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# DC Investment Options

Anne Swift - BlackRock

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# Agenda

- DC investment objectives
- A typical fund range
- Communicating the fund range
- Defaults and lifestyle
- Alternative strategies



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# DC Investment Objectives

“In selecting funds to offer as options to scheme members, trustees should...satisfy themselves that they have taken their members’ circumstances into account, and that they are offering a wide enough range of options to satisfy the reasonable return and risk combinations appropriate for most members.”

Myners’ Principles for DC schemes



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## Investment risks

- Inflation risk

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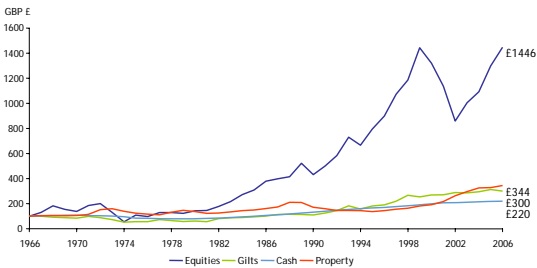
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## Long-term returns versus inflation



Source: Barclays Equity Gilt Study / Datastream  
Original investment of £100 on 31 December 1966 to 31 December 2006, gross income  
reinvested except property price performance. Adjusted for cost of living.  
All property data is using the UK Nationwide House Price Index.

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## Investment risks

- Inflation risk
- Pension conversion risk
- Capital risk

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## Investment risks

- Inflation risk
- Pension conversion risk
- Capital risk
- Risk of active management?

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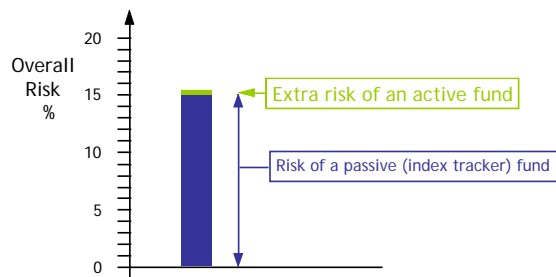
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## Active v Passive



Data source: Datastream, FTSE, Robson Associates

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## The fund range

“Decision-makers should consider a full range of investment opportunities, not excluding from consideration any major asset class, including private equity.”

Myners' Principles for DC schemes

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A typical fund range

- Equities
  - Global Equity
  - UK Equity
  - Overseas Equity
- Bonds
  - Long Gilt
  - Index Linked Gilt
- Cash
- Other?
  - Balanced
  - Property
  - Regional Equities
  - Ethical / SRI

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Some recent trends

- Lifestyle still dominates, typically as the default
- ...but some new schemes are being set up with no default
- Switching period has shortened; typically 5 years (previously 10)
- Global equities (previously Balanced / Managed) are the preferred fund option for the build-up phase of lifestyle
- ...and increasing overseas exposure (e.g. 50% rather than 30%)
- More use of "world index" (market cap) benchmarks for overseas exposure
- More use of corporate bonds in the pre-retirement phase
- Some use of index-linked, rather than long-dated gilts near to retirement, although removal of LPI requirement has impacted this

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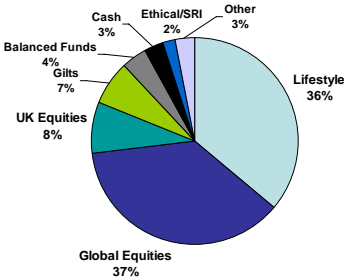
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Where are members investing?



Data source: Hewitt OC Survey 2008

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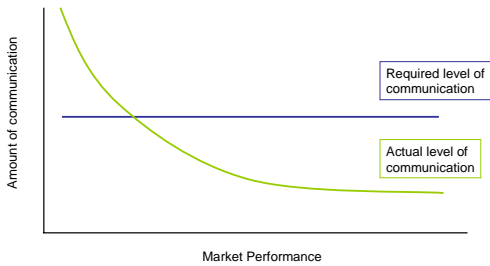
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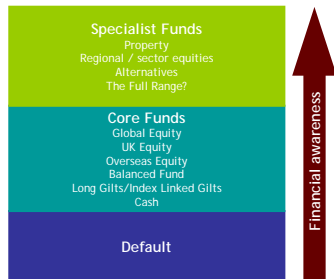
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## Thoughts on communication (1)



