CAMRADATA

DC Roundtable

A universal solution for the individual?

July 2019

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A Reminder About Our Aims

For the first time, on a global basis, we are at the point where Defined Contribution (DC) assets exceed Defined Benefits (DB) assets in the seven largest pension markets, according to Willis Towers Watson's Global Pension Assets Study. Over the last 10 years, globally, DC is growing at a faster pace at 8.9%, while DB assets have grown by 4.6% during this time.

In the UK, although 82% of the market is still invested in DB assets, this is set to change. We now have 15 million people invested in DC schemes totalling around £400 billion. The Office of National Statistics stated that UK employees paid more into defined contribution (DC) pension schemes than defined benefit (DB) schemes for the first-time last year, with employee contributions into DB pensions falling from £3.4bn to £3.2bn in 2018, and the amount paid into DC schemes rising from £1.4bn to £4.1bn.

This backdrop, along with the fact that employers have been pressured to increase their contributions to ensure that for employees the minimum overall contribution rates to DC pensions are at 8% from April 2019, all point towards the fact that the DC market is continuing to gain momentum and focus.

There are a variety of DC options available to the investor, but how do employers decide which one would be most suitable for their employees? An employer-sponsored scheme may be set up as a trust-based scheme or may be provided by a pension provider, such as an insurance company or investment platform, but ultimately this decision will be down to the individual employer.

Arguably, as the responsibility has shifted in most cases to the individuals, the key challenge is taking some of that responsibility back and keeping individuals within these schemes engaged with their pension, motivating them to continue to increase their contribution to their overall pension scheme, based on today's statistics that 25-year olds now have a life expectancy of 91 (BNY Mellon).

In addition, as the interest in considering ESG factors swells globally, there is also more of a requirement for a variety of options across investments, vehicles and outcomes, from both employers and individuals. This provides both challenges and opportunities across the market, in terms of innovation, education and distribution.

CAMRADATA's DC roundtable aims to investigate the investment options for investors, diversity amongst providers, how this should be adapted across schemes and individuals, and current challenges and opportunities surrounding how the market will look in the future.

> "As the interest in considering ESG factors swells globally, there is also more of a requirement for a variety of options across investments, vehicles and outcomes, from both employers and individuals"

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Capital Group

Company Profile

Founded in the US in 1931, Capital Group is one of the world's largest independent investment managers. Throughout our 85-year history, we have been focused on delivering superior, consistent results for long-term investors. Investment management is our only business, and the stability of our organisation has enabled us to maintain a long-term perspective. We build our investment strategies with durability in mind, backed by our experience in varying market conditions. Our investment process is designed to enable individual investment professionals to act on their highest convictions, while limiting the risk associated with isolated decision-making.

Josh Conran

Associate Director, UK institutional

Josh Conran is an Associate Director, UK institutional, at Capital Group. He has six years of industry experience and has been with Capital Group for one year. Prior to joining Capital, Josh worked as a DC investment relationship manager at BlackRock where he was also a summer analyst. He holds a bachelor's degree in management from the University of Nottingham. He also holds the PMI Certificate in DC Governance and the Chartered Alternative Investment Analyst designation. Josh is based in London

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Newton Investment Management

Company Profile

Newton Investment Management is a London-based, global investment management firm, providing a focused range of investment strategies to public and private-sector DB and DC pension funds, corporations, charities and, via BNY Mellon, individuals.

We run a broad range of equity, fixed-income and multi-asset strategies, and have particular expertise in absolute-return, income-focused, high-conviction and sustainable investing. We use a global thematic approach to help achieve long-term perspective. Our themes inform both the rigorous fundamental analysis carried out by our experienced global research analysts, and the construction of portfolios designed to meet our clients' requirements. We consider environmental, social and governance issues in relation to every company in which we invest, in the belief that responsible investment is better investment.

www.newtonim.com

Jin Philips

Head of strategic relationships, EMEA

Jin rejoined Newton as head of strategic relationships EMEA in 2018. She is responsible for directing Newton's sales strategy across UK institutional and charity channels and leading our London-based consultant relations and partnered sales teams. Jin previously worked at Newton in 2008–2013, initially as institutional relationship manager for Asia, Middle East and Europe, and latterly as co-head of North America. She rejoins the business from the aviation security technology industry where she held management consultancy and business operations roles.

Jin was selected for the 2016 Goldman Sachs Returnship programme in New York and previously held positions as client director in the institutional client group at Barclays Global Investors and as a consultant at Cambridge Associates in the US and UK.

Jin graduated from Mount Holyoke College with a BA in Economics and has completed the Investment Management Certificate (IMC).

Participants

Martin Willis
Principal

Martin currently leads advice to corporate and trustee bodies in relation to their DC pension arrangements. This includes scheme design, ongoing governance and member engagement. He has advised on many pension change exercises, including DC consolidation, DB to DC transition and wind-ups of DC schemes.

