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DEFINED CONTRIBUTION

roundtable

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Investment Management

Veronica Humble | Mitesh Sheth MBE
Paul Bucksey | Steve Delo | Lydia Fearn
Joanne Segars OBE | Sarah Smart | Philip Smith

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DEFINED CONTRIBUTION

De-risking a defined contribution pension scheme is a tried and tested strategy. As a member approaches retirement, they gradually move towards the perceived safety of some bonds, particularly those issued by the British government. The idea is to keep the pension pot away from the volatility associated with equities, which have a place in the early years of a member's journey to build a long-term retirement income.

It appears an ideal approach to protecting value as a member prepares to cash-in their pension, but we are not living in ordinary times. The sell-off in gilts following September's now largely reversed mini budget has reduced the value of such strategies, meaning members planning to retire imminently will receive a smaller pension pot.

"Glad I'm not retiring anytime soon," was probably the most common phase I heard at the PLSA's annual conference in October when asking those working in defined contribution for their thoughts on the gilt crisis.

Yet this reaction could be heard more often in the coming years as defined contribution schemes are facing many challenges.

Since the financial crisis in 2008, interest rates, volatility and inflation have been low. But things are changing. Inflation is at a 40-year peak, interest rates are rising and the outlook for equities has looked better.

So equities and bonds may not be enough to turn members contributions into an adequate long-term income. Workplace pension schemes may, therefore, have to bring more illiquid assets into their default funds.

This could be good news for the government, which has been trying to entice the stewards of private capital to repair and update Britain's infrastructure. The question is, do DC schemes have the expertise to assess such assets?

We sat down with master trusts, professional trustees, asset managers, a consultant and the regulator to discuss the industry as it enters a new phase that will challenge investment managers to earn a suitable real return for members. When looking at what has happened to gilts since the end of September, it may not be easy.

Mark Dunne
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DEFINED CONTRIBUTION IN FIGURES

27,700

The number of defined contribution schemes in the UK last year, with 26,260 having less than 12 members.

Source: The Pensions Regulator

£2.8trn

The total gross assets, excluding derivatives, collectively managed by defined contribution schemes at the end of 2021.

Source: Office for National Statistics

96%

The level of defined contribution scheme members who are invested in default strategies.

Source: The Pensions Regulator

£461bn

The expected total assets managed by master trusts in 2029, up from £79bn today.

Source: Broadridge

20 million

The number of master trust members, a rise of 10% in the past year.

Source: The Pensions Regulator

36

The number of authorised master trusts in the UK.

Source: The Pensions Regulator

PARTICIPANTS

Veronica Humble
Head of DC investments
Legal & General Investment Management

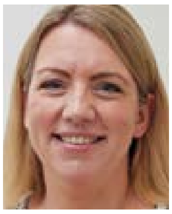
Veronica Humble is responsible for investments and ESG within the insurer's DC business. She sits on the L&G Mastertrust's investment committee and is an investment adviser for LGIM's DC clients. Humble has 10 years of service at LGIM, having worked in several investment roles before joining the DC business. Prior to this, she worked as a quantitative analyst at a hedge fund and as an asset manager.

Mitesh Sheth MBE
Chief investment officer for multi-asset
Newton Investment Management

Mitesh Sheth has had oversight of Newton's multi asset and fixed income teams since joining the firm in February. He is also responsible for the quantitative multi-asset team in San Francisco. Sheth joined the firm from Redington, where he was chief executive, ending a nine-year stint with the consultancy. He also has Henderson Global Investors, Aon and Willis Towers Watson on his CV. Sheth sits on the Diversity Project's advisory board, is a member of the CEO sponsor group for the gender workstream, an LGBT Great #50for50 ally and an executive sponsor of the Race & Ethnicity workstream.

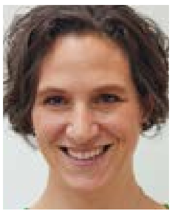
Paul Bucksey
Chief investment officer
Smart Pension

Before joining Smart Pension in 2019, Paul Bucksey was a managing director at Blackrock (and subsequently Aegon), leading the UK defined contribution workplace pension business. He has also held senior positions at Fidelity, AXA and PwC.



Lydia Fearn
Principal
Lane Clark & Peacock

Lydia Fearn re-joined LCP as a principal in the DC team in May to advise schemes on their investment, communication and wellbeing strategies as well as scheme design. Previously, Fearn was the head of pensions consulting at Capita and led DC and financial wellbeing at Redington. She has also worked for Barclays and Hewitt Associates (now Aon) where she was responsible for providing investment advice to DB and DC schemes.



Sarah Smart
Chair
The Pensions Regulator

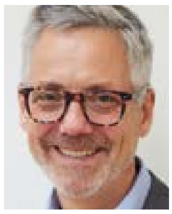
Sarah Smart has chaired The Pensions Regulator since June 2021. An experienced non-executive and independent trustee, Smart has a 20 year-plus track record, which saw her chair TPT Retirement Solutions for eight years, work with the London Pensions Fund Authority and Lothian Pension Fund, sit on the investment and funding committee for Unilever's UK retirement fund and chair the Financial Times Pensions Governance Committee. A chartered accountant by training, she also has roles at Standard Life Investments, Social Investment Scotland and Big Society Capital on her CV.

Steve Delo
Chair
Pan Trustees

Steve Delo is a chair of trustees for several defined benefit (DB) and defined contribution (DC) schemes, including The People's Pension. Prior to this, his career spanned senior roles in consulting and asset management. Delo has experience of DB funding negotiations, covenant evaluation, conflict management, regulator engagement, DC governance, trustee team building, scheme restructuring, asset-backed funding, setting investment strategies, de-risking and adviser reviews.

Joanne Segars OBE
Chair of trustees
Now Pensions

Joanne Segars has worked in pensions and investments for more than 30 years. She was the first chair of LGPS Central in 2017, has chaired Legal & General's independent governance committee and is a member of the pension fund governing body at CERN. Segars has also chaired the joint expert panel at USS and is a director of the Pensions Policy Institute. She has dedicated her career to solving inequality in pensions and is an ambassador for the CII's Insuring Women's Futures, and works with the Diversity Project.



Philip Smith
DC director
TPT Retirement Solutions

Philip Smith has more than three decades of pensions experience. He joined TPT from PwC where he served as head of DC. Prior to this, Smith held senior roles at Buck Consultants, Opus and Health Consulting.

Defined contribution

There is more to defined contribution than auto-enrolment and costs. Workplace pension schemes are turning more and more to alternative assets in the hope of generating inflation-linked returns. While they are trying to achieve what could be a real return of around 10%, they also have to protect members against the impact of climate change.

We brought those responsible for investing members' contributions together to discuss the challenges they face. With interest rates moving further away from their historic lows and inflation reaching double figures, it was a good time to sit down and discuss the industry.

How are defined contribution schemes maximising outcomes for members?

Steve Delo: There are a variety of ways. First, trustees look to diversify into areas that can deliver the desired degree of return at the right risk exposures. We also negotiate with investment managers to keep costs low to help members get maximum bang for their buck.

There aren't that many levers to pull, but generally trustees and providers are trying to do things in the optimum way possible in the circumstances to ensure member interests are best looked after.

