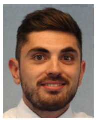
DC schemes - time for a service?



"Early and targeted action"

Luke Richards

BWCI

Location | PO Box 68, Albert House
South Esplanade, St Peter Port
Guernsey, GY1 3BY
Tel | +44 (0)1481 728432
Fax | +44 (0)1481 724082
Web | www.bwcigroup.com

With the increasing regulatory requirements for Defined Contribution (DC) pension schemes, it is easy for trustees to lose sight of one of their key objectives:

"Is our scheme providing good member outcomes?"

There are a number of different aspects to consider. Most trustees will already be reviewing the performance of the investments, but many have yet to consider the choices made by members and whether these are appropriate. The good news is that there are now tools available which can give trustees a complete overview of their scheme and can help identify any issues.

Monitoring default options

Trustees should monitor the ongoing appropriateness of members' investment options as part of good governance. According to Pension Insight's latest UK DC scheme survey results[1], a majority of schemes have over 90% of their members invested in a scheme's default arrangement, with 62% of schemes using a lifestyle strategy as the default arrangement.

The high take up of the default option is a feature of local schemes too. The survey statistics underline the importance of selecting and ensuring the ongoing suitability of the default arrangement, where the majority of a scheme's membership is likely to have invested their retirement savings.

It is particularly important that the default arrangement is reviewed regularly to check if it is meeting its objectives. A key part of this is considering how the investment performance compares to the trustees' targets. Where a lifestyle strategy is used, this is normally assessed by considering the performance of the individual funds that make up the strategy.

However, it is also possible to measure the performance of the lifestyle strategy as a whole. This can be used as a performance check against objectives and as an indication of the returns achieved by members.

As an example of investment monitoring in practice, Chart 1 shows BWCI's Blue Riband's default lifestyle strategy performance during the growth phase over the 5 years to 31 December 2017. The performance is shown relative to the weighted benchmarks of the funds, the UK RPI Index and the funds comprising the current strategy.

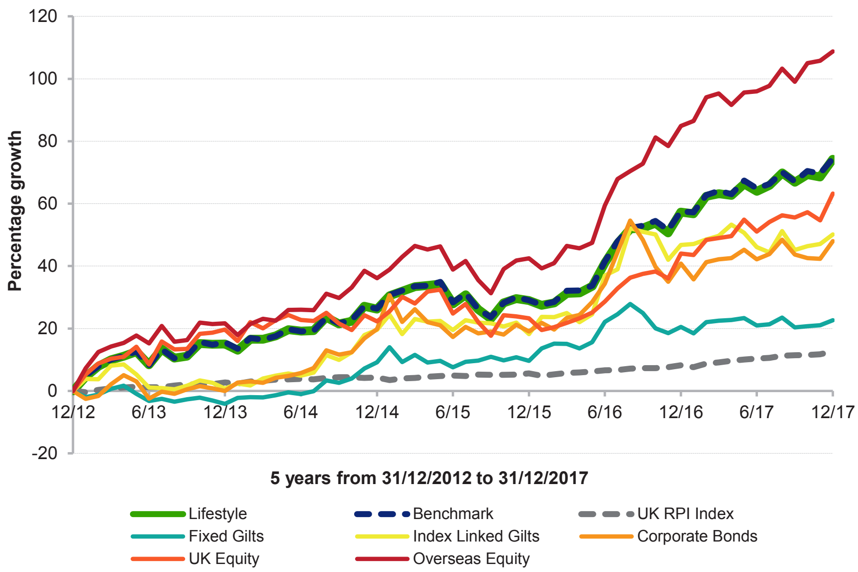
In this particular case, over the 5 year period the lifestyle strategy returned 74.2%, which is 61.5% over RPI. The graph shows that the lifestyle strategy provided returns which were higher than all asset classes (other than overseas equities), but with reduced volatility. The chart also shows that the lifestyle strategy tracked its benchmark, meeting the performance objective set by the trustee.

Review of member choices

Whilst most members are usually in their scheme's default investment strategy, the proportion of members who choose to select their own investment options can vary considerably between schemes. For this latter group, it is important that the funds selected by members remain appropriate for their changing needs over their period of scheme membership.

A review of member choices can help trustees identify any areas where members who opt to select their own investment strategy appear to have been making poor investment choices, such as taking a high level of capital risk relative to their period to retirement. This is done by allocating each member's current investment strategy a risk rating, depending on the mix of investment funds chosen.