Martin advises a broad range of organisations and acts as DC representative on Barnett Waddingham's charity and not-for-profit working group.

Martin has spoken at a variety of industry seminars focusing on DC pension issues, including ones run by the Personal Finance Society, the Investment and Life Assurance Group and the National Association of Pension Funds. He is also a member of the Society of Pension Professionals Defined Contribution Committee.

Erica Beltrami
Partner

Erica has over 15 years' experience advising DC schemes, with a focus on investment strategies and investment manager research. She has a comprehensive knowledge of the DC market and can bring you the latest ideas and solutions available and help you understand how they might enhance your offering to members.

Using LCP's innovative technology, she breathes life into the process of understanding investment beliefs and setting objectives, which are key when putting in place a strategy to deliver the best outcomes for members. With her extensive background in investment manager research she leads the efforts at LCP in this area to ensure that DC clients have access to the best investment products, from challenging the industry to integrate the best ideas from DB schemes, such as illiquid assets, to researching DC specific products like target date funds.

Erica spoke at LCP's latest annual DC conference about improving outcomes for members as well as taking part in a number of industry roundtable and panel discussions focusing on this topic and DC schemes' ability to access illiquid investments.

Participants

Steve Hayton
Head of Group Pensions

Steve is Head of Group Pensions at the Nuclear Decommissioning Authority (NDA). The nine pension arrangements that span the NDA group range from final salary pensions with continuing accrual, public service schemes, industry wide schemes and defined contribution schemes. The two largest pension schemes are Trust-based multi employer schemes with over £5 billion of assets, 30,000 members and 13 employers between them.

Steve managed the establishment of the NDA's flagship pension scheme, the Combined Nuclear Pension Plan (CNPP) in 2006 and was Scheme Secretary until last year. The CNPP has 20,000 members of which 6,000 are defined contribution.

Steve has a 30 year career in pensions, starting out with the Government Actuary's Department. He is a Fellow of the Pensions Management Institute.

Alan Emberson
Director of Workplace Solutions

Since joining PS Aspire as Director of Workplace Solutions in 2016, Alan's focus has been on two key areas of development and expansion, the Aspire Savings Trust (a Master Trust) and assisting employers and trustee boards in finding more efficient means to support members in their financial decision making. Alan has also taken a keen interest in helping to further develop the "Aspire2Retire" pre and at retirement support services, which provide scheme members easier access to impartial guidance and advice around pension flexibility and choice.

During a career spanning over 30 years in financial services Alan has held a number of senior business development roles, both within the traditional provider market and larger consulting community.

The major part of Alan's career has centred on assisting companies in selecting the right DC solution and delivering on large scale communication assignments, aimed at supporting employees' better understanding and ability to plan around their future financial needs.

Participants

Niall Alexander

Head of DC Solutions

Niall joined P-Solve's specialist DC team in 2011, focusing on working with fiduciary and non-fiduciary clients in the development of investment objectives, investment strategy, asset allocation, provider selection, and governance. In addition to running the DC Solutions team at P-Solve, Niall chairs P-Solve's Defined Contribution Management Committee, responsible for the composition of clients' DC default investment strategies.

Niall's previous experience was with Willis in Dublin, where he adopted a senior role in establishing an investment consulting business to provide advice for a range of DC and DB pension plans, as well as charities.

Niall has a First Class Honours degree in Mathematics from Trinity College Dublin and is a qualified Actuary. He is a frequent industry speaker and contributor to trade press. Outside the office, Niall is a keen marathon runner and endurance cyclist, and can often be found running or cycling around southwest London.

Elizabeth Garner

Head of Pensions and Investments

Elizabeth is Head of Pensions and Investments for Save the Children Fund, appointed in 2013. Save the Children UK's workplace pension is a Group Personal Pension with Legal and General, they also have legacy defined benefit pensions with TPT retirement solution. In 2014 Elizabeth was elected an Employer Nominated director of TPT retirement solutions. TPT is a multi employer pensions trust of £10 billion assets of which £1 billion are DC and has applied for Master Trust authorisation.

Elizabeth roles have included strategy for the pension provision and investments offered to DC members, including default funds and post pension freedoms. In May of this year she concluded the wind-up of a legacy trust based scheme of which she was chair.

Previously she was pension trustee pension trustee/director of the Atkins Pension Plan for 13 years; a £1bn Pension Plan with 22,000 members, where she sat on the DC committee for investment and administration. This ended in 2013.

She is passionate about pensions and getting the best value for workers who do not wish to work forever; and delighted to see the recent embracing of ESG and climate change issues within DC.

Elizabeth is Fellow of the Chartered Association of Certified Accountants, FCCA and member of the Pension Management Institute DipPMI.