Veronica Humble: Our master trust focuses on value for money and everything that involves, including investment strategy. All of this feeds into the outcomes for members and so it all needs to come together.

It is also important to understand the demographics of the members and help ensure that the investments are able to withstand different economic regimes, which will be interesting in the next few years.

Are default lifestyle growth funds appropriate in the current environment?

Joanne Segars: They are. The majority of our members invest in the default, which is built around their needs. The default is right, but we should acknowledge that the life-styling approach needs to change.

Years ago, life-styling was targeted at buying an annuity at the end of the piece, now it is targeted around people making different decisions at different points. For us, it is also about making sure that when we are designing those defaults, they are right for our members, which could be different from another set of DC members.

Due to consolidation, it will be interesting to watch how the market develops when there are several large master trusts.

Veronica Humble, Legal & General Investment Management

DC life-styling is still right and is the approach we take at Now Pensions, where we move people out of riskier assets as they hit their retirement glide path.

We have to recognise that for a new scheme like Now Pensions, where balances are quite small, most members take their money as cash. That will change when we see balances grow.

Sarah Smart: You cannot maximise an outcome until you have defined it. You then need to decide how you will measure what is being delivered. Then, crucially, when talking about life-styling, you have to ask: "Do you have the flexibility to change course if outcomes are not as expected?"

All of that will blend into our Value for Money framework, the key tenets of which are investment performance, costs and good governance. But it is not about keeping costs as low as possible. It's about understanding that paying a bit more for a better outcome is worth doing.

Ideally, we want those who decide which DC schemes to use do so based on the best outcomes for their membership. We want competition in the market, not just on costs and charges, but on good outcomes, too.

The government wants DC schemes to invest in infrastructure. Are you interested?

Philip Smith: We have been looking at alternative sources of return within our default funds. We have made some early investments in private markets during the past 12 months, which includes elements of green infrastructure.

Infrastructure definitely has a role to play in diversifying sources of return and balancing out some of the ups and downs we are seeing.

How easy is it to access these assets?

Smith: We access them through publicly traded vehicles, simply because of the operational constraints of having illiquids in the portfolio.

I suspect that as the industry grows in scale and the infrastructure begins to adapt, that will change.

Segars: I feel a sense of *déjà vu* with the government pushing pension funds into infrastructure. The Pensions Infrastructure Platform was created back in 2010 and we are still having this discussion.

I have always been a fan of infrastructure, believing it to be a good asset class for pension funds, but it is more than just telling them that they should invest in infrastructure. It is also about having the right pipeline for pension funds to invest in.

We will look at it as we grow, but infrastructure is not something we are doing right now. To do it directly, which is where you get the most influence, you need to be quite big and many of us are not there yet.

Humble: We have a significant allocation to listed infrastructure within our standard default funds, amongst other listed alternatives.

To consider an illiquid infrastructure allocation, you need proper scale and diversification. You cannot have a big slug of one asset class which is illiquid and difficult to deal with.

The conversation about value for money will help. The focus in the industry is still too much on costs and charges, but this is changing. Conversations have moved from: "It is interesting, but we have no idea how to approach it," to: "What are the considerations, limitations and barriers that we need to think through and how do we overcome them."

Lydia Fearn: Smaller schemes tend to get the short end of the deal because they do not have the governance budget. The larger ones need to push it through to give smaller schemes more access.

We are living in the 1980s in terms of giving DC schemes suitable access to infrastructure. Platforms do not have to give daily liquidity, but schemes are constrained by it. Liquid infrastructure is a great way to start but it is linked to equities.

It is about trying to get that breadth of diversification, particularly in the later years. We have found that people are in annuity-targeting investments when they have no intention of taking an annuity. When it comes to value you have to make sure members are invested in the right places, let alone getting the right investments throughout the journey.

Is the regulator happy that DC schemes are investing in infrastructure?

Smart: We have always encouraged DC schemes to look as widely as possible at what investment opportunities are open to them that will deliver good outcomes for members. But they need to be aware of the difficulties of investing in illiquids and how they would deal with those difficulties.

It is about understanding whether the assets you invest in provide the diversification you need and also the impact valuation and charging methodologies have on different members.

We are seeing what happens with illiquid assets when there is stress in the market and illiquidity starts to bite. Trustees of DC schemes using illiquid assets need to have a plan for how they will deal with that in their pricing.

Delo: It is not an easy action. There are still lousy infrastructure investments out there, so government cannot just say: “Go and invest in infrastructure.”

There is a nervousness about government spending the money under their control, let alone letting them tell us what to do with money under our control. If there are worthwhile infrastructure investments out there, as an industry we will find them, regardless of government directives.

Paul Bucksey: There is a massive difference between what a large single employer trust may feel it is able to do compared to a master trust that has to balance returns against price. I am not convinced that employers and consultants have moved away from price in absolute terms.

The charge cap has shone a light on the absolute price. We still see ridiculous pricing in the market, which is not an incentive to invest more.

The master trust versus non-master trust piece is a different kettle of fish. We are competing pretty aggressively at times. We have to generate great returns, invest sustainably and look at infrastructure, but do it cheaper. You cannot square that circle. Something has to give.

Regulation would help but is not the sole answer. This drive to the bottom on price that we have seen for years is not healthy from an investment perspective.

Fearn: As a consultant, we are mindful of value for money, not cost. When we do selections for master trusts, we do not put cost in the mix. We are trying to move employers towards looking at how the master trust is helping them to deliver for their members. Cost comes as a secondary part of that.

What we find is that master trusts feel they need to cost similarly to compete. That is frustrating. If we are going to do more infrastructure and ESG, the governance cost will be higher.

Mitesh Sheth: Looking at it objectively, I cannot blame anyone for going for the lowest cost over the past decade when a rising tide lifted all boats. Frankly, did you need alternatives to deliver reasonable returns?

In that context, would it be sensible to take the cheapest, simplest strategies and put them to work to maximise return for lower costs when those are two of the only levers you have outside of contributions? But we are coming to a regime shift where we cannot rely on market returns to deliver real returns over the time horizons we are talking about. We are dealing with structurally higher inflation and volatility, and so have to be more discerning about where are we going to find returns.

If we cannot get more in terms of contributions, if we cannot change the outcomes, what you have left are investment returns and fees. We have been allowed to get a little lazy, but that has not been terrible. It was okay to focus attention on

One of my fears is that people are seeing their pension as a savings pot rather than something to provide them with a long-term retirement income.

Philip Smith, TPT Retirement Solutions

other things. But that has to change, and change rapidly, otherwise we will lose the compounding benefit of the gains we have made in what will likely be a volatile environment.

On the alternatives point, I am not sure they were needed before. When we see equities likely to disappoint with rising inflation, with bonds not providing diversification, you need alternatives, not just infrastructure. We have to think more broadly about how we will preserve real returns, let alone grow them.

Smith: We are all talking about accumulation, but the big challenge coming down the track when peak defined benefit disappears and we are into true DC is delivering an inflation-linked income. That is going to be critical. One of my fears is that people are seeing their pension as a savings pot rather than something to provide them with a long-term retirement income. Dealing with that mindset is a challenge. Then there is how do we provide income which is inflation protected.

How can investors access illiquid assets in a liquid form?

