Aon's Global Defined Contribution (DC) Retirement Income

Point of View

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1 Introduction

Around the globe Aon is helping our clients tackle the challenges that come with the growing reliance on defined contribution savings.

The regulatory environment, the pace of change and the model of DC retirement provisions may vary from country to country, but many of the underlying challenges remain the same. These challenges include the shift of risk and decision making to individual employees, low savings rates, a lack of engagement and understanding, volatile investment markets and the impact of uncertain longevity on retirement planning.

The challenge for DC savers does not stop when accumulation ends. The transition from saving to spending and the management of DC funds through retirement mean difficult and intimidating decisions need to be made and even sophisticated DC savers may feel ill-equipped to make those decisions.

Aon's global DC team has a clear view of the key building blocks and design principles that have a positive impact on individual outcomes. We are delighted to share Aon's Global DC Retirement Income Point of View with you.

Looking for more? You can also access
Aon's 2021 Global Defined Contribution (DC) Retirement Study

2 Smart Design

Understanding employee demographics and how employees make decisions should influence plan design and implementation models, to potentially improve the resulting outcomes. Plan design needs to recognise real life issues such as funding of health care post retirement and how availability of guaranteed income sources changes the decision-making process. Also, design should be flexible to allow for a sudden change in circumstances, such as forced retirement or caring responsibilities requiring early access to pension savings.

Integration with Savings Phase

The design of DC plans should make the transition from saving to drawing income as easy and seamless as possible, to reduce the friction on decision making. Friction can lead to inertia and potentially sub-optimal decision making such as a reliance on default or easy to access options. This phase should also mitigate risks such as investment transitions (transaction costs and out of market risk).

Plans need to consider the member experience of moving their retirement benefit from the accumulation to decumulation phase, including timely communication to members and transfers to other plan sections or providers, where necessary

Some key points to consider include:	Timing of initial communications (e.g. 10 years before expected retirement date) to get member to start planning	Regular “nudges” to get/remind members to take appropriate actions in the run up to retirement such as reviewing investments & adequacy of savings	Which communication channels to use & that work best for your members	Directing members to appropriate support to help them decide what to do, such as modelling tools, Government services and Independent Financial Advice (noting the potential benefit of Independent Financial Advice vs self-management).

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Flexible Drawdown Options

Retirement is often not a single one-time event and individual needs change over time. Consequently, plans should offer the full range of flexible retirement income drawdown options possible including supporting gradual retirement with part time working and the ability to vary the income stream. This may include a combination of secured income (e.g. annuities), drawdown and lump sum payment options.

Institutional Pricing

Employers and Trustees/Plan Fiduciaries invest time and energy to manage the cost of accumulation savings and that duty of care should exist for retirement income options, even where the decumulation vehicle may be separate from the accumulation vehicle. At the point the DC saver has their largest benefit (i.e., on retirement) they should expect that the charges they will pay in retirement are similarly managed.

Employers should seek to provide access to institutional pricing for spending solutions, whether in or out of plan. The lower fees that institutional solutions are able to achieve should encourage members to take advantage of employer plans, as opposed to more expensive retail solutions.

3 Smart Choice

DC will be more successful if members can integrate it into an overall financial strategy, both before and after retirement. We believe that DC plans should be offered as part of a holistic, employer-supported financial wellbeing program.

Recognise Diverse Individual Needs

The transition from "working and saving" to "retired and spending" should be guided and planned well in advance. Success in retirement requires an income-oriented approach to decumulation planning and budgeting — an approach that is targeted to individual variable needs and circumstances.

Members need help in understanding how the assets in their retirement account translates into income and in understanding optimal methods in converting those savings into income. They should be guided through budgeting for retirement, cognisant that income needs will vary at different stages of their lives and taking into account other assets/savings and Government support in retirement.

Putting Retirement in the Context of Financial Wellbeing

Individuals are looking for support in making effective financial decisions about retirement, in the context of their broader financial circumstances.

At Aon we define financial wellbeing as 'the ability to confidently manage financial life today, while preparing for the future and anything unexpected along the way'. A smart financial wellbeing program works alongside the employer provided benefits programme through a suitable range of tools, services, communications, and interventions at each stage of an employee's financial life, both before and through their retirement years.

We summarize the elements of a strong financial wellbeing program into four categories: prepare, plan, protect, and preserve. Post retirement we concentrate on the preserve element – "Make sure you have financial freedom to enjoy life". This will include consideration of the retirement benefit aggregated alongside other savings and investments, government support and expectations of lifestyle in retirement.