Participants

Brendan Maton

Freelance Journalist

A highly experienced financial journalist with an expansive network of contacts in the UK and across Europe. Brendan has written about pension schemes and national welfare systems from Finland to Greece for 18 years and understands the retirement savings industry in each European country.

Brendan has interviewed EU commissioners and national ministers; central bankers; pension scheme heads; insurance chief executives; chief investment officers; actuaries; union officials; professional and lay trustees.He worked at Financial Times Business for eight years, finally as editor-in-chief of all international pensions titles. Brendan has spent the last ten years as a freelancer for a number of publications, including Financial Times, Responsible Investor, Nordic region pensions news and IPE. He is also Chief webcast host for IPE.

Brendan has acted as conference chair for Financial News, the UK National Association of Pension Funds, Dutch Investment Professionals Association (VBA), Corestone, Insight Investment, Marcus Evans, Robeco Asset Management, Sustainable Asset Management (SAM), Towers Watson.

A universal solution for the individual?

If savings are a money trail, then it takes no more than a couple of steps to reach the default fund in defined contribution pension schemes. This is where almost all the money people save in modern workplace pension schemes ends up. The sixth annual CAMRADATA DC roundtable began by acknowledging this fact. Steve Hayton, group pensions manager for the Nuclear Decommissioning Authority (NDA) said that around 75% of DC assets were housed in the scheme default fund. Elizabeth Garner, head of pensions and investments at charity, Save The Children, said more than 90% of its members' total DC savings were in the default.

> "Ethics are personal. 'Should people eat meat? Would the world be better off if we all went vegan?'"

Given this weight of savings, the panel was asked whether Environmental, Social and Governance (ESG) considerations should be baked into the default option. "It is still early days and whilst ESG is being considered across our client base, making a specific ESG allocation within the default strategy isn't the norm. Instead it has been more around understanding how existing managers are considering ESG" said Erica Beltrami, a partner at LCP, a pension fund consultancy. "Further consideration around whether a specific allocation should be made is the natural next step as ESG integration becomes the norm."

Integration means including ESG considerations in all aspects of capital management, not merely offering it as an option on the side. "Schemes can and should evaluate asset managers on ESG integration. Ask your manager to demonstrate how ESG is integrated across their research and portfolio construction processes – not at one point in time, but on an ongoing basis," said Jin Philips, head of strategic relationships, EMEA, at Newton Investment Management. She explained that if a manager is deploying high-calibre research, then ESG should doubtless form an integral part of that research capability. "We see ESG factors as risks and opportunities, which is why Newton has developed our own, transparent ratings methodology," she said. "ESG is very much about financial outcomes."

Niall Alexander, head of DC solutions at River & Mercantile Solutions, distinguished between ethics and ESG. "Ethics are personal. 'Should people eat meat? Would the world be better off if we all went vegan?'" These issues matter a lot but, for Alexander, they do not relate directly to finance. "We describe ESG as telling factors, just like currency and inflation.

So we include them but in the same way - truly holistically rather than a separate debate. And their influence waxes and wanes."

That means investors should not apply ESG criteria in a static fashion, according to Josh Conran, associate director for UK institutional at asset manager Capital Group. As an example, he pointed out that analysing and engaging with companies thoroughly can mean potential issues are identified long before any scandal; this contrasts with many ESG rating systems which only pick up issues after an event. Such backward-looking assessments were in contrast to the Capital Group approach whereby ESG analysis is incorporated into a whole-of-company assessment by portfolio managers and analysts on a forward-looking basis.

Philips agreed. On the final point she noticed that one value-play in ESG was to focus on those companies progressing their ESG potential: "the improvers". Philips said that only backing the recognised ESG champions of today could potentially mean missing out on future financial upside from those companies working to improve their ESG footprint over time.

The debate over ethical versus ESG persists, however, because many people instinctively want to use their wealth to benefit other people with great need as well as get a return.

"We always have staff asking about ethical options," said Garner.
"I would have my own retirement sorted if I had a pound for every time I had to explain the difference between ethical and ESG," commented Martin Willis, a principal at pension fund consultancy, Barnett Waddingham.

He noted that pension scheme members can put ethics into a collective pension fund but it requires a high quorum of approval (Cancer Research has a tobacco-free default fund).

As ever with DC, communication raises its head as a major feature. Philips noted that Newton has been working with a major public-sector pension scheme in California to communicate how ESG factors are taken into consideration in the scheme's ESG balanced investment option. The intention is to communicate directly to the scheme's members using tangible and local language to convey how their investments impact the environment, society and their future retirement income.

> "Pension scheme members can put ethics into a collective pension fund but it requires a high quorum of approval (Cancer Research has a tobacco-free default fund)"

Who the cap fits

The CAMRADATA panel then segued into fees and costs. These are influential in the UK market ever since the government introduced a 75bps cap on default fund costs. Willis pleaded that people should not see cheap as best or good value.

