versus potentially seizing opportunity.

Extract from a discussion between Aon's Jennifer O'Neill and Mark Carney, Vice Chair and Head of Transition Investing at Brookfield Asset Management and the UN Special Envoy for Climate Action and Finance, about the actions now needed of investors to address the climate change challenge. The full interview can be viewed here.

3 Is There a Place for Illiquid Investment in DC Schemes?



To date, DC investment strategies have been based around liquid assets, primarily equities and bonds. However, as long-term investors, DC schemes could benefit from exposure to more illiquid assets, such as infrastructure and private markets.

There has been significant interest from the UK government to encourage DC schemes to invest in illiquid assets. A consultation will explore ways to make illiquid investment more accessible to schemes.

Illiquid investments will clearly be a major focus for DC over the coming years, but our findings show there is still significant uncertainty — and possibly limited knowledge — about their role. While only 24% said they thought there would be no benefit to members from illiquid investment, the rest of the respondents were equally divided between believing there are advantages (38%) and being unsure of the benefits illiquid assets can deliver (37%).

Using illiquid assets can help improve member outcomes, but their most significant role could be as a diversification tool that offers wider access to markets. Benefits include lower correlation to equity markets, inflation-linked returns, and illiquidity premium to potentially improve long term returns and ultimately pension outcomes.

Aon's Expert View

As with all DC investments, illiquid assets have to be viewed in the context of improving member outcomes. My motivation for allocating to any investment is that it must enable DC savers to retire comfortably. It is not simply about introducing the newest, shiniest funds in response to market trends

Given the long-term nature of DC savings, illiquid assets are a natural fit, but they are not a homogenous group of asset classes. I have first-hand experience of building illiquid investment portfolios for DC savers — including for superannuation funds in Australia — and of the benefits they can provide for retirement savers. But it's important to understand your objectives before diving in.

Chris Inman
Partner and Head of DC Investment Advisory

For example:

- If you're looking for explicit inflation-linkage, many brownfield infrastructure projects and real estate assets can have this built into their contracts, supporting real long-term growth.
- The relatively high expected return potential from private equity or venture capital portfolios may benefit members in their 'early career' stage. They will typically have a higher risk tolerance and can take advantage of the opportunity to seek higher returns through illiquidity risk.
- Superior downside protection, compared to many listed exposures, is on offer with illiquid assets and particularly during times of market stress.
- With cash and fixed income not providing meaningful income or yields, many illiquid assets have a natural income yield, which can form a significant part of an investor's spending needs post-retirement.

Actions Checklist

Investments

- Consider how you monitor investment performance; do you know what your long-term return targets should be?
- Ensure your ESG investment principles are embedded in your default option.
- Stay aware of developments in illiquid investments — consider learning more about which illiquid assets could genuinely be suitable for your scheme and members.

4

Engagement and Wider Financial Wellbeing

Headlines

- Nearly half of schemes plan to provide more targeted communications over the next two years.
- A third consider Diversity, Equity & Inclusion principles when planning their pension communications.
- Two-thirds of schemes measure changes in member behaviours to measure the effectiveness of their communications, while one-third of schemes monitor what impact this has on projected retirement adequacy.

The principles of Smart Design and Smart Governance are vital to deliver good pension outcomes for members of DC plans.