Sheth: Investment trusts are popular. It is interesting that if you had asked me this a few weeks ago, they did not look great value. But now, if defined benefit schemes are stepping away from listed investment trusts, it could be a great chance for DC schemes to step in. They are now a genuine liquid alternative and are not forced to sell underlying assets to manage redemptions.

Bucksey: Holding illiquids via a pooled fund is hugely expensive. For example, the additional expenses of holding real estate are punchy. Even with aggressive negotiating, we are probably talking 150 basis points.

In an ideal world, if the way these particular charges are disclosed, particularly the additional expenses could be a more level playing field, it would be an incentive for master trusts to allocate to these assets.

How will master trusts influence the portfolios of DC schemes?

Humble: Scale, first and foremost. Master trusts will eventually replace the large DB schemes. They have the governance, the investment expertise and the external advice smaller schemes will never have. It is a great model to get something scalable and agile. That will be interesting to watch.

Our master trust's trustees are interested in what is going on in the markets, they are interested in illiquids and, when we speak, they are wearing their governance hat, so they are not

gung-ho in trying to chase the latest investment trends. They ask how they can do that properly.

Due to consolidation, it will be interesting to watch how the market develops when there are several large master trusts.

Sounds like diversification is not going to be a problem.

Fearn: Historically, we have put equities and bonds on the glide path. I'm not sure that is going to wash going forward with the impacts we have seen in the past few weeks.

Investment strategies need to be governed, monitored and consulted correctly. You have to think about the membership. We will see continued consolidation towards master trusts, which is the right thing to do. Master trusts are in a good place to watch, govern and check on member's strategies.

The endpoint is becoming more of an issue. We have a few years before people start panicking. But even now, being in the wrong strategy can cause issues for their future plans. It is trying to create an environment where the members are taken on an investment journey, one that they are going to expect a decent outcome from for a reasonable cost, but not the cheapest.

Bucksey: Most of us are in a good position to harness this thing called inertia. You want people to be saving for as long as possible to get the benefit of compounding. That is the magic of investment and you are only going to do that if you keep contributing.

Inertia has been a success in getting people into pensions and staying in them. The dichotomy we quite often have is that providers can be criticised for not doing more on member engagement. Actually, the last thing you might want to do is over engage younger members because you destroy that link to inertia of getting money in.

Most master trusts have a good sense of keeping less engaged members saving. Then, with all of the money flowing into master trusts and the ability to be agile in improving the default investment option, disengaged auto-enrolled members is not necessarily a bad thing.

In the United States, you can put people back into the default after three years of self-selection, which could otherwise be self-harming, but not necessarily if you have a well-managed default that you are monitoring and tweaking when necessary.

You need to ramp up member engagement as members get closer to retirement, so if they are tracking towards an annuity purchase they are aware of what they are tracking and can work out if it is right for them.

Over recent weeks, annuity prices have reduced and while the optics do not look great as members in bonds may have seen a drop in their fund value, if they are going to buy an annuity you are matching off the two. Which is what they were designed to do: a mixture of bonds and gilts tracking annuity pricing.

Delo: Of course, members are now out of the habit of buying annuities because the general view has been that they are poor value. We need to recommunicate on this pretty damn quickly.

Bucksey: Our standard glide path is flexible and is based on staying invested. We have more than 1 million members and only 1,800 have selected an annuity-target glide path. It is relatively modest, but that is not to say we have not looked through the portfolios to see what our exposure to gilts and bonds is.

Our flexible, stay invested glide path has held up pretty well.

Segars: Can we speak about scale and looking beyond portfolio construction? As master trusts continue to grow, which they will quite rapidly over the next few years, there are broader influences that they should have.

First is around the policy agenda by making sure we have a pension system that works for everybody. It is also using our leverage, individually and collectively, on stewardship and ESG.

I remember in a previous existence, individual funds being picked off because they were not big enough to have influence. But as our assets under management grow, we should be more influential over that corporate governance and stewardship agenda. It is important that we do not forget that when we talk about the role of master trusts.

Another issue is inflation. Are DC schemes reviewing their default funds in light of the rising cost of goods and services?

Sheth: Most default funds probably are not going to deliver value in real terms if we settle on a higher level of inflation. Given some of the supply-side shocks that are not going away anytime soon, we are likely to see more inflation volatility too.

When you look at history, higher inflationary environments see equities and bonds correlate positively. It is not unusual that we have seen equities and bonds behave similarly. We can see a future scenario where cash outperforms bonds and bonds outperform equities.

I am guessing that most default funds are not designed to capture that. It is not just about alternatives or infrastructure, but also thinking carefully about how to maintain pace with inflation and not get whipsawed with market volatility.

Bucksey: There is a massive timing issue here. If you are young, you can take depressed equity markets. If you are closer to retirement, then it is a bigger problem.

Smart: There is a timing issue and a path dependency issue. The point we tried to bring out in our value for money discussion paper was the importance of recognising the path is dependent on outcomes.

If you are just measuring the outcome of a DC default fund relative to inflation, that completely misses the experience members are getting at different cohorts. If you need a big return

your assumption maybe you can get that when the pot is big. That is crucial to your outcome.

If you get a big return when the pot is small and a tiny return when the pot is big, the impact on the overall outcome is enormous. That is why we say focus on measuring the outcome for different cohorts and think about different scenarios for assets. If you are clear about what outcome you are looking for, you will be better able to react in ways that meet that outcome.

We have seen the issues inflation can create in assets. Understanding how that affects different members at different parts of their journey and acting on it is key to achieving the outcome you are aiming for.

Delo: This is the nature of the beast with DC because you cannot control much around outcomes and thus member disparities are inevitable. There will be winners and losers and differential outcomes which will be problematic over the years. It will take some member understanding. It will test communications. We will have to go the extra mile on getting members to understand what is happening, what can happen and why.

Smart: Is it about getting members to understand what is happening or making sure they tell you what they plan to do and when so you can make sure they are in the right place?

Delo: It is a bit of both. This is quite challenging and not just for master trusts. DC as an overall concept is still not that well understood by members and I suspect they generally think outcomes are more certain than they are. They do not understand the cliff-edge nature of some aspects and, therefore, we have to up our game in that area. But it is still, as I said, unfortunately, it is the nature of the beast.

Humble: We also often overestimate how well people are preparing. When we did focus groups research on how people approach retirement, they are disengaged, disengaged, disengaged, and then they are super-engaged.

So people are engaged, but it is broadly in the last six months when they are close to retiring, so they are well prepared but they are a bit late.

Smart: Is that because we are not engaging with them until six months before they retire?

Humble: From our research this was much less about their retirement investments and much more about their stage of life and uncertainty about life events.

Smart: It is difficult to say people are not engaged 10 years before retirement if we are not trying to engage them. If we were sending lots of communications which were simply thrown away, then it might be the case. But I don't think that is what is happening.

Look at Nest. When its 12 million members reach retirement, they will be told to sort themselves out. But many may never have engaged with their pension before that point. There is something needed that would help with that decumulation journey for millions and millions of savers. What that regime ends up looking like, is not in our gift.

Humble: We send quite a bit. We do have some level of engagement, and some methods yield better results. We often overestimate how uncertain people's lives are.