Alexander's remedy was for trustees to concentrate on their risk budget first and foremost, rather than extrapolating 'value' from past performance and/or fees. There is a further complication in that the insurers and platforms from whom schemes access investment management typically charge a fee, while the houses which actually do the investment management charge the platforms a sub-fee. The scheme will not see those two elements separated.

Conran suggested that splitting them out could be beneficial. There is currently no guidance to trustees on the two parts in isolation so they don't know what they are paying.

Philips asked why administration costs do not get split out from investment costs. This is a moot question, as the latter is typically perceived as the higher of the two while in reality some platforms take the lion's share just for administration. Beltrami warned that even if some platform providers rebuff such attempts to make their charging more transparent, there should continue to be a collective push for more transparency in this area.

The panel then came to some fresh thinking on how trustees might get the kind of risk-return pay-off they need for the years ahead. The UK government has been consulting for the best part of a year on how to open up illiquid investments to DC plans. Illiquids here means the likes of real estate and infrastructure, privately traded debt and equity. Alexander did not see an overwhelming need: "What are you trying to achieve?" he asked. "Why worry about this stuff when there are still a lot of schemes with a UK equity bias; and some with 100% in equities in the growth phase at ages when members can retire. There are basics to be improved upon, never mind the refinements."

Beltrami, on the other hand, said that DC plans were in the habit of using daily-dealing funds even though a member's time horizon is over decades. She pointed out that daily dealing was not a legal requirement but a norm which merited rethinking. LCP has done just that for a client – taking them into weekly and monthly-dealing funds, which Beltrami claimed was a first not just for the client but also for the platform provider.

> "DC plans were in the habit of using daily-dealing funds even though a member's time horizon is over decades"

Newton gains exposure to less liquid assets via listed securities and trusts and has been able to harness the diversification benefits of these assets within its multi-asset strategies and solutions. "Some illiquid specialists also prefer to incorporate listed securities and trusts, because it is currently the most likely way that pension schemes can access the likes of private equity while staying under the price cap," said Philips.

Opening up the DC investment landscape means that pension schemes are becoming more aware of the risk-return profiles of all types of investment strategy. This includes the section before retirement where hitherto sovereign fixed income and cash were used to dampen volatility. Nowadays, more active managers are offering higher-return, lower-volatility approaches to appeal to DC plans.

Conran followed Alexander's point about doing better from within the universe of public securities by making the case for putting more exposure to Emerging Markets into UK DC plan portfolios. He explained that Emerging Markets [as defined by MSCI] account for 40% of the global economy and 70% of its growth. Yet in global equity indices, these countries only receive 11% of the weighting, and often even less than that in DC default funds. One route Conran strongly advised against, though, was merely tracking a representative index of leading EM companies. "The EM index is highly concentrated," he said, "with for example over 53% just in IT and financials. As a result, it can also be very volatile." Instead, Capital Group advocates taking a broader approach to emerging markets – including EM debt and also companies outside emerging markets but which derive most of their revenues from those countries. This then lowers the heavy exposure of the EM equity index to banks, insurers and IT stocks. To this, Capital adds governance and company engagement. The result is a strategy that produces cumulative returns equivalent to the index but with considerably less volatility.

> "Opening up the DC investment landscape means that pension schemes are becoming more aware of the risk-return profiles of all types of investment strategy"

Hayton said he would be interested in the money-weighted returns as these reflected the lived experience of a DC saver. Philips noted from an emerging markets debt perspective, large UK DC schemes have implemented absolute bond strategies, such as Newton's global dynamic bond strategy (GDB) as part of the default. "GDB is a way for schemes to gain selective, actively-managed emerging markets debt exposure tactically alongside global HY, sovereign and corporate fixed-income exposure," she said. "The strategy's absolute return focus is closely aligned with DC members' desired outcomes in the growth and in-retirement phases."

Philips commented that the extraordinary equity returns of the last ten years have undoubtedly impacted default design and asset allocation decisions. She said that focusing on relative performance has been palatable over that period, but "we ultimately should be focusing on absolute returns and outcomes for DC members."

Late adopters

The golden age of DC is not yet here: one reason being the slowness of financial services in the UK to embrace technology. It is now possible to manage most of your day-to-day money needs using a smartphone. Challenger banks and tech-focused specialists will bring together on one screen various savings pots, including ISAs and SIPPs alongside current and deposit accounts. But progress has largely been thanks to the ambition of the tech companies rather than incumbent banks and insurers. Pension funds and administrators are even further behind the curve. In spite of the trillions of pounds saved specifically for retirement, there is no popular pensions app. The CAMRADATA panel discussed why.

> "Progress has largely been thanks to the ambition of the tech companies rather than incumbent banks and insurers. Pension funds and administrators are even further behind the curve"

"We have created a pensions dashboard but there has not been a joint initiative with the wider savings industry," said Garner. "Post Pension Freedom, I think people do think of pension as savings but they can't access them in the same way."