Chart 1



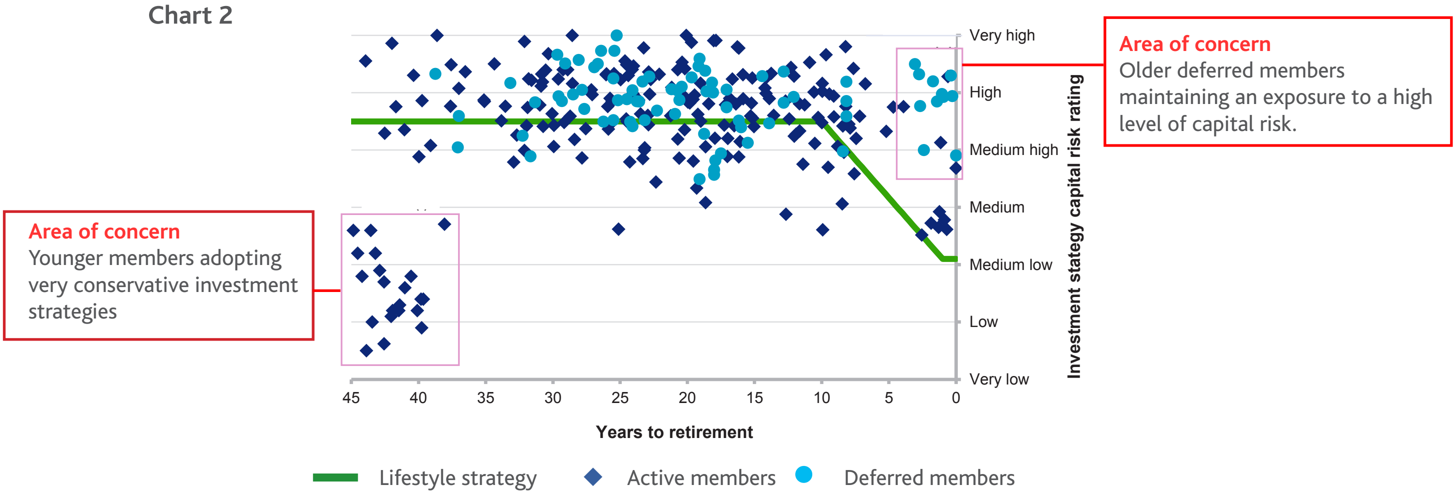
For further details on the tools to monitor DC Schemes, please contact:

investmentservices@bwcigroup.com

[1] Published in DC Landscape: Defined Contribution Pension Plans in the UK an analysis (May 2018) by Pensions Insight in association with Legal & General Investment Management.

Chart 2 shows what the output might look like for a typical scheme. A standard lifestyle strategy (green line) has been included as a benchmark of the expected level of capital risk at each period to retirement. In this example there are two potential areas of concern that may warrant further investigation.

Chart 2



The very low capital risk strategy chosen by members with 40 or so years to retirement suggests that they are invested in low risk/low return funds and could indicate a lack of investment knowledge. In contrast, the high capital risk strategy, predominately amongst deferred members who are within 5 years of retirement, could indicate that they may have not reviewed their investment strategy since leaving service. Armed with this knowledge, trustees can decide how best to address these issues. This could include reviewing communications to target them more effectively.

Projecting retirement benefits

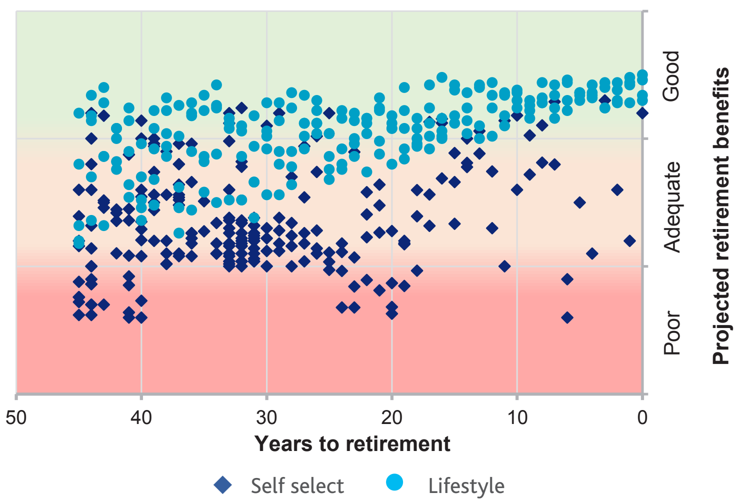
It can be difficult for trustees to understand how a member's particular investment decisions could impact on their retirement outcome, or whether current contributions are likely to be adequate. A projection of members' benefits can help. Chart 3 shows members' projected retirement benefits, relative to their period to retirement.

In this example:

- Younger members have a wide range of projected outcomes for both lifestyle strategy and self-select options
- The projected outcomes are generally poorer for self-select than lifestyle strategy members
- Older self-select members have a larger spread of outcomes than older lifestyle strategy members

In light of these results, the trustees may decide to try to improve member engagement to encourage greater awareness of the need for retirement planning.

Chart 3



Conclusion

Good governance is not a static process; trustees need to consider outcomes for all members on an ongoing basis. Regular monitoring of the default arrangement is particularly important, as it is generally where most members are invested.

The additional reporting options illustrated are powerful tools to enable trustees to track if their scheme is on course to achieve good member outcomes and, where this is not the case, to target action to achieve this. The exercise can be repeated over time to measure the effectiveness of any change and can include other member options such as the level of take up for member contributions by age. Early and targeted action by trustees is more likely achieve better outcomes for all stakeholders involved.