Delo: From a consumer perspective, this subject matter is simply not attractive or compelling. We struggle as an industry to make it interesting enough for people to look at it early enough in their lives.

Fearn: That is why auto-enrolment worked. We just chuck them in and they think: "It's done, the company is looking after it and 8% is fine."

There will be a crisis at some point that wakes the nation up to it. I can't see any other way. It will start to have an impact when people see someone having a difficult time because they did not plan or put enough in.

Segars: We need to be careful when we say people did not plan or put more in because some of this is about the system. The system says 8% and that is what most people get in an auto enrolment.

> **Most default funds probably are not going to deliver value in real terms if we settle on a higher level of inflation.**
>
> Mitesh Sheth MBE, Newton Investment Management

We need to be wary about how much can be dealt with through better member engagement.

Smart: There are three questions I would ask DC members. One, is your address up to date? Two, are you contributing the most you can afford? Three, have you thought about when you are going to retire?

If we can engage them every now and again on those three things, that will get us a long way.

Delo: In an inflationary environment, people are not going to have any spare cash. They cannot afford to do more. Maybe we can squeeze the pips a little bit by ensuring efficient schemes that are well diversified, but in reality we are probably going to walk towards the point where the pensions timebomb is going to go off.

Sheth: That is the double whammy. You are less able to contribute and your investments are less likely to do as well. You lose meaningfully through that period, so perhaps that is what causes the crisis.

Smart: That is interesting when talking about diversification as well. Some say it is the only free lunch in town, but could there be a point when we eventually diversify any return away?

We cannot do everything for everybody. The point of people being in a scheme throughout their lives is that they have a long period to be exposed to growth assets and can take a certain amount of volatility. There is a conversation to be had about when diversification is needed and what it should look like. Savers should be able to benefit as much as possible from being in growth assets.

One of the things that will be important in the proposed Value for Money framework, which could be difficult to get right, is ensuring the focus on returns does not drive short termism. It is not acceptable to pay lots of money to follow a certain investment strategy, and then, after 30 years, saying: "Oh, well, that didn't work." By that time, lots of value has been lost and you cannot get it back. Finding the middle ground will be tricky.

What assets are schemes using to hedge inflation?

Segars: Inflation is a core part of Now Pensions' investment philosophy. We have a balanced risk approach and one of our buckets is around inflation, which is core. We have set an infla-

> **We still see ridiculous pricing in the market, which is not an incentive to invest more.**
>
> Paul Bucksey, Smart Pension

tion-linked return target for our growth funds.

We look to invest in inflation bonds and swaps as well as commodities, excluding fossil fuels. We invest in a mix of assets that fit into that range of buckets which together give us that inflation-linked return.

That has become more difficult, but it is core to what we are trying to do.

Bucksey: You cannot expect to turn members into CIOs. It is tricky to get your head around. The key is not over communicating. Making sure that you are doing the best you can for them in how you put things forward.

We have tried loads of things. Our members get an app through which we do lots of nudging. We try various tactics to wake them up to doing something. It is difficult to get younger people to engage. They are busy; life gets in the way and there are other calls on their money.

I wonder if ESG is a potential silver bullet. The world is on fire and you cannot get away from flooding in the news. A proportion of our members tell us they care deeply about it; equally a proportion of our members do not seem to care as much. It is not one-size-fits-all, but neither is life. Pulling on ESG to try and get members to take more interest in their finances overall, is going to have a beneficial impact on the pension.

Then there is the cost-of-living crisis. People will say that you need to upgrade to a heat pump, you need to get an electric vehicle, but they cost a lot of money. What you could do is tell people they could have a positive impact by making sure that their pension is invested in a sustainable way.

You build that story by explaining how much carbon they have reduced from investing in a wind farm, or they are helping to build social or affordable houses. That will, over time, get people a bit more interested, building up pride in the way that their money is being invested.

Humble: These themes resonate in our research. Interestingly, they resonate across ages. Climate and environmental topics matter more to younger members, but the social and governance side is favoured by older members, for whom that is lived experience.

That is intuitive. The gender pension gap resonates with older women, for example, because, again, that's their lived experience. We should not think that this is just for younger members.

Bucksey: The other question we have asked is: to what extent would you be happy investing in a sustainable way if it meant getting a lower return or paying more in charges?

It comes back to what do people really think. It is interesting that most master trusts and other providers are seeing outflows to the consolidators, which have charges comfortably above what they have been paying in master trusts.

So we know that price does not seem to be the key issue for members, but this is not one-size-fits-all. A survey of ours found that about 42% of respondents would be happy to invest in something for the good of the world, even if it meant getting a slightly lower return. Those wanting to focus on the investment return were in their mid-30s. This has led us to recalibrate our default options to members.

Thus far, we have three risk-rated growth funds, so members can pick whether they want to take a little bit less or more risk in the early phases. We are moving away from that towards beliefs based, due to demand.

Our flagship fund is 100% ESG. It has an impact allocation, some private market assets and green bonds – it is a potent mix.

Back to my pricing point, if we have employers, or indeed members, that want to pay a little bit less, perhaps go a little bit slower and be a little bit less impactful, we have a strategy for them. Conversely, if they have a strong desire to invest in a more aggressively impactful way, and they are willing to pay a bit extra, then they can do that.

We are at a potential point of inflection. Based on this subject of sustainability, we need to be looking at different growth assets because of the bigger macro climate. But the sustainable agenda forces you to look for more actively managed mandates and infrastructure venture asset classes.

ESG and sustainability are big issues for the regulator. What is the policy intent here on things like climate risk reporting?

Smart: The policy's intent is to ensure members are not adversely financially affected by climate risk or other ESG risks. It is not just about filing in a Task Force on Climate-Related Financial Disclosures [TCFD] statement.

It is about a scheme understanding where they are financially exposed to climate risks, having a plan to mitigate those risks, enacting that plan and measuring how they are doing against it.

I have never understood the clash between sustainable investing and fiduciary duty. They go hand in hand. Obviously, when more aggressive exclusions are put in place it can get a little more difficult. But it is about good investment governance and taking account of all the risks out there, of which climate is a big one.

Bucksey: It is not only about risk, but embracing the opportunities that investing sustainably should give.

Smart: And recognising there are metrics within TCFD that can be backward looking. We are keen not to get too driven by things that create perverse outcomes and incentives. For example, if the push for a net-zero world means not investing in organisations with a high-carbon footprint now but they will be the major investors in the clean energy of the future. That is not necessarily a good outcome for savers or for anybody else. These things are tricky.

How influential is ESG in DC portfolios?

Humble: It's significant. In all our conversations with employers in the past three years ESG played a big role, which is remarkable. Some of that is due to regulation, but it is also driven by an interest in risk and the investment opportunities as well as by member engagement.

The majority of DC members are quite passive in terms of

We want competition in the market, not just on costs and charges but on good outcomes, too.

Sarah Smart, The Pensions Regulator

investment knowledge but they are an engaged minority when it comes to ESG. For some schemes that can be up to 30%, so trustees are reacting to that.

Segars: ESG is integrated into all that we do. We only have one investment fund, so it is not like we offer a separate green option.

We have set a target to have 50% of the net-asset value of the fund in responsible assets by the end of this year. A target we have already surpassed.

Smart: How do you define an ESG asset?