Willis said that pension providers were reluctant to engage in a way that would offer scheme members all their financial accounts on one screen, ie pension alongside current account and insurance policies. In theory it is possible but in practice it is not happening. Alan Emberson, director of workplace solutions at PS Aspire, said that it was possible now to establish such a savings dashboard (if you have the right underlying technology platform in place) however, that does require the member's consent to such data requests and that schemes also had to make the effort to negotiate with their relevant providers to get these types of data feeds established. He said there are companies who can facilitate this, but in workplace pensions more generally "we are not there yet." That is because, according to Emberson, no one has yet answered the big question of who should be paying for such unification. At present it could be either of the employer, the Scheme or, the members themselves.

Like most bigger pension consultancies, both Barnett Waddingham and PS Aspire offer their own platforms which tackle the issue. The former's, called ME2, works as a web app. But it doesn't have feeds from every source, e.g. student loans, and cannot currently model big expenditures such as weddings.

This matters because if ordinary working people are to gain a better understanding of what their pension savings can do for them – as part of total wealth and personal finance - then pension providers need to reshape their communications into the kind of language around spending ordinary people understand.

Beltrami said that people don't start planning for retirement in response to a figure on a sheet of paper. They need help to think what sort of lifestyle they expect, e.g do they want to eat out once a month or twice a week? Beltrami said the pensions industry needs to do more straightforward communication on this level of ordinary household budgeting.

Willis agreed. As one example, ME2 uses images such as cocktails to help client schemes' members decide how much they want to spend on drinking and socialising. Hayton told the CAMRADATA panel that "the solution is not to tell people what to save but to offer better modelling to help them understand."

The NDA's flagship scheme has recently switched its plan administrators in order to give members new tools to allow them to do just that – work out what they need to save under various scenarios.

But the NDA is an unusual employer, often one of the biggest in the locale, with a unique purpose, which makes for a very loyal and stable workforce. "We have generations of the same family working for us," says Hayton. "And there will be work for another hundred years at some sites."

> "Why should employers wish to take on the responsibility for a future benefit that may materialise thirty or forty years further down the line when the employee may only stay in that organisation for a few years?"

Nuclear energy is thus the only man-made activity with a longer life than pensions. Elsewhere in the UK, however, employees come and go. Fundraisers at Save The Children might stay for just two or three years, according to Garner. Which brings us back to Emberson's question of who should pay the cost of data aggregation and the hauling of pensions into work patterns of the twenty-first century. "Why should employers wish to take on the responsibility for a future benefit that may materialise thirty or forty years further down the line when the employee may only stay in that organisation for a few years?" he asked. "Employers will want to look after their employees - but perhaps only for that shorter time period."

PS Aspire's platform extends across all savings and finances and is designed to support the process of financial guidance for larger audiences, which Emberson distinguishes from advice. The platform aims to offer value even for workers with relatively little savings e.g. pots of £30,000 or above, where the existing advisor market fails to offer cost effective solutions. The system is geared towards assisting self-selection. However, Emberson emphasizes that there comes a point where people do need a proper human contact, "a voice" before executing on their important financial decisions.

And here the CAMRADATA panel touched upon the kind of "voices" workers currently rely on. Both Hayton and Beltrami noted that, worryingly, colleagues in the workplace were often easiest to approach because they are trusted individuals. Hayton said there was an excellent response to roadshows when NDA was in the process of announcing the new DC scheme to employees. Save The Children also gets an annual roadshow from its scheme provider. So physically meeting pension professionals responsible for running savings has a positive influence. Beltrami contrasted this with badly designed technological help; members' frustration with the rigmarole of log-ins to access their pension account online will have an impact on how much they are willing to engage with their pension.

> "By 2050 as much as half the UK workforce could be self-employed. It's imperative for the DC pensions industry to be more mobile (physically and digitally)"

That is just dawning, thanks to the compulsory nature of auto-enrolment. Moreover, Philips noted that by 2050 as much as half the UK workforce could be self-employed. It's imperative for the DC pensions industry to be more mobile (physically and digitally) as a greater proportion of the population becomes aware that they have one or more pension pots. They will be searching for them online and ideally from their mobile device.

