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Do default investment strategies align with members' needs?

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Do default investment strategies align with members' needs?

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- Definitions: what are default investment strategy objectives?
- Considerations: how are objectives set?
- Coverage: How can strategies meet the needs of the greatest number of members?
- Barriers: why isn't there more transparency?

The language around objective setting is confusing

- Provider language is inconsistent
- "Default strategies" are commonly referred to as "default funds"
- Default "design" (the way that contributions are invested) is sometimes reported as default "objectives" (the member outcome objectives which inform the design)
- An upfront clarification of language could assist providers when setting objectives and implementing investment strategies consistent with them

Objectives –

the investment outcome or outcomes that the default strategy is aiming to achieve.

Beliefs and Constraints –

the principles which underpin the implementation of the investment strategy to meet its objectives:

- Asset class beliefs
- Responsible investment requirements, and
- Cost constraints.

Design -

the approach taken to the selection of the individual element of the investment strategy:

- Asset allocation,
- Security selection
- Manager selection

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Objectives are set with reference to three main consideration

- Default strategy objectives are generally set with reference to three main considerations:
  - ➢ Regulatory requirements and guidance,
  - ➢ A provider's definition of value for money,
  - ➢ The needs of the greatest number of members.
- There is some clarity around regulation but less consensus on how to measure value for money or how to best meet the needs of members

There is a lack of consistency in targets/measures of return

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- Returns are generally considered an aspect of value for money
- A range of targeting approaches are used, for example "inflation plus X%", or different aims for the short-term and long-term.
- Returns do not always reflect targets, and records are seldom readily available. Where records exist, return often does not reflect targets suggesting they may not be targets, but long-term expectations.
- If investments are not being managed to deliver the set return targets, this makes evaluation of value for money and performance more difficult.

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Default strategies cannot cater to the needs of the entire membership

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- Default strategy objectives are designed to meet the needs of the greatest proportion of members.
- There will always be members who have different needs to those which the default strategy objectives are set to meet.
- One of the challenges facing providers is to identify those who are not catered for by the default strategy and support them to make different investment choices

There are other ways to approach an assessment of needs

- The most typical approach providers take to this challenge is to set the default strategy objectives to suit a person who meets the average of a combination of characteristics
- Some schemes set default objectives based on the expected behaviour of members in retirement
- Separate default strategies can be offered for those on trajectories for lump sums, drawdown or annuities or other behavioural options

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Assessing value for money is difficult because of a lack of transparency

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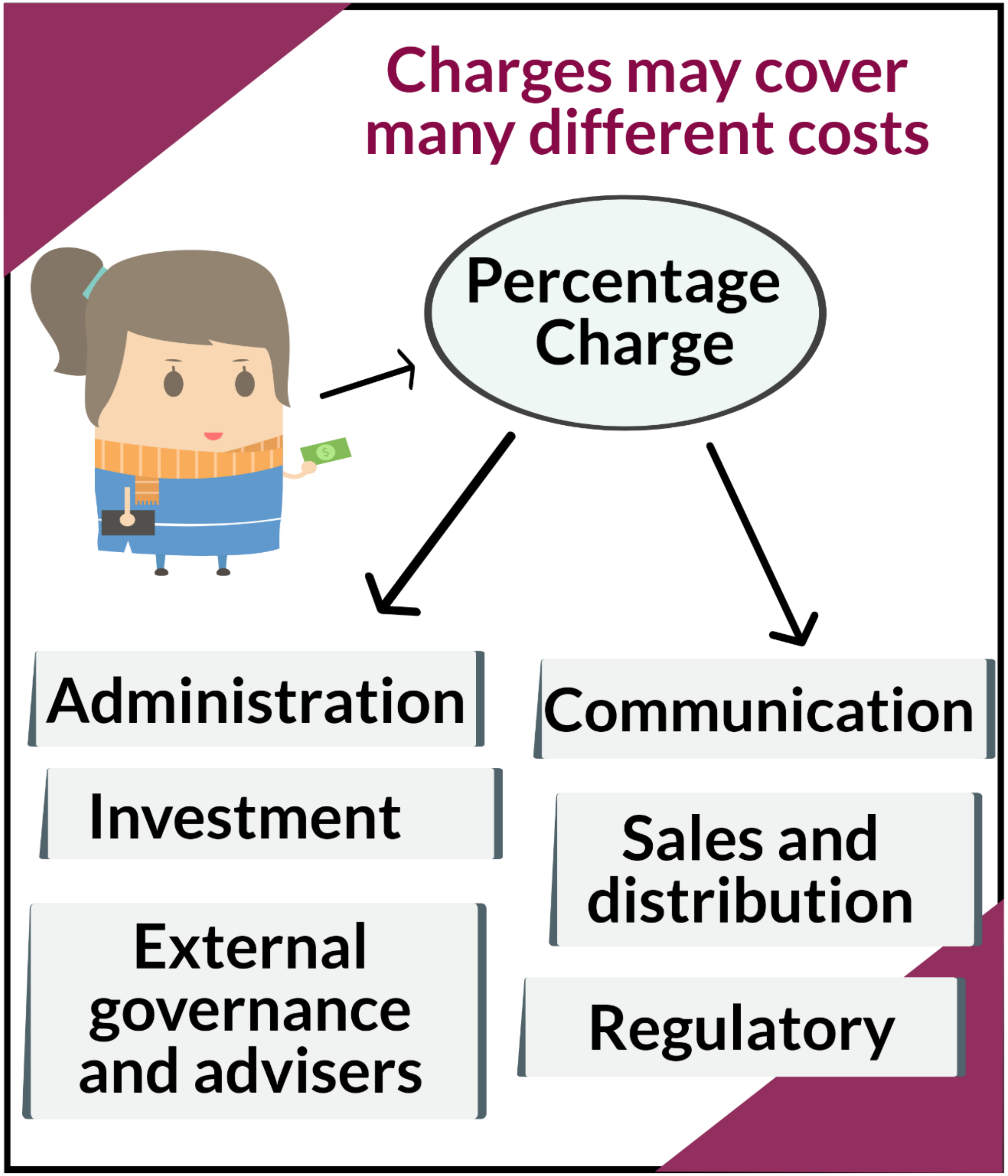
- Most DC schemes charge a percentage of the fund amount to cover all services
- The investment manager is generally responsible for allocating payment for administration, governance, communication costs and investment charges.
- This payment chain makes it harder to provide a clear breakdown of how costs and charges are used to fund specific services, and in most cases this breakdown is not readily available to employers or members.



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Trust based schemes face further transparency barriers

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- Trustees are often responsible for setting the default investment objectives, but also making the key investment strategy decisions and reviewing them in order to assess value for money.
- This puts trustees in the difficult position of reviewing their own decisions, rather than having their decisions reviewed by an independent external body.

Conclusions

- Default investment objective setting, in the best interests of members, is hindered by confusion and a lack of transparency.
- Up front clarifications of language and greater cost transparency could aid providers with setting objectives and reviewing performance.
- Default objectives can be set with reference to potential behavioural outcomes of members. In some schemes, more than one default strategy may be appropriate.
- One of the challenges facing providers is to identify those who are not catered for by the default strategy and support them to make different investment choices