Segars: We are defining them narrowly. We can go further and faster, but we do not want to greenwash or pay over the odds for greener assets coming onto the market.

We have talked about the E, but it is also important to talk about the S and the G, because they can be at odds with each other. You might want to invest in an electric car company, but the materials for the batteries extracted from the ground may not be very E, while the way they treat the miners may not be very S. We need to think about ESG across the piece. Stewardship is important here.

Sheth: I hope such conversations can be more nuanced. Asking if members are willing to give up return by going down a sustainable path was academic a couple of years ago. It is only over the last couple of years that we have been able to see what you might give up by not owning energy or defence stocks.

Smart: The argument of giving up return to invest sustainably only relates to short-term returns, right?

Sheth: It depends on what you consider short. It could be over a number of years.

The point is that unless you have strong beliefs – and that is hard as a master trust because they represent so many members – the pressure needs to be on fund managers to think about this in their assessments. Is this the right timing? Is this the right pricing?

It is much more of a nuanced conversation which has to be integrated into the portfolio manager's job, so there is no philosophical difference. Then your core funds and core strategies are being managed with an eye to net zero, and the social and governance issues are also managed to the point where they have to deliver a financial outcome.

That is a stock by stock, company by company, bond by bond assessment at different periods of time, which should not be

made by trustees unless they have a strong set of beliefs.

Smart: In an ideal world, boards would run their companies with a view to all of these future risks. Fund managers would pick companies based on who's doing that well and trustees would not have to do anything because the world would work perfectly. But it does not work like that.

The reality is, in some areas, it is still much more financially productive for a company to not act sustainably and take the fine that comes their way. It is investors who have to put that challenge on through fund managers.

Segars: It goes back to stewardship and engagement. It is about encouraging carbon emitting companies to transition, in a just way, to become more sustainable companies. The energy companies are going through that process, but it is about the role that we can play as investors, individually and collectively, to help facilitate that.

Delo: The essence of the problem here is that these are long-term issues and we do not know when they will manifest themselves. Many members may, therefore, be through a scheme and gone before any of these issues do manifest themselves.

This has to be considered in the context of an investment industry has always been judged in the short term – short term returns, performance against benchmarks, etc. Until we get away from that, we are going to end up in a bureaucratic mess, because it feels like a writing job as opposed to critical long term risk decision-making.

The industry is working hard on TCFD reports that are important but few members will read. It is almost like you want the risks to manifest themselves to prove that you we were right to have done all this, but in reality we also do not want them to manifest themselves.

Humble: Stewardship and engagement are dealing with these risks. Capital flows and analyst assessments are much longer term, whereas engagement is changing things now because nobody wants difficult questions asked at the AGM.

Smart: But they also want a share price that holds up and making a profit does that. As investors, we do not necessarily react in a consistent way in our engagement and in what we buy and how we reward performance.

Humble: We look at things systematically, which helps us to consistently communicate with members. Defence stocks are a good example where the knee jerk reaction a few months ago made such stocks questionable, but suddenly they are quite demonstrably doing good. If you have a systematic approach to assessing these things, that would not have been a shock to you.

Delo: If you are going to retire imminently, what do you wish the trustees would have done? Worried about these risks or given advanced thought to how many bonds they were sitting on that have just been flattened in value?

We are worrying about members being disadvantaged down the track because of risks that blow up and make their retirement worse than it could have been. But we have just had one of these for some members and there could be bigger ones to come. Looking at the totality of all of these risks and issues in a proportionate way is a massive task.

Segars: That is the circle we have to square, as trustees need to look at both of those at the same time.

Smart: As the regulator, we have to understand the risks savers face, quantify them, apply our resources in ways that mitigates the biggest risks – accepting there are some we cannot mitigate – and then measure our outcomes. That is a similar process for trustees. There are certain risks and opportunities savers are exposed to that trustees try to mitigate or take advantage of, but they only have a certain amount of governance time.

Fearn: It goes back to demographics. If you have a bunch of members coming through as well those starting to invest in the early days, we tend to look within the cohorts to make sure we are aware of what is going on within each part of the journey.

The biggest issue we saw after the mini-budget was the annuity

If we are going to do more infrastructure and ESG, the governance cost will be higher.

Lydia Fearn, Lane Clark & Peacock

purchase issue, where if you are not going to purchase an annuity you are in the wrong place. Ensuring that you spend some governance time on those members, as well as the rest of the journey, is important. It is all proportionate that depending on what your membership looks like. Smaller schemes struggle with that a lot more.

We have talked about the E, S and G. It is great that you can look at the whole thing but pinpointing the climate issue with measurable carbon is an easy way for small schemes to get started on the journey. Hopefully, that will pan out into the S and the G over time, but master trusts should be looking at the whole thing.

What is happening with Collective Defined Contribution (CDC) schemes?

Smart: We are ready to look at our first CDC application. Hopefully, that will come soon. The CDC regulations have been drafted with a single-employer scheme in mind. Multi-employer CDC schemes are more challenging. They need a little more work to understand what the regime looks like, but there is a demand for them, not least from master trusts.

Smith: The potential for CDC is there. A lot of the issues we have talked about today are around asking members to make choices and get engaged. It feels like we are still in a retail-driven world where individuals are asked to look after themselves, rather than us collectively helping them on their journey.

I do not know if some of the engagement issues we have talked about today could be solved through some form of collective activity. There could be something there to make people's journey easier and share some of those risks. It is a debate we need to have.

Delo: I worry about DC in retirement. As a pensioner gets further into retirement, they still have to keep making decisions on what they are going to drawdown. Whereas in a DB scheme, your pension is paid out every month without any personal action so you do not have to worry.

It is pretty important that decumulation is low intervention from the pensioner's point of view. Something that does that would be welcome, but I have not yet had a single serious conversation about launching CDC.

Bucksey: The horse has bolted. We are a different society to Holland, for example, which is flirting with CDC. We are not seeing any demand for it from employers or consultants.

In the retirement space, we are innovating with a four-pot product.

Fundamentally, people do not like giving their money away and never seeing it again. That is what killed annuities.

Segars: If you ask people what they want, they want a guaranteed income for life that goes up with inflation. What does that sound like?

Humble: We're finding that many people also value flexibility and often want to retain the ability to change their choices.

Segars: It has gone from one extreme to another. There is possibly scope for it to swing back. Most of our members are tak-

If you ask people what they want, they want a guaranteed income for life that goes up with inflation. What does that sound like?

Joanne Segars, Now Pensions

If there are worthwhile infrastructure investments out there, as an industry we will find them, regardless of government directives.

Steve Delo, Pan Trustees

ing their money as cash because their pots are small. That will change over time.

We are looking at what this means for people approaching retirement and how that will change as pots grow. It is part of the circle that we have to keep squaring.

Fearn: CDC is not going to rear its head much in accumulation. Steve Webb talks about flex first, fix later. He has a concept about retiring but not buying an annuity until you hit 80. It is a mindset of "this is my pot to use in my retirement until I die, it is not to be used as an inheritance".

There are some concepts that master trusts are trying to build something around to allow that *en masse* solution. We will need something for the middle pot people who need more than the state pension but do not want the advice piece. I hope we can get that before that wave hits.

What will be the biggest investment challenges for DC going forward?