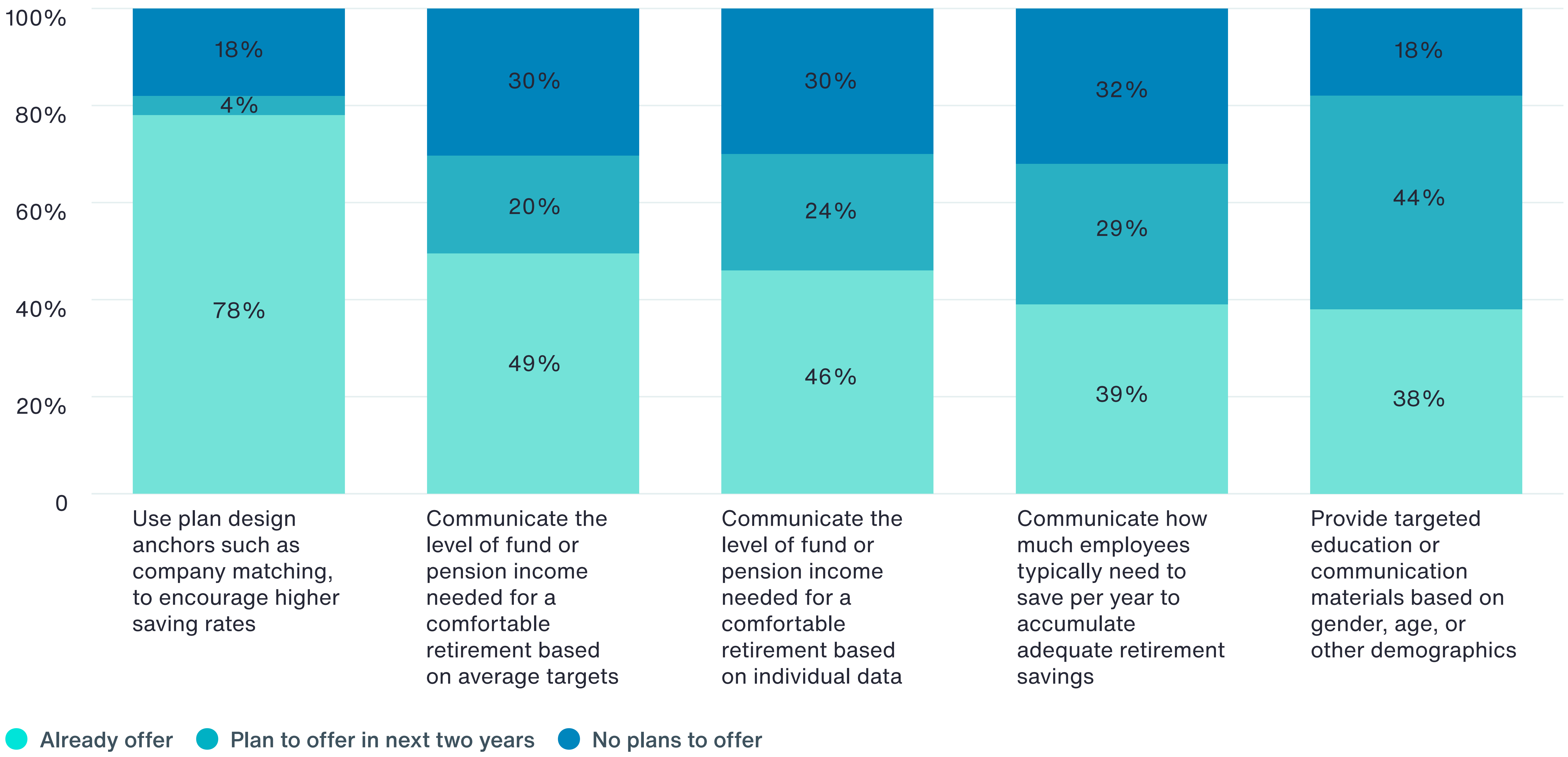
However, a smart approach to engagement is also key to ensure that the right messages are being delivered to the right people at the right time and in the right way.

Aon Global Points of View — Smart Engagement

DC retirement plans should recognise diverse employee needs and perspectives. They should promote flexibility, choice and financial wellbeing to support members in making the best financial decisions. Communications should use a multimedia approach where possible and be targeted to ensure they are relevant to the recipient and prompt appropriate actions.

4

How Are Employees Encouraged to Save at the Appropriate Levels for Their Retirement?



78%

use a matching contribution design to encourage employees to save more

71%

of members had not set a goal for how much they need to save for retirement

We found that most schemes (78%) use a matching contribution design to encourage employees to save more for their retirement.

The next most popular approach is to communicate what level of retirement fund or pension income might be needed for a comfortable retirement, either based on average targets such as the PLSA's Retirement Living Standards or using individual data.

Our 2021 employee research — *Keeping on track in challenging times* — found that information on how much to save into their pension was the most popular request from employees. Around 40% of schemes currently communicate this type of information, with a further 30% planning to do so.

We also found that 71% of members had not set a goal for how much they need to save for retirement. There is a clear need for schemes to do more to help members understand the appropriate level of pension savings across their working lives and to feel confident in their ability to retire.

Aon's Expert View

I cannot overstate the importance of considering pensions in the context of an individual's wider financial position when communicating with them about their pension savings.

In our 2021 employee research — *Keeping on track in challenging times*, we found that affordability was the main reason people do not save more for their future, followed by other financial priorities and then concerns about low interest rates. Communications from pension schemes about saving more for retirement need to be mindful of these points. Likewise, communications and support provided around retirement planning should take into account other savings and wealth people may have alongside their pension savings.

Aon's Well One app is a great example of a financial aggregation tool that we can provide on a standalone basis or for members of the Aon MasterTrust and our Group Personal Pension, "Big Blue Touch". It gives individuals a holistic view of their finances to help them improve budgeting, to increase their understanding of whether they are on track to retire, and, ultimately to take better-informed decisions about money.

Tony Pugh
Partner and DC Solutions Leader, EMEA

What Do Schemes Consider When Planning Their Pension Communications?