4 Smart Income

Guided Pathways

Managing cash flows over an uncertain time horizon is tricky enough for actuaries with all their tools and training. DC retirees who plan to remain invested and draw down their funds are generally ill-equipped for managing those cash flows. They may not draw enough income for fear of running out their savings. Others may draw too much and then need to reduce their income in later life or run out of income altogether.

Providing guided decumulation pathways for likely retirement journeys can help address some of those challenges. Offering default investment strategies (before and during retirement) and default decumulation pathways that suit the demographics of the plan members can be very beneficial in mitigating these risks and use inertia to steer people towards better outcomes.

Do-It-Yourself Pathways

Providing other solutions for sophisticated investors that want more control or have outside help from advisors would nicely complement the guided pathways described. This can include in-plan and out-of-plan solutions. It can also include guaranteed and non-guaranteed income solutions.

It's important to note that, similar to savings solutions, member circumstances are unique and having a varied set of solutions provides the best chance that everyone will find something that fits their individual needs and appetite for risk.

Manage Investment Risks

For both guided and do-it-yourself pathways, the offered solutions should provide income stability and manage longevity risks. Strategies should also access an appropriately wide range of public and private asset classes to enhance portfolio diversification and take advantage of secured income when appropriate.

Investments should recognize sustainable global practices related to supporting environmental, social responsibility and corporate governance issues consistent with local regulations.

Transparency of costs and a focus on the value to plan members is key to generating strong outcomes and improving individual confidence and understanding.

5 Smart Support

Advised and non-advised members

An important distinction when we look at support needed by members is whether they are advised (by an Independent Financial Adviser) or non-advised. Non-advised members will need significantly more support and direction towards tools and guidance to help them manage their retirement income.

Budgeting and Expenditure Calculators

Ideally, income modelling tools pre and post retirement should help users, particularly non-advised members, assess their income needs and take into account local taxation and means testing rules. Case studies and a variety of engagement tools should also be used to help retirees understand the likely changes in their income needs over time. Tools need to be user- friendly, supported with accessible materials to engage users and encourage regular use. They should also be able to manage mix and match solutions of guaranteed income, lump sum withdrawal and drawdown income

Retirement Income Projections

Members should have access to in-retirement modelling tools to help them manage issues such as how long their assets may last, based on varied income projections.

Include Coaching and Advice

Access to guidance and advice should be offered where possible, pre and post retirement. Recognizing many employees are unwilling to pay for financial advice, ensure free financial guidance and coaching is available through a wide variety of media to help non-advised members understand the key decisions they are required to make in planning for & managing their retirement and why these decisions are important.

Monitor the development of technology based advisory solutions, such as robo-advice, as these may make Financial Advice more appealing to members with lower account balances.

Recognising Vulnerability

Support mechanisms need to be able to recognise and support vulnerable customers and give access to later life support services. If using employer sponsored retirement solutions, ensure that the provider process for identifying and supporting vulnerable members are in place and sufficient, noting that all members are likely to become vulnerable at some stage.

6 The Big Picture

Across the world the need for Plan sponsors and Trustees to provide support and solutions that enable a comfortable and secure retirement income will grow as the balance of retirees drawing DB benefits switches to the majority relying on their accumulated DC funds.

The responsibility for decision making sits with the individual DC member at and post retirement and these decisions have huge financial consequences.