Humble: Being in a different market regime. There is a generation within the industry who have never seen equities fall or a high inflationary environment. It will be interesting to see how investment strategies adapt.

Delo: We are entering an era of explaining disappointing outcomes.

Smart: The big investment challenge is knowing what to provide for members.

They do not know if they want to buy an annuity or drawdown their money. It is not like DB where we broadly know what we are shooting for because we have a liability profile and can invest accordingly.

Sheth: A quick mindset shift is required to move away from assets that have benefited from low rates, central banks printing money, low volatility, and low and manageable inflation rates into strategies that are likely to benefit from a market regime that we have not seen for 40 years.

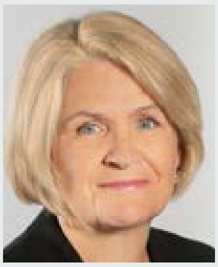
We are entering a potentially decades-long new era, so we cannot wait it out patiently.

Some of the maxims we use, like 'diversification is a free lunch', were developed over the past 40 years when they worked.

We might have to review not only our models and assumptions, but some of our investment principles, too.

Another challenge will be looking at things that have fallen out of fashion because they did not work for so long, such as currencies, commodities or other liquid alternative strategies that could bring diversification to a portfolio at a reasonable price.

Quite a significant shift in approach is now needed to deal with this new environment.



Rita Butler-Jones is co-head of defined contribution at Legal & General Investment Management

LEVELLING UP IN PENSIONS? YOUNGER WORKERS ARE PLAYING ON BUMPIER FIELDS

It's almost 10 years since rules came into force to automatically enrol workers into workplace pension schemes. It was one of the most positive moves to help protect the financial security of older people since the introduction of pensions themselves.

Yet, as we rightly celebrate the milestone, we need to acknowledge that there's still a long way to go to tackle pension inequalities for groups such as workers under 22 years of age.

For workers under 22, even getting started on their savings journey can seem like a step too far.

The main issue for people yet to celebrate their 22nd birthday is that they fall below the age threshold for auto-enrolment, which means that while some may be offered membership of a pension scheme by their employer from age 18, most are not.

In our latest research, Legal & General looked at what's happening in terms of workplace pension provision from the perspective of those who may be in a position to receive it[1]. We found some troubling trends among women and younger workers who disproportionately make up the lowest paid group of workers.

Understanding the rules – knowledge is (pensions) power

We found that around half (49%) of those under 22 knew that if you earned less than £10,000 a year, you do not qualify to be auto-enrolled into your employer's workplace pension.

However, 62% of young workers did not realise they could ask to be enrolled if they earned less than £6,240, while most under 22s (56%) were not aware that employers do not have to make contributions on the first £6,240 of their income.

Once they know their entitlements, there is a significant appetite to join a pension. Overall, 29% of under 22s said that if they had known they could, they would have asked to join their workplace pension even if their employer did not contribute to it. And nearly 20% would have asked to join their workplace pension if they had known that their employer would make contributions. Both statistics suggest that better education by pension providers and employers would make a difference to pension savings choices by those under 22.

Some of the people we interviewed were surprised to hear that the employer and government paid into workplace schemes, as they thought that all contributions came from their wage packet alone.

1) Research carried out in summer 2022 by Ignition House on behalf of Legal & General Investment Management (LGIM). The research sampled 5,259 people in the UK private sector workforce

For instance, one 21-year-old man changed his view about paying into a scheme after a moderator told him that his pension would not just be from money deducted from his salary. He shifted from saying: "It's not something I'm too intrigued by or too involved in. I just know some money that I get paid gets deducted and put toward the pension. That's not something I would see until obviously I get old …", to commenting: "If I put in and the employer puts in, that's fair. I might not opt out as soon as I hear about it, you know, so I might keep it running for a while."

And it is not just awareness of rules around auto-enrolment that might make a difference to retirement saving behaviour; it seems that there's considerable confusion around pensions in general. As one of our female interviewees aged 30 put it: "You leave school and you're literally thrown into the world to do what you want. And, you know, for the first few years of your working life you are literally earning money and spending it. And actually, you know, we should be more educated on things…like pensions and savings and investments".

More than half of younger workers (54%) believe that the amount they could be saving would be so low that it would not be worth it. This indicates to us that there's still a long way to go to ensure that people understand the mathematical basics of pensions, such as how compound interest works so that even small amounts can add up significantly over time, the importance of starting contributions as soon as possible, and the value of employer contributions.

Removing barriers and levelling up

Our interviewees showed strong support for removing the current barriers to saving. Young people could not understand why they were being treated differently to older workers with 72% agreeing that employees aged under 22 should be treated the same as those aged 22 and over and be automatically enrolled into a pension.

Almost three-quarters (72%) of young workers would like to see a more progressive system that offers additional support to low earners, as is the case in Australia.

At Legal & General, we support the recommendations in the government's 2017 review of auto-enrolment to lower the age threshold from 22 to 18 and remove the lower limit of qualifying earnings.

We would also like to see government, regulators and those of us in the financial services industry working even harder to promote pension benefits more clearly. And perhaps there is an argument for examining the case for financial education in our schools.

Onwards and upwards for auto-enrolment

The success of auto-enrolment is reflected in the fact that nearly three-quarters (73%) of the workers we surveyed across different age, wage and gender categories, now have a workplace pension, and that nearly all of these (94%) are paying into it.

It's also heartening to hear that once they understand the benefits, many workers are interested in signing up to a workplace pension. So, despite the challenges for groups such as younger workers, there are signs that by developing the auto-enrolment model to be more inclusive, and through re-doubling efforts to boost knowledge of pensions, we could extend the reach of this precious employee benefit to help improve the retirement prospects of older people after their years of hard work.

LGIM

Mitesh Sheth MBE is chief investment officer of multi asset at Newton Investment Management

DC INVESTMENT IN A NEW MARKET REGIME

I believe defined contribution (DC) schemes and master trusts have been unfairly criticised for being too focused on fees and efficiency, at the cost of maximising outcomes for members.

Investment commentators are referring to the past 40 years as a 'super bubble' or even the 'greatest bubble of all time'. As we know, the investment backdrop was characterised by declining nominal interest rates, low and stable inflation, and a furious drive for globalisation. Central banks stimulated economies freely, and cheap credit fuelled leverage in the system. A rising tide lifted all boats; the prices of equities, bonds, property and pretty much all assets rose strongly.

With the benefit of hindsight, I find it hard to criticise DC trustees and chief investment officers (CIOs) that chose to invest in low-cost passive balanced funds when everything was going up, while focusing their efforts on other more pressing matters.

Looking forward, however, we are clearly entering a new regime, characterised not only by higher interest rates and inflation than many of us have seen in our working lifetimes, but also by more volatility, given the uncertainties around government intervention, supply-chain problems, climate boundary conditions, growing inter-generational inequalities and the reversing of globalisation. Several of these trends are now well under way. Regime changes are indeed rare, but they do happen and tend to have profound implications for financial markets.

It could be much more difficult to achieve positive returns in the next few decades than in the past 40 years, with passive management at risk of disappointing, particularly in real terms, and as it becomes harder to rely on bonds to protect capital given rising correlations between equities and bonds.