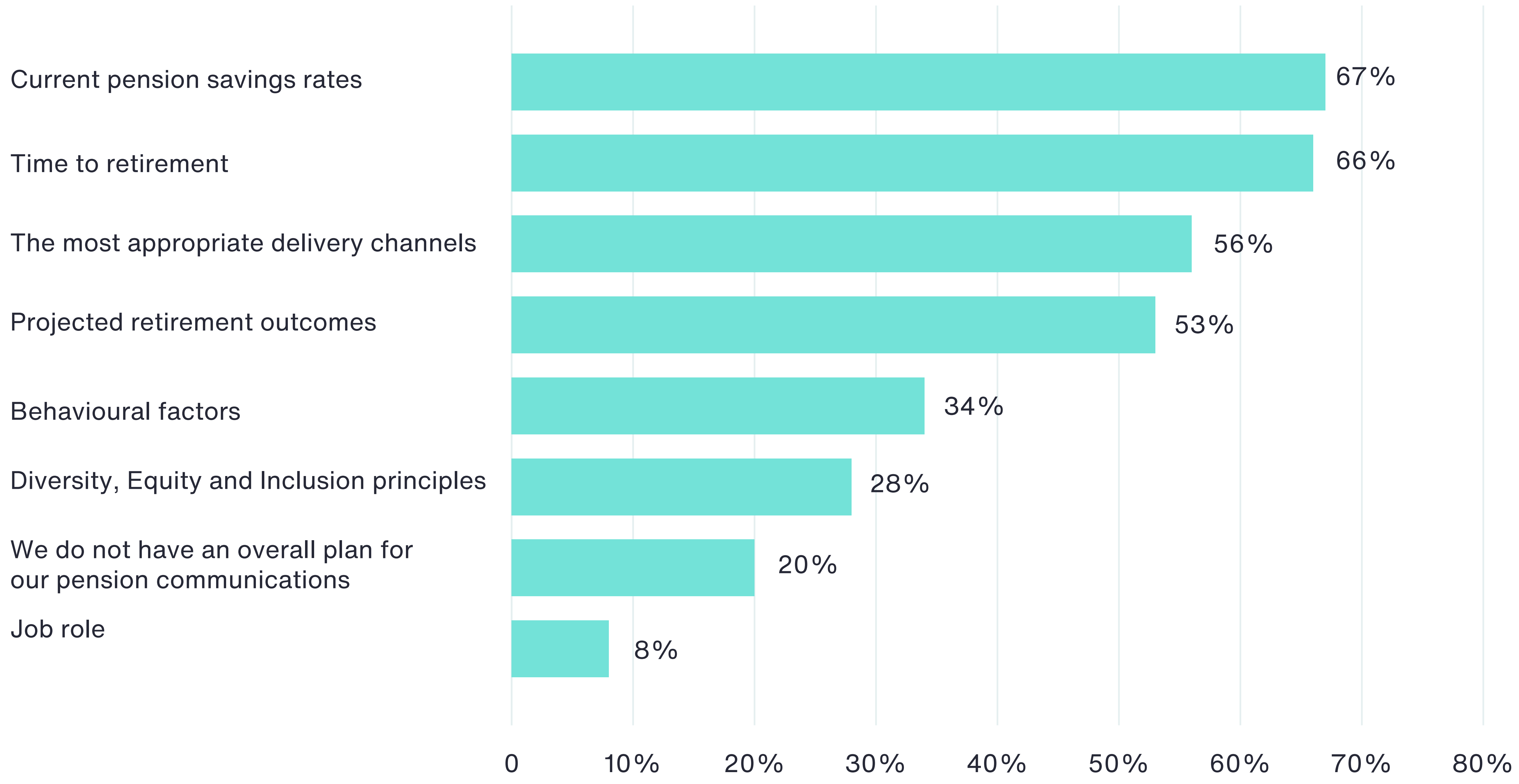
When planning their communications, the majority of schemes use criteria such as employee savings rates (67%) or length of time to retirement (66%). Both of these are sensible factors and will mean that messages are appropriately tailored in terms of generic actions that members can take.

> 67% of employers still feel they are not doing enough to support financial wellbeing and pensions through communications.
>
> Benefits and Trends Survey

Worryingly, 20% of respondents said that they have no plan at all for their pension communications — this must be addressed urgently. As we have seen earlier in this chapter, DC scheme members are calling out for more support to help them understand how much money they need to save for retirement and to be able to plan accordingly.

20%
have no plan at all for their pension communications

What factors do you consider for your pension communications as part of your planning?



Aon's Expert View

I found it a little disappointing that only 28% of schemes take diversity, equity and inclusion (DEI) factors into account when planning their pension communications. This compares with 58% of wider communications around benefits as reported in our latest Benefits and Trends Survey so it feels like the pensions world is lagging behind on this.

Different groups of savers, such as women or part-time workers, can have significantly different challenges when it comes to building up adequate pension savings, compared to a 'traditional' full-time male employee. From ensuring that the language and images used in communications are inclusive, through to designing appropriate prompts and nudges, the role of DEI is becoming increasingly significant and has a direct impact on member engagement.