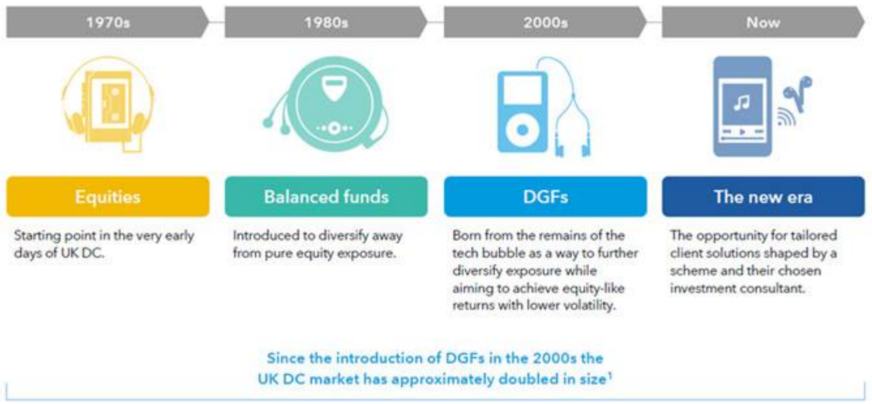
Continuing a tale of growth and diversification

CAPITAL GROUP℠

The UK defined contribution (DC) investment market has evolved and matured since its very early days, with increasing diversification being a key theme throughout this evolution. Today we are seeing this development continue as a result of increased scale within the UK DC market, enabling a more member-centric approach to investment design, driven by both organic asset growth and scheme consolidation. This has enabled single-employer trust-based schemes and master trusts to consider not only off-the-shelf-solutions, but also solutions that are tailored to their member demographic or objective.

Diversified growth funds (DGFs) have played a key role in this evolution, and have provided an improvement on traditional balanced funds by adopting a multi-asset approach.

A story of diversification and maturity as DC of age



> "DGFs have typically offered DC schemes a "one-stop-shop" for diversification, enabling access to a range of investments that might not otherwise be accessible, especially for smaller schemes"

DGFs have held broad appeal for pension funds as a strategy capable of delivering long-term returns in a consistent manner. But it is no surprise that the latest evolution we are seeing in the market also comes at a time when some DGFs, a well-used strategy in DC schemes, have come under criticism for not delivering on their original promise of "equity-like returns with lower volatility". While this feeling has made schemes reconsider their options, we do not believe that it alone is what is driving change.

DGFs have offered a simple "one-stop-shop" solution

DGFs have typically offered DC schemes a "one-stop-shop" for diversification, enabling access to a range of investments that might not otherwise be accessible, especially for smaller schemes. They provide a simplified governance framework and effectively delegate the asset allocation decision; as such, they can be suitable for those that either don't have the scale or in-house skill necessary to make those decisions. In light of the increased scale and accompanying governance ability, in-house skill and sophistication of DC plans and master trust consolidators, the question arises as to whether there is a better way to do things.

New era: change drivers

Past results are not a guarantee of future results.
1 . As at 31 December 2017. Source: Broadridge
Past results are not a guarantee of future results.
2. 60% equities and 40% fixed income

Approaches we have seen used in this new era

When thinking about approaches DC schemes could take we have identified three that seem to be gaining momentum within the market. These are:

1. DGF hybrid option: This involves reducing reliance on pure DGF allocations by adding a blend of higher growth strategies in order to increase potential returns while still offering downside protection.

- We believe this could be a suitable option for schemes that do not possess the governance ability, scale, or in-house skill required to build a customised solution, but are not looking to outsource investment decision making.

2. Deconstructed DGF option: This would require creating a growth/de-risking portfolio tailored to a specific scheme's needs from a range of different underlying building-block strategies.

- We think this could be an appropriate option for schemes that have depth and breadth of resources, and which also possess the ability to construct a tailored glide-path portfolio that is aligned with their specific return and risk objectives.

3. Fully outsourced solutions: These would comprise full end-to-end glide path-implemented investment solutions.

- In our opinion these could be suited to those schemes seeking to take advantage of a reduced governance burden that a master trust or delegated investment offering, such as target date, affords.

> "DGF hybrid option: This involves reducing reliance on pure DGF allocations by adding a blend of higher growth strategies in order to increase potential returns while still offering downside protection"

Each approach has a number of benefits and drawbacks, which we have highlighted in the table below.

Approach	Pros	Cons
DGF Hybrid	√ Retains known and understandable approach √ Relatively simple to implement	x Unlikely to be fully tailored to a scheme's specific needs x Limited ability to implement strategic asset allocation at scheme level
Deconstructed DGF option	√ Offers the ability for a simpler yet superior governance framework √ Can be tailored to the client's specific objective √ Enables a strategic asset allocation to be set, with the ability for managers to be tactical within underlying components √ Smoother use of components within the glide path, no opaque strategy	x More involved solution to implement x Likely to require sufficient scale
Fully outsourced solutions	√ Decisions outsourced, less governance burden	x Likely to be a non-tailored approach x Loss of asset allocation control or oversight

A focus on the deconstructed DGF approach

The deconstructed DGF approach has proved popular with large single-employer trust-based schemes as well as master trusts that are looking to make use of improved access to different asset classes their scale and increased sophistication affords them.