Value focus

The Pensions Regulator's 'value-for-money' push may be timely in encouraging trustees to place less emphasis on cost and a greater focus on value. More active strategies, for example, could be better placed to take advantage of the growing divergence between companies, sectors, styles, strategies and countries. Allocating to more flexible, higher-conviction, unconstrained multi-asset and fixed-income strategies may be a better alternative to classic passive balanced funds.

One way in which larger DC schemes have been attempting to diversify in recent years is by investing in alternatives. However, most have faced difficulties accessing real illiquidity premia, as well as cost constraints. Again, with the benefit of hindsight, I am not sure that DC members have missed out by not being able to access these alternatives.

DC schemes looking to find better future diversification in their portfolios may consider investment trusts to be a good vehicle to enable them to have exposure to illiquid assets such as infrastructure; moreover, given that in recent weeks defined benefit (DB) schemes have been forced sellers of these assets, now could be a good time for DC investors to step in. Indeed, those members who self-selected a dynamic multi-asset strategy in place of the default are already likely to be doing so, given the compelling opportunity in this market.

Active, diversified capabilities

While fee caps and cost constraints can limit DC schemes in terms of where they are able to look to invest, what is clear is that there is an urgent need for more active, diversified capabilities, which can deliver real returns for members against a challenging market backdrop.

There are already plenty of large, liquid, scalable markets that the industry should be willing to offer at a lower fee for DC clients, whether that is actively investing in global large-cap equities, global government bonds, global currencies or global commodities, especially if done quantitatively, where capacity constraints are not an issue.

While more active default funds may be appropriate for younger DC investors, we need to increase engagement with end-beneficiaries and their advisers as they approach retirement to understand what they are likely to do with their pension, as this will materially change their investment options and strategy. Our parent company BNY Mellon has been conducting extensive adviser research and focus groups – to better understand what members' requirements are once they reach retirement, and to be able to offer more targeted strategies. The insights from this research have been instrumental in shaping our thinking around product development and solutions for the DC market.

Ultimately, amid a painful market regime change, it is important to look forward rather than backwards, because relying on the models, maxims and assumptions of the past 40 years could not only be misleading, but also dangerous. I think time will still look favourably on the actions of DC trustees and CIOs over the past 10 to 20 years; however, their actions and decisions in the next few quarters will determine their future legacy.

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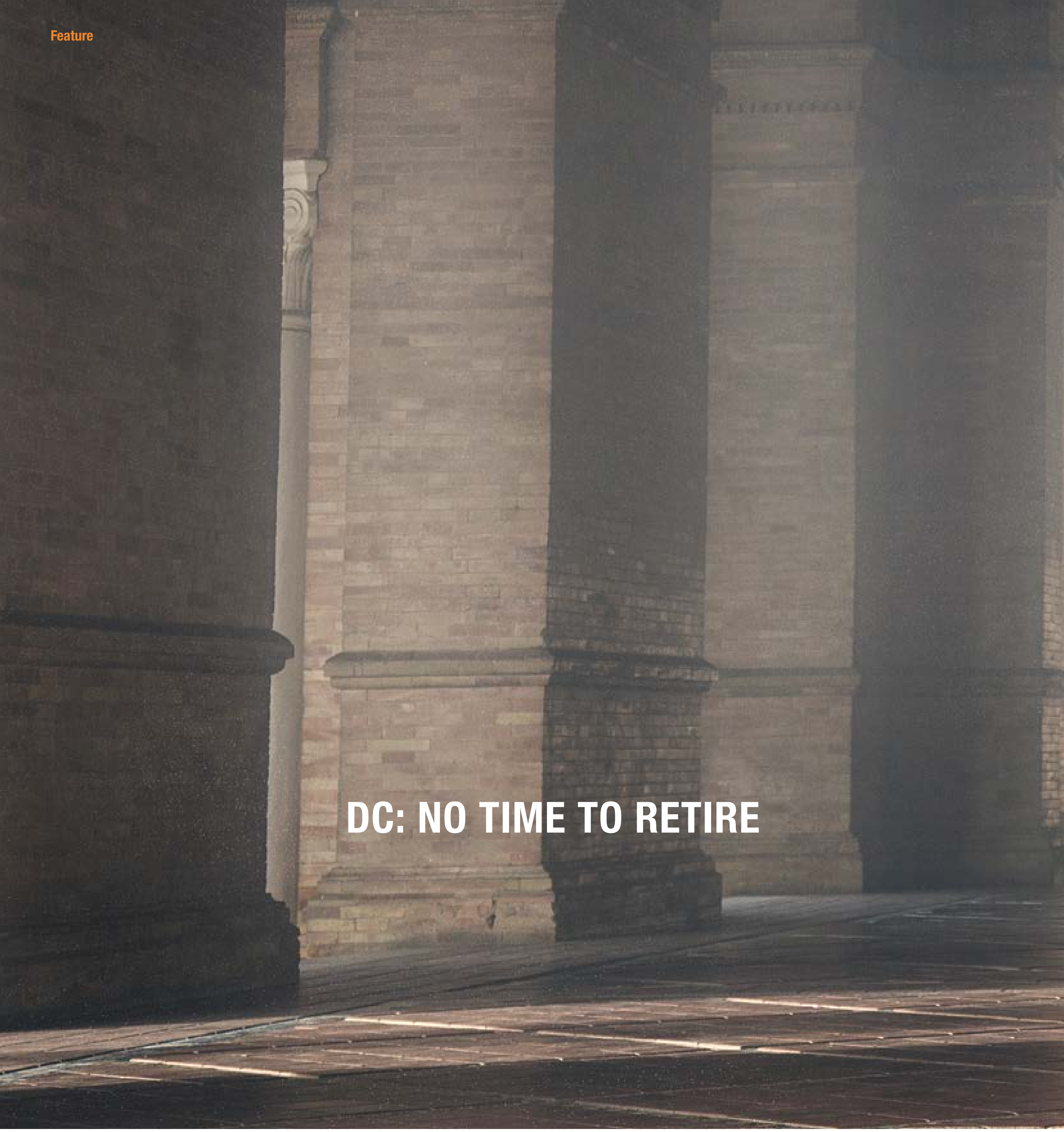

DC: NO TIME TO RETIRE

The crisis in gilt markets made national headlines following the government's mini budget in the final days of September. This left members of defined benefit (DB) schemes worried, rightly or wrongly, that their pension might be at risk. Yet one aspect that has received little attention is the impact that the plunge in gilt markets is having on members of defined contribution (DC) schemes, especially those who are due to retire.

With the burden of disappointing investment returns being shifted onto members, few seem to care that those returns can vary considerably and workers planning to retire imminently might be left with less money to fund their twilight years than previously anticipated.

The question is, how are DC members navigating volatility in bond markets to prepare for an uncertain future?

Lifecycle

Decumulation, the cornerstone of most pension investment strategies tends to be based on adjusting the investment strategy to the lifecycle of the scheme member. The default funds for younger members tend to be invested in growth assets,

While reporting of the gilts crisis focused on how it impacted DB schemes, it has also been bad news for some unlucky DC members. *Mona Dohle* reports.

such as equities, but as they approach retirement their portfolios are gradually converted to more liquid, and presumably more secure, fixed income assets.