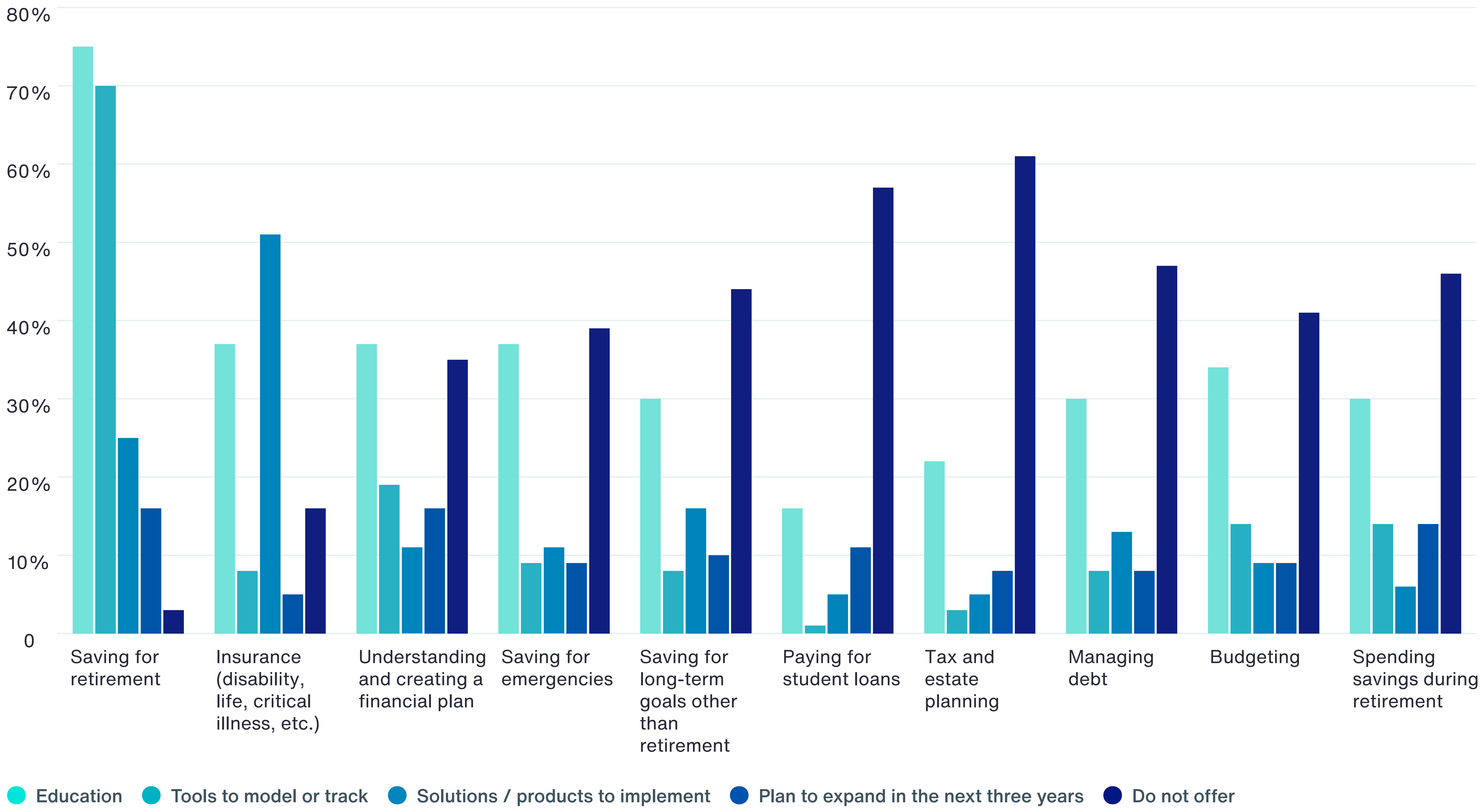
I have worked with colleagues to produce a *Practical Diversity & Inclusion Guide* which is available for all to download. It looks at practical ways to tackle diversity and inclusion actions for pension schemes, including communicating with members.

Susan Hoare
Partner

4

How Do Pension Communications Fit with Wider Financial Wellbeing?

Types of Financial Wellbeing Support Offered



How much to save for retirement

75% provide education

70% provide tools

Saving for other long-term goals

37% provide education

16% provide tools

Spending in retirement

30% provide education

Pensions are intrinsically linked to wider aspects of financial wellbeing. For example, scheme members who are struggling with debt or lack basic budgeting skills are unlikely to be able to save effectively for retirement — and may be more likely to fall for a pension scam.

More employers know the impact poor wellbeing can have on their bottom line. This can be through behaviours such as absenteeism, or presenteeism, i.e. people turning up to work but not being able to perform effectively in their role.

Part of financial wellbeing is being able to prepare for the future. Therefore, those running pension schemes also have an important role to play helping members to engage with their pension and to ensure they have sufficient income in retirement.

Our findings show that most respondents are focused on supporting members with pensions accumulation, rather than wider financial wellbeing. 75% say that they offer education about saving for retirement, and a similar number provide access to tools or modellers, but just 37% offer support with financial planning, and 30% with spending after retirement.

A useful starting point when thinking about a more tailored financial wellbeing benefit package is to review what is currently offered to determine any gaps and to understand the 'typical' level of support offered.

Our free *Financial Wellbeing Gap Analysis* survey can help with this and a link to the survey can be found here.

This support is badly needed. We saw in our *2021 DC member survey* that one in four individuals cannot find £1,000 in an emergency, suggesting that building and maintaining emergency savings could be a greater priority than saving for retirement.

Aon's Expert View

It is great to see how many schemes are offering education and support programmes on saving for retirement, but our research suggests that only 20% of people actually engage with traditional financial education programmes.

The traditional approach seems mainly to engage those who are already financially confident with money, while the majority of individuals who may be less comfortable discussing basic finances will not attend a talk or webinar. If this is the case, we will just keep on helping the 20% who are already financially confident. How can we engage the remaining 80%?

We have developed a way to address this and to help employees make better money decisions. A financial wellbeing programme that aims to reduce financial stress and increase happiness through sessions and action planning focusing on wellbeing NOT wealth and behaviour NOT budgets. I believe that if we can get people feeling comfortable discussing money and have a better relationship with money, then they are far more likely to attend, and benefit from, the traditional financial education sessions that many employers are offering.