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## Thoughts on communication (2)



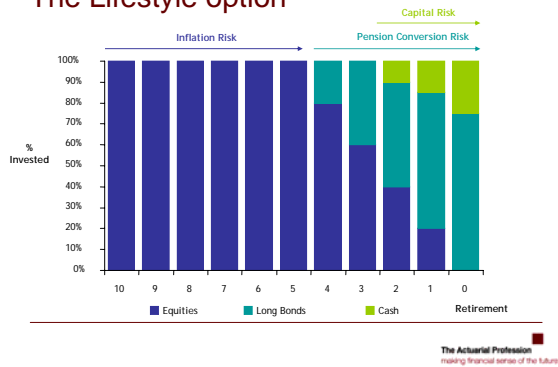
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## Should schemes have a default?

YES - Pros	YES - Cons
Easier administration	Over reliance by members - lack of ownership of their investment decisions
Higher take up	Belief that it must be "right for me"
If design of default is right it should meet the needs of the majority of members	Risks to trustees if default doesn't deliver
NO - Pros	NO - Cons
Members take full ownership for their investment decisions	Lower take up
Less risk to trustees (?)	Greater administration
	Level and quality of communication needs to be higher

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## The Lifestyle option




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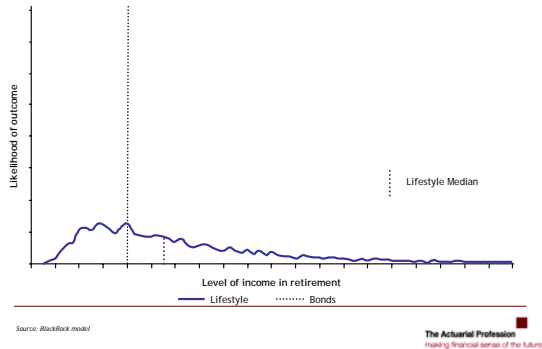
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## Does Lifestyle work?




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## What do members expect from their investments?

- Don't like market falls
- Don't understand the concept of benchmarks
- Expect investment managers to lock in profits
- Want to know what they are going to get
- Don't like any form of risk

Are there any alternatives?

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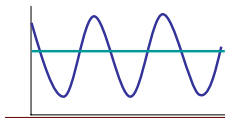
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## A “Target Return” approach

- Traditional balanced fund: asset allocation remains constant; investment returns fluctuate



- “Target Return”: asset allocation fluctuates; investment returns remain constant



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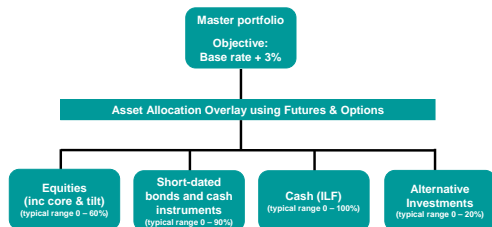
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## Building a Target Return portfolio

With ranges appropriate for a Bank of England base rate +3% objective



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## A more dynamic approach to Lifestyle

- Target a specific fund size, investment return or annuity amount
- Alter equity/bond weighting by reference to progress towards the target
- “Bank” any supra normal returns
- Focus on the “destination” as well as the “journey”

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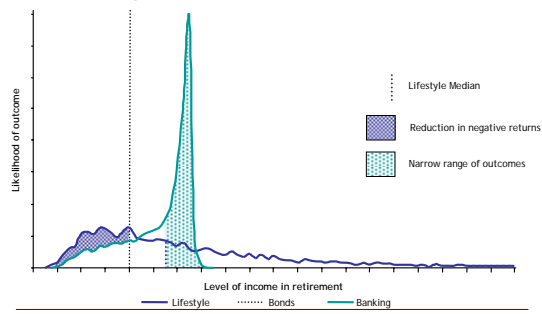
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## An example



## Conclusions

- All investment carries risk
- Offer reasonable choice
- And communicate it well
- Think carefully about the default