The main reasons for such an approach have been to:

1. Ensure allocations to long-term growth drivers, in line with their members' demographics

2. Avoid transparency issues with asset allocation within glide-path design

3. Improve risk adjusted returns.

What components should feature within a deconstructed DGF?

As we have seen from the evolution of the DC market, diversification is a key consideration for a scheme that aims to ensure the growth of member assets, but also seeks protection during market downturns.

We believe that a deconstructed portfolio should feature three vital elements, namely:

1. Return-seeking component: assets offering attractive return potential, such as emerging markets

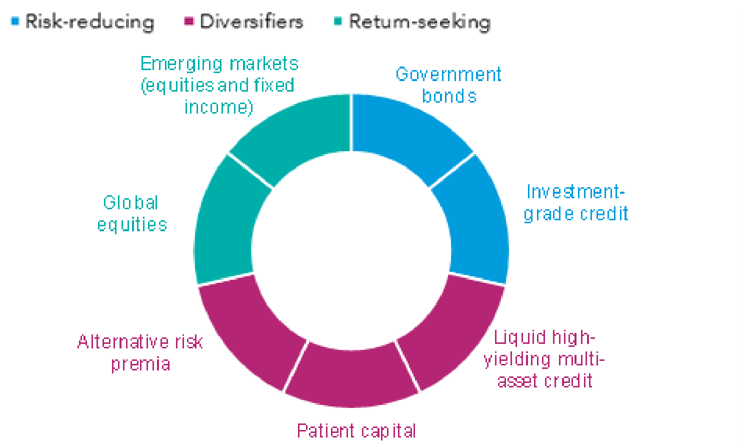
2. Diversifiers: assets with low correlation to equities, and potentially bonds, which can help smooth the performance of a portfolio, or at least serve as an alternative return driver

3. Risk-reducing component: assets that can help reduce the impact of market drawdowns

The illustration below highlights assets we have seen used in this context, with the broad aim of increasing returns while providing some downside protection.

> "In considering the options currently available to them, there is an opportunity to replace broad off-the-shelf solutions with a more transparent investment approach"

Asset classes we have seen used in this context



Past results are not a guarantee of future results. Segment sizes are for illustrative purposes only. Source: Capital Group

While DGFs may be falling out of favour we do not believe this means that multi-asset strategies cannot play a value-added role. For example more refined strategies such as liquid high yielding multi-asset credit or emerging market multi-asset could help capture the benefits of a dynamic investment approach while still allowing for greater transparency in glide-path design.

Conclusion

As the UK DC pension landscape has continued to grow and mature the options available to schemes has expanded. In considering the options currently available to them, there is an opportunity to replace broad off-the-shelf solutions with a more transparent investment approach that is better tailored to a scheme's member demographic or objective.

Written by

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3. Source: International Monetary Fund: World Economic Outlook (based on purchasing power parity), April 2019 edition. GDP: gross domestic product.

As a millennial working in the pensions industry, I come across terms like retirement, drawdown and replacement rates daily, and, even then, it still all seems very abstract and far off. And if it is abstract for me, it is even more ephemeral for those in my age group who do not come across these ideas on a regular basis. I recently sent a series of questions to some of my contemporaries, asking how they felt about their pensions, and their replies were very illuminating.

Pensions: not a priority

Pensions are far from the most pressing financial issue for millennials, and the statistics are bleak. On average, millennials graduate with £32k-£50k in student-loan debt, and 18-36-year-olds tend to be spending a third of their post-tax income on rent. If there is any money left over after all that, a pension is still unlikely to be the top savings priority; it is probably buying a house. This is no small task, with it now taking a person in their late twenties nineteen years to save for an average house deposit. In the 1980s, it took just three years.

We all seek to achieve these different financial goals in different ways. For example, someone may use a short-term savings account for more immediate requirements like a student loan or holidays, and a separate help-to-buy ISA for a house deposit. It is at this point I think of mental accounting, a concept from behavioural finance which describes how we all have a tendency to separate money into different 'pots' in our heads, based purely on our own subjective criteria as to the source of money or how we intend to use it. However, this behaviour can lead us to make irrational decisions, such as keeping a savings account for a holiday while running significant credit-card debt.

> "Misunderstanding risk is fatal when it comes to saving. Risk is not just about losing money; it is also about not having enough when it comes to retirement"

Remind me what DC stands for again?

A recent personal finance survey found that millennials know a lot about borrowing, a surprising amount about saving, but very little about the concept of risk.[1] Misunderstanding risk is fatal when it comes to saving. Risk is not just about losing money; it is also about not having enough when it comes to retirement, with not taking sufficient risk potentially making that a very real prospect. Owing to their long time horizon, most millennials have a fairly high risk tolerance when it comes to their pension. They have plenty of time to recoup any losses they may incur.