James Collier
Associate Partner, DC Pensions and Financial Wellbeing

How Do You Measure Employee Engagement with Your Retirement and Financial Wellbeing Support?

While member engagement may not be the easiest aspect of pensions management, it is crucial to respondents' aims of achieving better outcomes for members. As we have already seen in this chapter, providing appropriate and inclusive communications, and helping members understand how much they need to save for retirement, will help to drive engagement as well as potentially boost outcomes.

Measuring the effectiveness of engagement campaigns and communication approaches is crucial if schemes are to develop appropriate strategies for the future and use their resources efficiently. That means assessing whether members act once they have read communications.

Our results found that while 80% of schemes use proxy measures of engagement, such as how many members access websites and online tools, only around a third (35%) assess whether individuals are saving enough, and whether they are on track to achieve their retirement goals. Of these, just 13% measure this regularly. This is an area where getting sight of the right data analytics can enable better decision making.

80%
use proxy measures of engagement

35%
assess whether individuals are saving enough

4

Does Engagement Matter in Pensions?

The vast majority of members will contribute to their scheme's default investment option and, according to our *2021 DC member survey*, a third of members base their pension contribution rates on their employer's default level.

Should schemes simply accept that members will never fully engage with pension savings? Aside from the clear risk that members may face poor retirement outcomes, a fundamental problem with this approach is that at the point of retirement members will be forced to take a decision about how they access their pension. If they have engaged with their pension savings previously, particularly in the context of their wider financial situation and how much they might need to in order to retire, this could help avoid any nasty shocks and employees potentially carrying on in work far longer than they had hoped.

Actions Checklist

Engagement and Wider Financial Wellbeing

- Consider how your communications reflect the diversity of your audience and whether any groups may be inadvertently under-served.
- Look at the bigger picture of financial wellbeing and think about carrying out a gap analysis to understand employees' broader financial needs.
- Review how engagement is measured to focus on hitting targets in areas such as how changing contribution rates are leading to better projected member outcomes.

At Retirement

Headlines

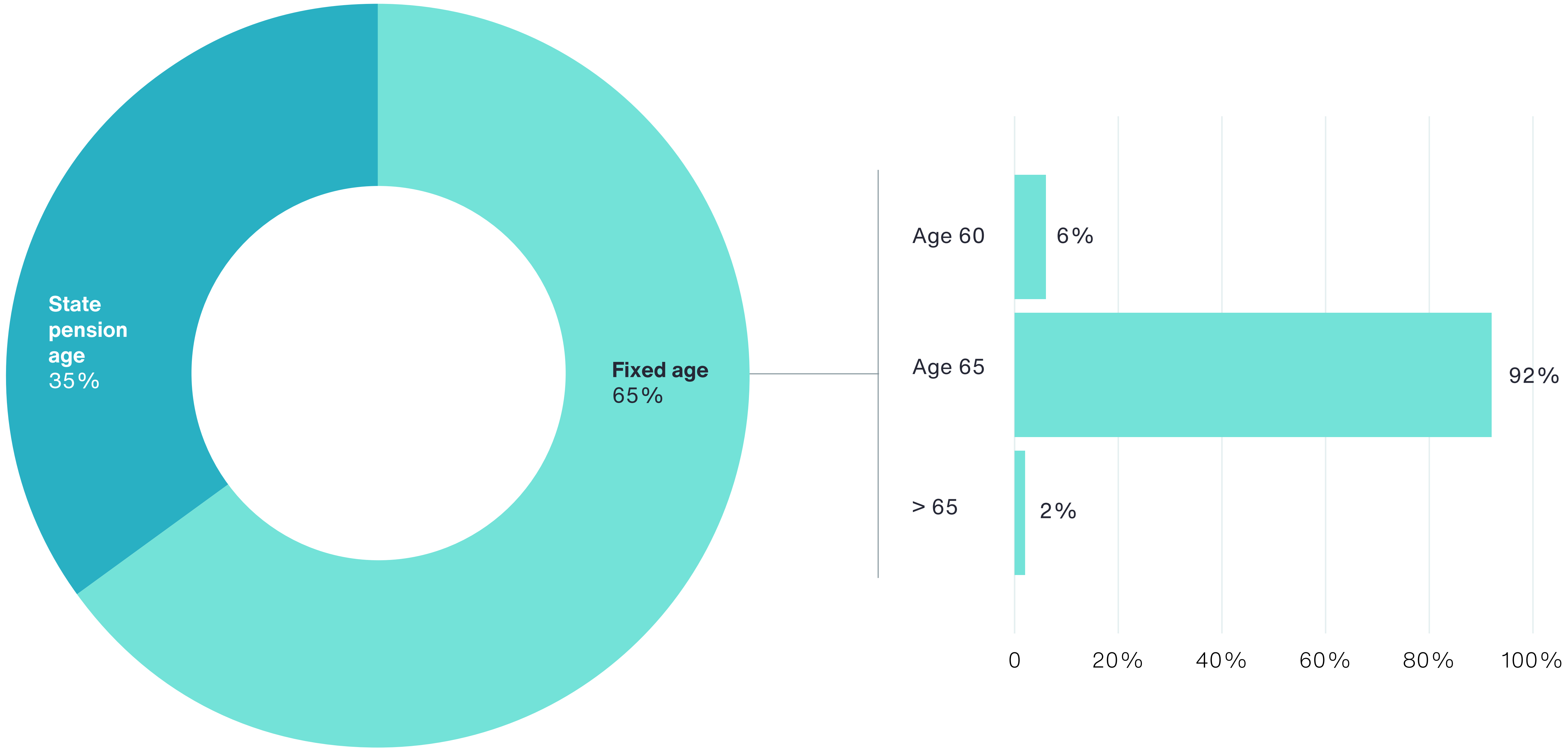
- Most schemes report that less than 10% of members have selected a target retirement age.
- 39% of schemes currently signpost a financial adviser firm for advice at retirement, with a further 19% planning to do so in the next three years.
- 17% of schemes now offer drawdown at retirement via an external master trust.

