

point of view

DC investment strategies

Defined contribution funds have long been regarded as less sophisticated in terms of investment strategies than their defined benefit counterparts. However, this is starting to change with the widespread adoption of diversified growth funds. In this point of view discussion a panel of experts explore the issues surrounding DC investment strategies.

Hear a panel of experts discuss the issues on [this link](#).

How are DC schemes coping with the market volatility?

Simon Chinnery: We are still gathering information about what people are doing in the current situation but historical evidence points to the fact that DC investors tend to be pretty stable, they don't do much. They put their trust in the default manager to insure they survive and their assets are held safely and grow over the longer term. Certainly at the periphery you get the ones who are still managing their own DC pots of money, and they are potentially more sophisticated and therefore able to make decisions about diversifying their portfolios. But I would say the majority will probably keep calm and carry on.

Barry Parr: I recognise a lot of what Simon says, I think the key thing is default funds – perhaps 80 to 90% of members are typically in the default fund – are still heavily weighted towards equity investment. Certainly they are seeing

quite a big shock at the moment, not unlike 2008 for example. One of the points that come across is how quickly the market moves. It is very difficult for pension trustees to respond in anything like a dynamic way to that, it is just too quick. Typical pension trustees meet quarterly – there may now be a movement towards fiduciary management, or even delegated consulting, which may bring a faster capability.

Jenny Kirkwood: I would go with what my other panellists have said and say that generally nothing happens. What I do see is trustees who are on top of the situation; they communicate with their members and tell them what is going on. They make sure that they are aware of the options open to them. You will see one or two members who will be engaged and who will be actively phoning the help lines. But generally we hear nothing from 80% to 90% of members, they will generally be relying on



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the fact that the trustees are looking after the default fund. The majority of default funds are still far too equity based and biased, but we are seeing that change. People are looking to diversify portfolios. I would say about 80% of funds I have spoken with brought DGFs into their default fund, and the others have definitely added it as a fund option.

Have defined benefits schemes taken the whole issue of de-risking a lot more seriously than DC schemes?

Jenni Kirkwood: DC schemes by their nature are less mature. The majority of the membership within a DC scheme is in their 20s and 30s, and through lifestyle schemes and also through target date funds; they will be de-risking at an age that it is appropriate for them. If we move everybody into bonds overnight, and they are 35 years old, you are condemning someone to a too low pension.

Ben Shaw: We are also seeing very large proportions of people in the default fund. Whilst the default fund is a diversified fund we see very few people who actually look to do much outside of that. Telereal Trillium is a property

company and you would have thought that if any set of members was going to be putting money into property we would be one of them. Yet I think we have about 2% of members who have actively put money into a property fund.

It is a shame because in a way members don't take an active involvement in the running of their investments, and they should do. At the end of the day it is their retirement pot, it is very different to a defined benefit scheme where you are relying on the employer to give you a guaranteed 6% return.

I think somehow a message needs to get to DC people that they need to take active control of their investments or else they are not going to get a decent pot in their retirement.

Diversified Growth Funds (DGFs) are the hot topic within DC. What they are meant to achieve.

Andrew Cheseldine: The danger with using a term like diversified growth is a bit like talking about a hedge fund which can be anything from a cash fund to the 3.30 pm at Haydock fund. In theory they are all trying to produce some kind of stable return – not necessarily absolute return, but an evened out

performance and they can do it in lots of different ways. So they can just invest in real assets or they can diversify across all sorts of different asset classes. You have got commodities, private equity, hedge, infrastructure, high yield, agriculture, a whole range of assets. Or they can invest via derivatives for those to maintain some liquidity. But the essence of them should be that they are there to reduce risk.

The difference between a DGF and an old style balanced managed fund is the balanced managed fund was targeting a level of return, whereas DGFs are targeting a level of risk. Typically the investment managers are trying to produce somewhere between 50% and two thirds of the risk of equities, while producing equity like returns maybe half a percent a year below that.

Over the last month I think most DGFs have done something like they say they are trying to do, in terms of reducing risk.