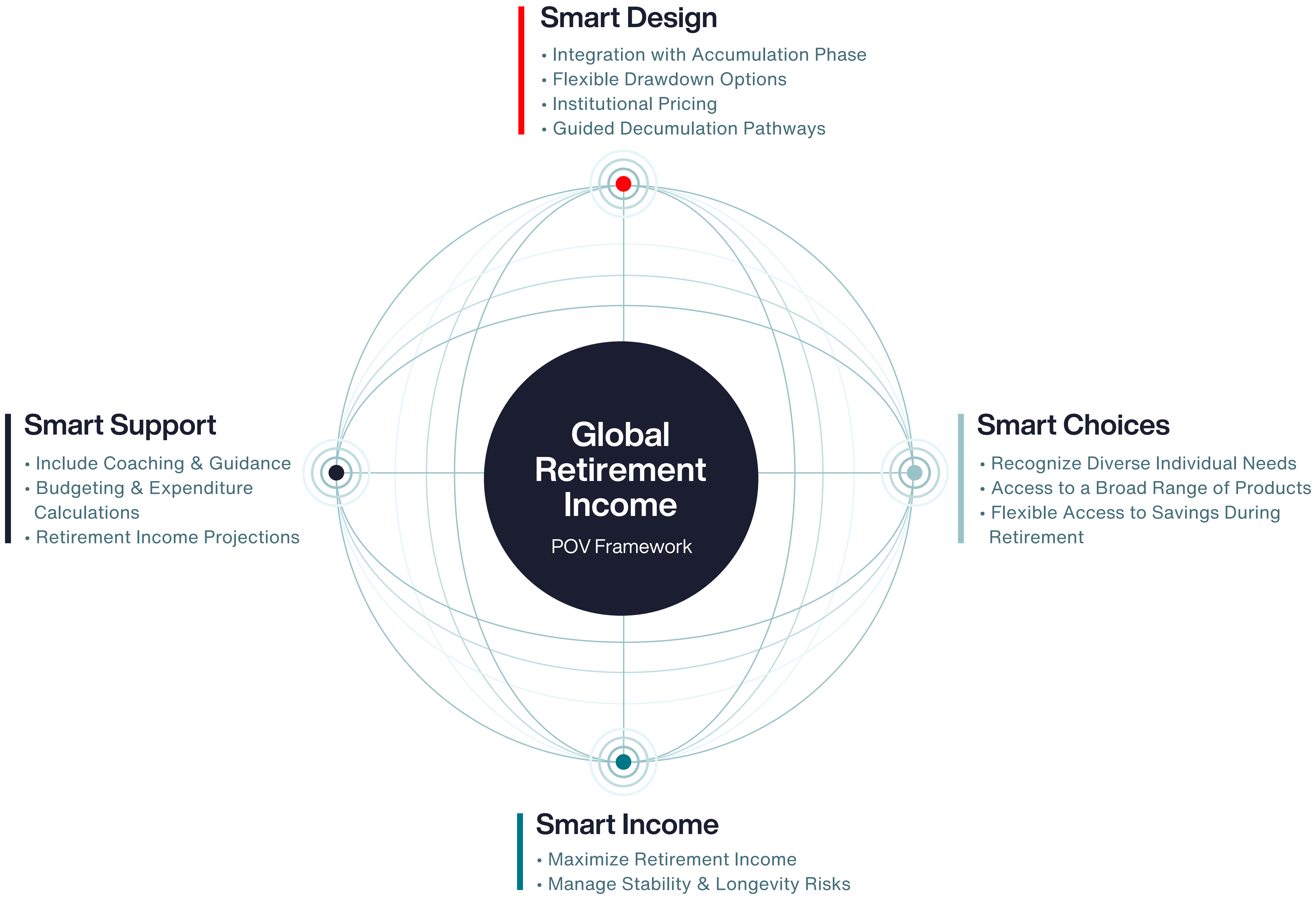
Based on our employee surveys, we know that DC savers want their employer to offer retirement income options and their expectation is that their Plan sponsor or Trustee/Fiduciary will support their decision making, offer cost effective well researched options and make the transition as easy as possible.

Schemes need to either ***Get busy*** ensuring they have done the work to put the support in place or ***Get scale*** by outsourcing.

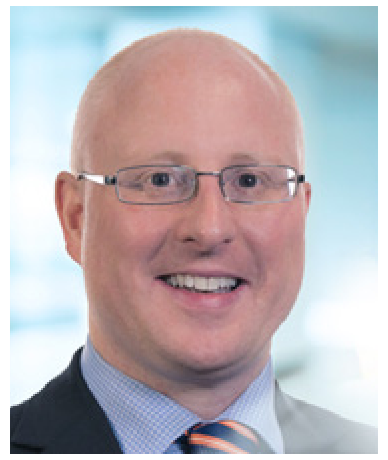
Aon is well able to help with all such options and would be delighted to assist you.

Aon's Global Retirement Income POV Framework

A Model for Sustained Retirement Solutions



7 Contacts



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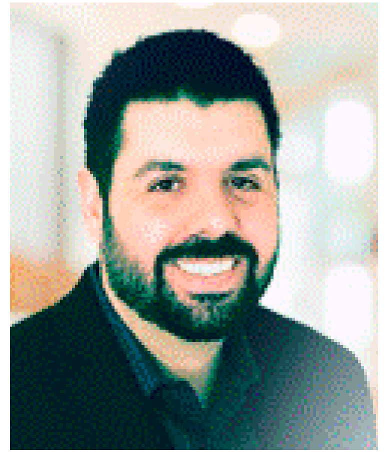

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About

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