5 The Changing Face of Retirement

Over the last decade, there have been wide-reaching changes to the way in which people retire. The traditional model of reaching State Pension Age (SPA) at 65 (or earlier), and of leaving work and starting to take a workplace pension at the same time, has been completely eroded. People can now flexibly access their workplace pension from the age of 55 onwards, will receive their State pension at different ages depending on when they were born, and are not compelled to retire at a fixed age.

Our 2021 research with DC scheme members showed that around half of employees expect to continue working past the age of 68. But are pension schemes keeping up?

What is the Default Target Retirement Age for Your Scheme?



Retiring and the State Pension: a Changing Landscape

April 2011	April 2015	April 2016 to November 2018	October 2020	2026 to 2028	2044 to 2046
Abolition of the default retirement age. Compulsory retirement at 65 is no longer permissible, and employees can choose when they leave work	Pension freedoms mean that DC scheme members can flexibly access pensions from age 55	Women's State Pension Age (SPA) is increased to 65	SPA increases to 66 for men and women	SPA increases to 67 for all	SPA will increase from 67 to 68 (subject to review in 2022, with a possible acceleration to 2037 to 2039)

Despite this maelstrom of change to retirement, we found that most schemes set a default retirement age of 65. It is now over a decade since employees could be forced to stop work at 65 and it is no longer the State Pension Age (SPA).

Surprisingly, 35% of respondents say they use the SPA as a basis for their default pension age. However, given the continual shifts in SPA planned over the next 20 years we believe it is unlikely that many schemes have been designed to take all these changes into account, and use different default ages for different age cohorts.

While members can select their own target retirement age, most do not. Only one in ten schemes say that 10% or more of their members have done this, meaning there is a significant importance in setting the default at the most appropriate age.

Most schemes report
less than 10%
of members have selected their own target retirement age.

Aon's Expert View

It is really important that schemes consider the appropriateness of their default retirement age. We know that most members do not change this themselves, and that it can have two very significant consequences for members.

First, the usefulness of the projected pension figure in members' annual benefit statements is related to the retirement date being used. So, for example, a move to an older retirement age if this is appropriate, would result in a higher projected pension which allows for more time for contributions to be made and for any investment growth and a better conversion rate for a fund into income.

The second big impact is whether pension savings are being invested appropriately. Most members use a lifestyle or target date investment approach, so the timing of their savings being automatically switched into different asset classes is based on the term to their target retirement age. If this is out of line with the real world, this could be financially detrimental for the member.