Ben Shaw: Can I challenge that though? I think maybe the reason they have done that is because they have roughly speaking a third in equities, a third in bonds and a third in other. If the other are sufficiently illiquid or not correlated with equities they won't have gone



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Barry Parr

down. The debt hasn't gone too badly and therefore it is only the equities. So you might have seen a 15% equity fall, the other two have stayed the same, the equities have still got a 5% fall. The question in my mind therefore is, have those diversified funds really done what they are meant to, that an individual or a pension scheme investing in a portfolio of other bonds and equities wouldn't have done himself?

Andrew Cheseldine: I think the answer is yes, but again it actually goes back to Alex's initial question, what is a diversified growth fund? There are diversified growth funds out there that are just one third equity, a third bond a third something else.

Barry Parr: There are now at least 40 different DGFs on the market. Their profiles differ markedly, some correlate very strongly with equities, and some are far from that. The big issue for me is the cost of these though, in that to get equity like performance, but with a cost excess over what could have been achieved over 20 to 50 basis points more, depresses the end outcome quite considerably.

I question whether DGFs are really the right strategy for the core growth phase of a pension scheme because of cost. I do think they

have a very strong role as one is de-risking, perhaps at the end of the accumulation phase, and maybe in the early stages – NEST is taking on board some aspects of that.

Hamish Wilson: It is a good development because it is bringing home the fact that diversification is a key risk mechanism. I do take on board the point that there seems to be a broad church out there, which is a bit of a difficulty. It does mean people don't necessarily know what they are buying, unless they use their advisors carefully.

Is it harder to benchmark these funds, if you have got so many different strategies?

Andrew Cheseldine: Part of the problem is none of them have really been going for very long, and if you have got a decent track history then you can measure risk against reward. Reward should always be net of fees, and I agree entirely that we have got to be very careful over the fee structures. There is a fairness bias as well in there. Should you be paying people 20% out performance premium?

Simon Chinnery: It is about this certainty of outcome and it is also about the fact that most people are not saving anywhere near enough for retirement. The

other part of the equation is really about understanding what your members are doing and their saving behaviour, and how you nudge them to put more in. I would have thought one of the ways is to show them see their pot growing.

Are they going to be worried too much about cost?

I think that in the longer term it clearly does have a big impact and therefore it behoves on our industry to produce transparent funds where if it is beta it should be cheap.

Are DC funds going to be benchmarked against NEST?

Ben Shaw: It is difficult to benchmark against NEST because it is such a low common denominator, and it has got to be by its nature relatively simple for people to understand. If you are operating a large DC scheme you should be able to negotiate very good annual management charges. Certainly less than the 1% maximum NEST are going to impose. It is hard to get active management with those sorts of numbers.

Is collective defined contribution a possible solution to DC investment problems?

Hamish Wilson: Apathy, high management charges, the fact

you are having to disinvest at retirement, you add it all together and the cost [of DC] is prohibitive. If you just translate that into pooling your resources, and doing the best for the member, you can achieve an awful lot. You can overcome many of the obstacles in relation to raw DC by collected DC.

Andrew Cheseldine: I like CDC as a theory, just not in practice. I agree the benefits of scale are clearly one of the major advantages to collective DC. A couple of the fundamental issues though are you have got to change legislation.

One of the things that you would have to watch out for is not having to take an annuity. There is a lot of legal comment which thinks that unisex scheme pensions will apply for IOPS, as well as insurance annuities.

Finally and I am smiling as I say this, how would you differentiate between collection DC and a Ponzi scheme? In terms of it is all about sharing risk between different generations. It seems to me that the older generation, would saying to our younger generation “You take more risks so I can take less.

Is that not a Ponzi scheme?

Hamish Wilson: I can't think of the obvious answer to your Ponzi scheme but it certainly isn't Ponzi. I think possibly the answer to that is good governance. Which means applying that good governance and active management to volatile conditions.

I personally, would love to be in such an arrangement.

[Hear the full debate here.](#)



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This point of view is supported by:

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