The majority of millennials who answered my questions had no idea about the risk of their pension portfolios, with those who had bothered to look saying they simply opted for the default owing to a mixture of apathy and feeling most comfortable with a 'medium' amount of risk. The standard default pension scheme will be a balanced portfolio of 60% equities (higher return, but riskier) and 40% bonds (lower return, but safer). If you use the general rule of thumb that 120 minus your age is a suitable percentage to have invested in equities, this is an inappropriate asset allocation for millennials, and could mean they are missing out on big returns.

Administrative nightmare

In a world where people can track current accounts, credit card and ISAs via smartphone apps, it seems irrational that this is not an option for pensions. Life trajectories do not necessarily follow the same traditional path they have in the past either. Millennials tend to work at one firm for a far shorter period than previous generations, and, knowing they are set to work for longer than their parents, many are taking career breaks to go back to education or to travel. This makes administration very difficult in a DC pensions world which may appear to be inflexible and lack transparency.

How to increase engagement

Putting together a timeline of major global economic, social and cultural events since 1985 (when the first millennials were born), three key areas stand out:

1. The technology boom, and the power it has brought consumers to access whatever information, product or service they like, when they like.

1 Source: The TIAA Institute-GFLEC Personal Finance Index (2018)

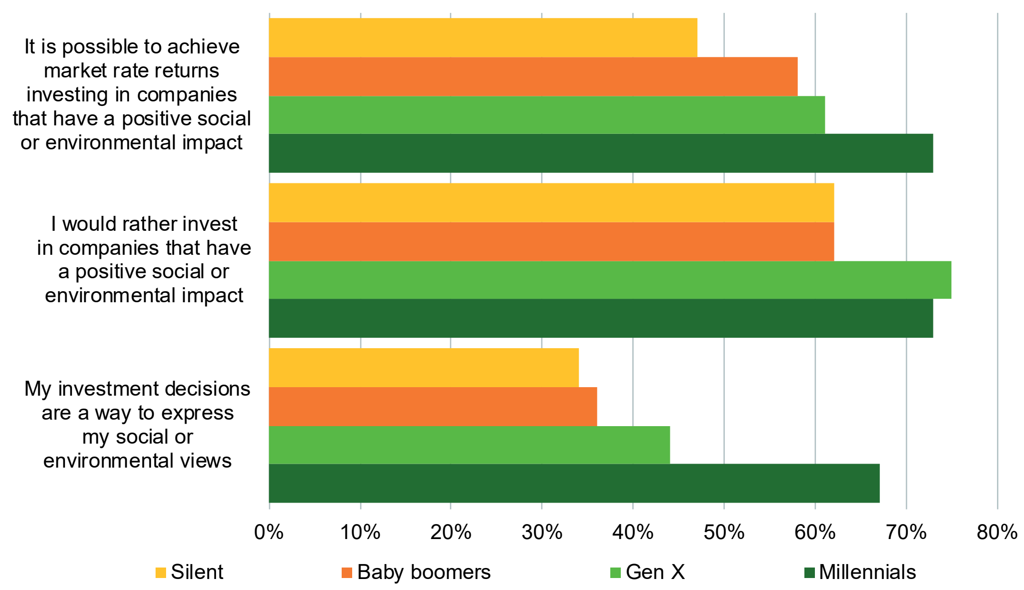
2. The rise of environmental awareness from the discovery of the hole in the ozone layer in 1985 to the Extinction Rebellion protests this year.

3. The financial crisis of 2007/2008, which severely damaged millennials' trust of financial services.

We think the pensions world can use some of these millennial-shaping events to its advantage:

1. Use different types of responsible investment to engage
It is well known that the millennial generation is generally more socially and environmentally conscious than previous generations, and there is also evidence that this is affecting how they choose to invest their money, as the chart below indicates. This tells us that environmental, social and governance (ESG) investment could be a great hook to get young people interested in the power of using their money to promote their own personal values.

Investor attitudes about social impact investing



Source: Bank of America Merrill Lynch, BNY Mellon

2. Using technology to facilitate communication and education
The financial technology sector wipes the floor with its clunkier, slower and far less glamorous older brother the pensions industry when it comes to communications, content and transparency. However, many exciting and innovative companies are emerging which could make pensions accessible, understandable, and perhaps even interesting.

> "Many exciting and innovative companies are emerging which could make pensions accessible, understandable, and perhaps even interesting"

3. Flexibility: new products that give access for key life events
Could a lifetime savings product that incorporates all your goals and allows you to withdraw from it whenever you need to be the answer? Possibly, but we also have to remember another key concept of investing: that each goal has a different time horizon and risk tolerance and therefore requires different asset classes. This muddies the waters somewhat, but one near certainty is that many of us would benefit from simplicity in the way we save, and that this would encourage people to engage and save more. In fact, some research by BNY Mellon showed that 63% of millennials would save more if their pension account allowed multiple withdrawals throughout their lifetime.

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