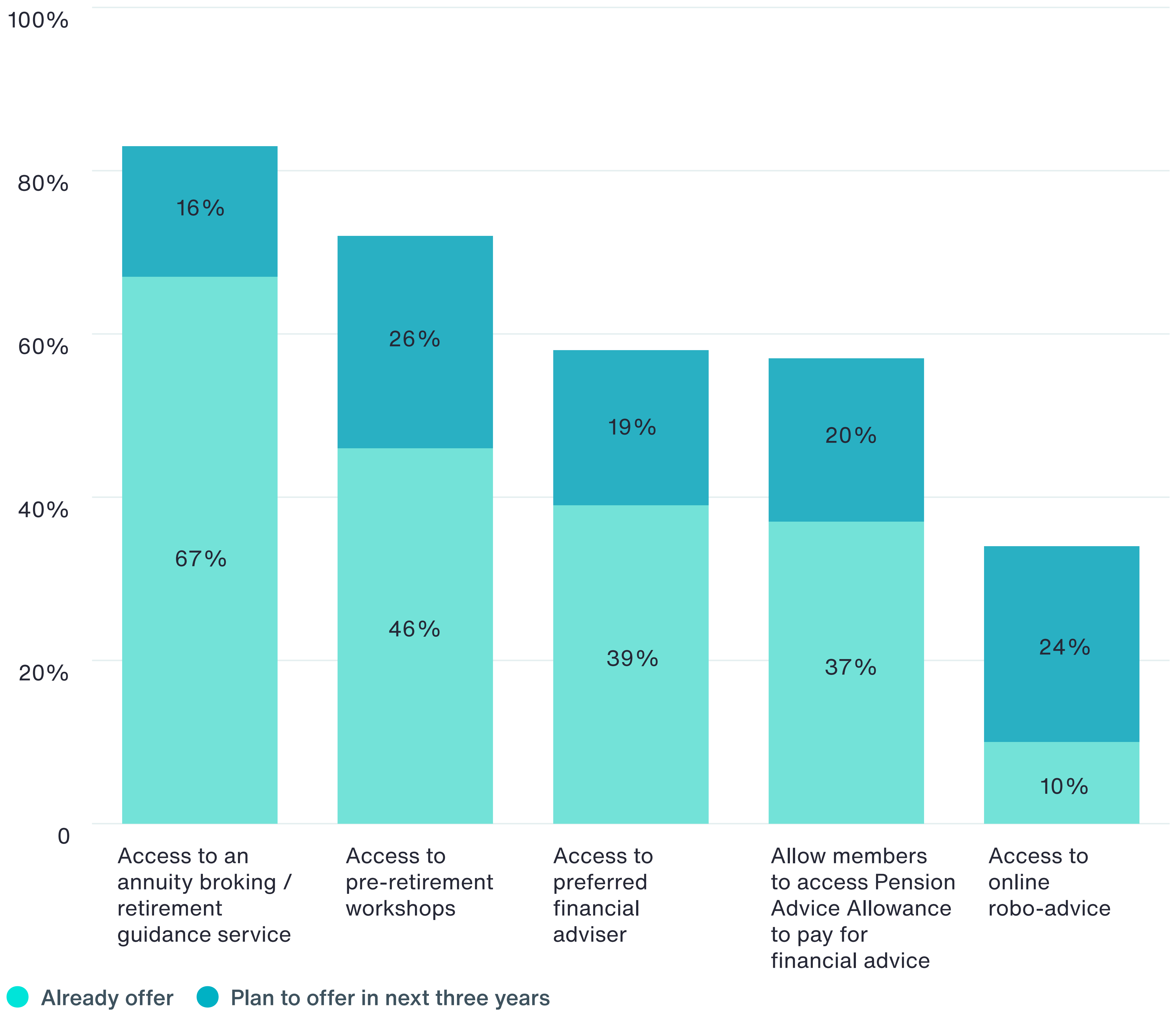
Pranesh Gathiram
DC Consultant

5 Support at Retirement

Accessing pension savings at retirement is one the most crucial steps in a member's retirement journey. For many this could be **the most difficult financial decision they ever take**.

We wanted to understand how DC schemes are supporting members as they approach retirement.

What Types of Support do you Currently Offer, or Plan to Offer, to Members at Retirement?



Most respondents provide a retirement guidance or annuity broking service (67%) or plan to introduce this type of service within the next three years (18%). Some of these services have been in place for many years and have not always kept up with the way people now access their pension savings.

The next most popular type of support is access to pre-retirement workshops, although, as noted in chapter four, this type of support is not always taken up by those who might most benefit.

These types of services can be really helpful for the more informed and proactive pension members, but it is encouraging to see many schemes going further by offering access to advisory support. Nearly four in ten schemes (39%) currently offer access to a preferred financial adviser.

We know from our annual Member Options survey that it is becoming more common for schemes and employers to subsidise the cost of advice at retirement for DC members, as well as DB members — 10% of schemes are now doing this. While it is still more common in DC that a member meets the cost of financial advice themselves, they are still likely to benefit from reduced rates that can be negotiated by schemes as well as the due diligence that will have been undertaken on appointing a preferred financial adviser firm if a scheme puts one in place.

Interestingly, only 37% of schemes allow access to the Pensions Advice Allowance, which could help members to meet some or all of the advice costs directly from their pension fund.

More widely in our latest Benefits and Trends survey, we found that 58% of respondents from the HR, Reward, Compensation and Benefits sectors do not know how retirements are managed within their organisation.

Individuals making poor retirement decisions, or even not retiring through a lack of support, has an impact beyond the individual themselves. It can present a corporate risk from increased costs, including insurance and healthcare costs, absenteeism and blocking career progression for others.

We explore this topic and how business are adapting to changing employee needs in our Rising Resilient report.

Aon's Expert View

A big reason why I think it is so important that schemes put appropriate support in place for members at retirement is that for many DC members it could be the first time they have had to make a decision about their pension. Auto-enrolment means that there are defaults for contribution rates, investment options and retirement ages. Over the savings period up to retirement, a well-designed and governed scheme can get most of the membership to a pretty good position via the power of inertia. But then we get the real cliff edge decision point for members — because when it comes to accessing savings — suddenly there is no default!

At the point of retirement, members are also exposed to big risks, not only of falling for pension scams, but also the risk of making bad or even just 'not very good' decisions which could cost them tens of thousands over the course of their retirement.

More and more schemes I work with are reviewing whether the retirement support they have in place is enough to enable members to make good decisions. Many are considering signposting to selected IFA firms as well as drawdown solutions.