The irony in this case is that the assets many investors deemed to be the most secure – UK government bonds – have been far from stable. While equity markets have been rocky. The FTSE100 is down -2.6% when compared to the same period a year earlier.

In contrast, yields on 10-year UK government bonds have risen by more than 250%. That is good news if one plans to hold these bonds for a longer period of time, but not for those wishing to cash in on their retirement savings.

"The sell-off in gilts has meant that older pension savers invested in defined contribution pre-retirement funds might have noticed a dip in fund values, which will have an impact on individuals if they intend to retire imminently," says Jon Cunliffe, managing director of investments at B&CE, the provider of The People's Pension.

A closer look under the bonnet of different retirement stage strategies reveals that the outcomes can vary significantly, depending on the investment strategy the DC provider pursues, but also on the amount of support that has been put in place for members approaching retirement.

Under the bonnet

When comparing DC retirement-date funds, even within the master trust landscape, it is worth noting that it will inevitably result in comparing apples with pears because every provider approaches the retirement stage differently.

Nest, for example, has funds for each year of retirement. Its 2022 fund is for members due to retire this year, whereas Now Pensions only has two main investment strategies – the growth-oriented Diversified Growth fund for younger members and the Retirement Countdown fund for older members.

Nevertheless, it is striking that the asset allocation and subsequent investment performance can vary significantly from provider to provider.

Nest's Guided Retirement fund, for example, is aimed at members aged between 60 and 70. It still has significant exposure to growth assets, but members allocate only a proportion of their savings into the fund, the rest is kept aside for emergencies. The Guided Retirement fund still has a quarter of its assets exposed to global equities and 19%, its second largest holding, in global high-yield bonds. It also has a 13% allocation to hybrid property funds, but no investments in gilts. The fund is down -6% this year.

In contrast, TPT Retirement Solutions 2020-2022 Target Date fund has about half its portfolio invested in gilts, roughly a quarter of those are inflation linked. It still has a 17% exposure to global developed equities. Since last year, the value of the fund has dropped by -2.8%.

The People's Pension's closest comparator is the Pre-Retirement Fund, which, however, is aimed at members just before the retirement stage. Members start transitioning into the fund from 15-years prior to retirement and will be 100% invested by the time they reach retirement. After that, they can either switch to cash or an annuity.

Its biggest holdings are money market funds at 20%, US treasuries at 18.6%, followed by US equities at 9.7% and 9.5% each in gilts and UK corporate bonds. Since last year, the fund is down -9.6%.

Meanwhile, LGIM's Pre Retirement fund, which is also aimed at members approaching retirement, invests in a combination of gilts at 34.6%, utilities at 10%, UK financials corporate debt at 8.5% and consumer services corporate debt. As of June 2022, its value had fallen by -19.5% when compared to the previous year.

Now Pensions Retirement Countdown fund is aimed at members before retirement. Once they retire, they will be expected to convert their savings into cash, which makes risk reduction all the more important, as Emma Matthews, head of investment at Now Pensions explains. "The Retirement Countdown fund is focussed on minimising the risk of capital loss (risk objective) and to deliver a return equal to the Sterling Overnight Interest Average (SONIA) rate, consistent with the preservation of capital return objective. As a result, the fund will typically invest in the money markets, cash deposits and short-dated bonds."

At the time of writing, its entire portfolio has been invested with Blackrock's Liquid Environmentally Aware fund, which is a money market fund. As of July, the Now Pensions' Retirement Countdown fund performed 0%, year-on-year. But it should be added that prior to retirement, members will be invested in a combination of the Diversified Growth and Retirement Countdown funds with the former down -8.6% since last year.

The examples show that DC members could get different outcomes, depending on what their funds invest in. While it is difficult to generalise, it appears that diversification, and particularly not just being invested in fixed income, seems to pay off.

The sell-off in gilts has meant that older pension savers invested in defined contribution pre-retirement funds might have noticed a dip in fund values, which will have an impact on individuals if they intend to retire imminently.

Jon Cunliffe, The People's Pension

We are looking at how to solve the post-retirement problem – we are mindful that member needs may change and we want to be on the front foot to deliver a great post-retirement solution for them.

Emma Matthews, Now Pensions

Annuity headache

Another challenge for the pre-retirement stage is that in most cases, members will convert their savings either into cash or annuities and with gilt prices falling they could be in for a bad surprise, warns retirement consultant Lane Clark & Peacock (LCP). The volatility in bond markets has wiped out more than a third of annuity values since December 2021, this could be disastrous for people looking to cash in right now so holding onto the annuity might be the better option.

This could be a problem, not so much for master trusts but for members in legacy schemes following an annuity-targeted strategy, says Lydia Fearn, a principal at LCP. "It depends on what strategy members are invested in. We still have a lot of members who want to take out cash.

"What we are finding is that there are some legacy arrangements which mean that members are still on an annuity-targeted strategy which invests in long-dated gilts to try and match annuity pricing in the market. If annuity prices go up, they go up, if they go down, they go down. It is doing what it is designed to do but if you have members who are in the later stage of an annuity-targeted strategy but have no intention of buying an annuity, they will see their assets drop considerably. This goes back to good communication and ensure members are in the right place," she adds.

The challenge here is to distinguish between investment losses in retirement stage default funds and a lack of guidance, particularly given the fact that DC providers are not meant to provide advice, but members might not make the most informed decisions.

This is also a problem that has been on the agenda of the PLSA, which in 2020 published a set of recommendations for DC decumulation to navigate this balance. Among others, it recommended that schemes could be doing more to provide the right products for withdrawing cash and keeping members informed about the different options available.

Investment tweaks

At the same time, DC investors have a role to play and it would be a remiss to suggest that they are not responding to a rapidly changing market environment.

Just like in DB land, interest and inflation risks are on the agenda of DC investors, as Cunliffe explains. "Earlier in the year, The People's Pension acted pro-actively to reduce the interest rate sensitivity and credit risk of our bond allocation by reducing our allocation to gilts and sterling corporate bonds in favour of US treasuries. With market valuations much more attractive we feel that the outlook for investment returns over the long term is markedly better than at the start of the year and we expect markets to begin their recovery phase once the peak of the inflation and interest rate cycles are in sight."

Now Pensions' Emma Matthews says that there is still value in the traditional transition from risk assets to fixed income, but that guidance matters. "For us at Now Pensions, it comes back to how we believe we can best support our members – taking risks to grow assets (over the long term) in excess of inflation in the early years, focussing on balancing the risks that drive different asset returns. Then gradually de-risking to be majority invested in the Retirement Countdown fund at the point a member reaches retirement."

But she also acknowledges that there is room for change. "We review our approach regularly, with a deep dive every three years. We are looking at how to solve the post-retirement problem – we are mindful that member needs may change and we want to be on the front foot to deliver a great post-retirement solution for them," she adds.

For Nest, diversification is an important element of the puzzle, even at the decumulation stage. "We developed the Guided Retirement fund to support our members who are over 60 and who want to start taking their money out of Nest while still benefiting from potential investment returns. "Because our aim is to provide these members with sustainable withdrawals until age 85, they can continue to benefit from the returns from illiquid investment," a spokesperson for Nest said.

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July – Social impact investing
September – Diversity
October – Sustainable strategies

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