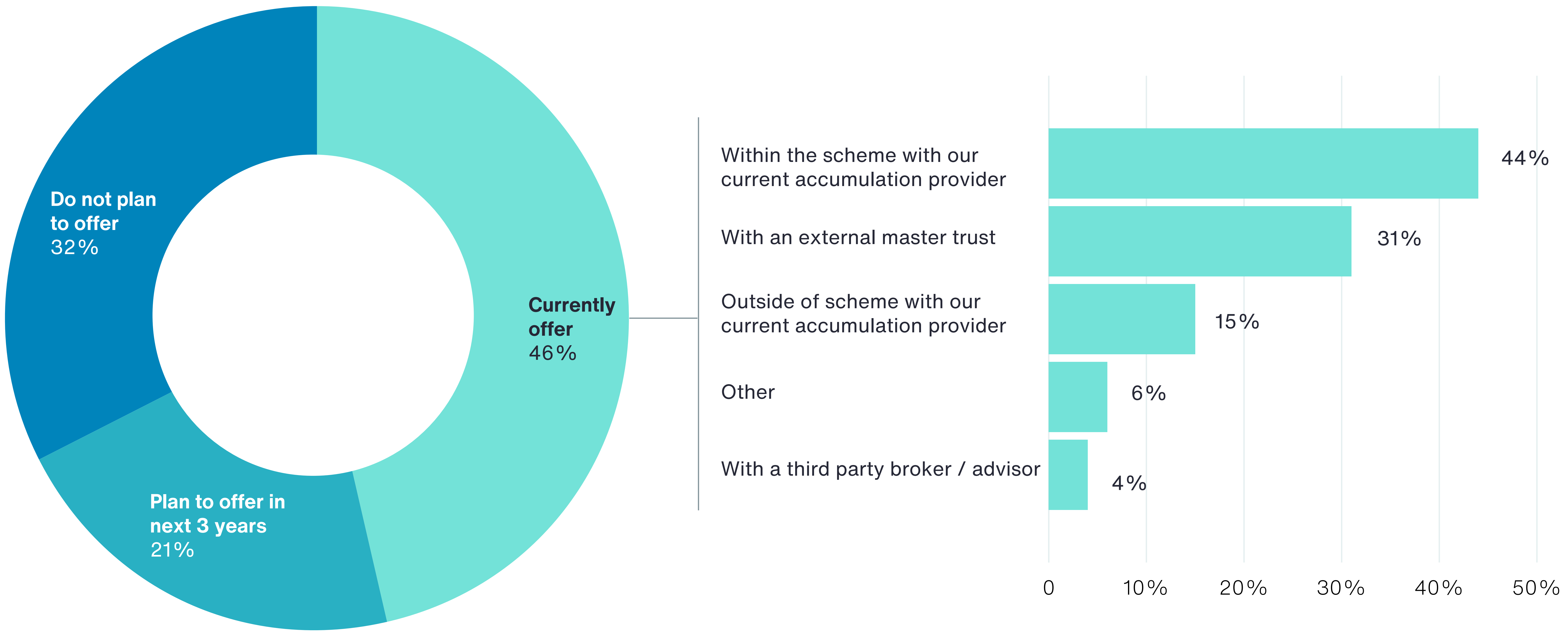
Sophie Moore
Associate Partner, DC Consulting

How Are Schemes Supporting the Move to Flexible Drawdown for Retirement Income?

As we saw in chapter three of this report, most schemes are now targeting drawdown or flexible approaches as the outcome of their default investment option. This mirrors what members are telling us, with our 2021 DC member survey *Keeping on track in challenging times* showing that six in ten expect to use drawdown when they retire.

Signposting members to a drawdown solution that has been subject to due diligence by the scheme and / or sponsoring employer could benefit many members. As well as helping to protect the unadvised members from scams or poor decisions, signposting provides an opportunity for schemes to negotiate lower charges and to streamline the transfer process to improve the member journey and potentially reduce transition costs.

Do You Currently Offer or Plan to Offer a Preferred Drawdown Solution for Members?



Schemes' approaches to supporting members with drawdown once they reach retirement is still evolving, albeit things are moving fast! Around two-thirds of schemes say they currently offer (46%), or plan to offer (21%), a drawdown solution for members — a huge jump from around one-third in our 2020 survey.

Most use (or plan to use) the drawdown arrangement offered by their provider within the scheme (44%) or via an external drawdown product from their existing scheme provider (15%).

Of the remaining schemes that look beyond their existing provider, a significant minority (31%) have opted to use a master trust solution.

46%
currently offer a drawdown solution

21%
plan to offer a drawdown solution

Aon's Expert View

Overseeing a pension plan to provide income in retirement is a very different prospect to overseeing a scheme for saving towards retirement. Plus there is no consensus in the industry on the right way to structure default investments in retirement. This means that there are significant differences between providers in the drawdown space and in their investment performance. It is encouraging to see more schemes looking beyond their current accumulation provider. A risk can be that where no alternative is signposted, members may assume that the drawdown option offered by the current provider has been assessed as being appropriate by those running the scheme — whether or not this is the case.

Given that so many members are starting to rely on flexible income now and in the future, I think it is really important that the drawdown offering is fully considered as part of the ongoing governance and value assessments.

Madalena Cain
Associate Partner and Head of DC Governance

Actions Checklist

At Retirement

- Assess your default retirement age — is this still appropriate and do members understand how it could impact their pension saving?
- Review your current retirement support — are communications and wider support structures appropriate?
- Consider solutions such as IFA advice and signposting a drawdown option to avoid risks of bad member decisions at retirement.

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About

Aon plc (NYSE: AON) exists to shape decisions for the better — to protect and enrich the lives of people around the world. Our colleagues provide our clients in over 120 countries with advice and solutions that give them the clarity and confidence to make better decisions to protect and grow their business.