

Pamela Atherton talks to **Simon Chinnery**, UK institutional client adviser at **JPMorgan**, about what makes a good default fund, the importance of addressing the over-45 age group, and the need for better targeting of information at members

Search for a smart default

Simon Chinnery is a man of strong views, with an ardent desire to shake up the defined contribution investment world.

As vice president of JPMorgan's UK institutional business, he is acutely aware of the huge responsibility that trustees and providers of DC schemes shoulder in respect of their members. In brief, he wants to see DC members get a better deal.

He is particularly concerned about the straightjacket represented by default funds, in which up to 90pc of DC members invest in some schemes. Even a 2005 survey of 97 FTSE100 company schemes conducted by Watson Wyatt showed that 62pc of members invested in the default option, while more than half never changed their investment option.

Default funds can range from pedestrian insurance company managed funds to full-blown lifestyle funds that switch members into "safer" assets, such as fixed interest and cash, as they near retirement.

"There's been a lot of discussion around what's a good default fund. It might be a passive global equity fund, with lifestyling in later years," he says. "But if you look back to what has happened in the past eight years, equities fell from 2000-2003 and have fallen again since August 2007. If you were being moved out of equities when the stock market was down, it would not have been great for your pension fund. Trustees may find that a default fund set up 10 years ago is no longer appropriate."

This is not only because investment conditions have become so volatile – membership may also be getting older. But he fears that trustees do not always make the right choices – they may act out of fear of litigation from disgruntled DC members if they reach retirement with inadequate pensions. "A defensive 'belt and braces' approach is unlikely to be best for members over the long term," he says.

Chinnery sees a huge need for an intelligent default fund, consisting of global diversified multi-asset equities, providing smoother returns and which can default to cash in the run up to

retirement, but only if the member wants it.

He thinks members should have a choice as to whether their fund is phased out of equities five to 10 years from retirement. Many members in the over-45 age group are keen to continue actively investing their funds right up to retirement and should be given the facility to do so, he says.

Senior focus

So the debate now is around older members who want to do something different. They may want to focus on different funds, make their own investment choices and make additional contributions.

That said, Chinnery is aware that many DC members are not very good at making investment decisions when presented with a vast range of funds. There has been much discussion of the problem of "analysis paralysis", whereby DC members give up making any investment decision because they feel overwhelmed by choice.

Hence opting for the default fund may stem not just from ignorance or inertia, but from being offered too many options.

But he urges trustees not to allow this to discourage them from



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addressing the needs of the over-45 age group in their DC membership – a cohort of the membership he sees as currently being "disenfranchised" when they could be the target for a more dynamic breed of lifestyle funds.

Chinnery sees the problems surrounding DC schemes as not just being a question of fund choice. "The cry for more member education is not always helpful. We need better and more user-friendly administration and technology. What we really need is easy-to-use tools that actually work. Trustees need to fix on this, rather than throwing more and more information at members," he says.

Many members have highly unrealistic expectations of what their retirement income will be, which is why they should be encouraged to work backwards from how much they want to live on in retirement and then work out how they might reach this goal.

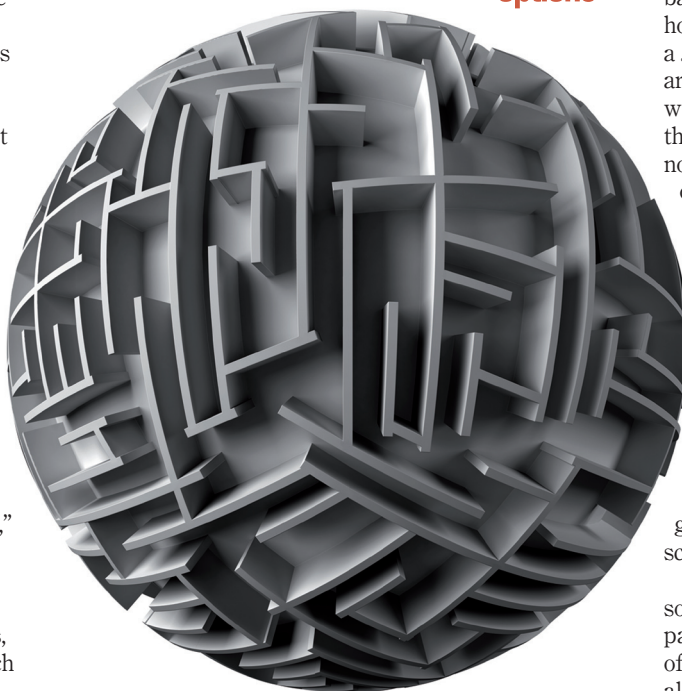
This can be easily done by inculcating in members that £100,000 of pension fund will roughly equate to £5000 annual pension, give or take a couple of thousand pounds either way, depending on age, gender, state of health, marital status, whether they smoke and so on.

Once members understand this basic fact, they might grasp just how much they need to save to get a £25,000 a year pension – namely around £500,000. The trouble is that with group personal pensions, where there are no trustees, and therefore no governance, members are entirely on their own, unless they have their own source of independent financial advice.

Problems with GPP

Although some group personal pensions are set up by an IFA or other investment consultant, the ongoing service can be patchy to say the least. Anecdotal evidence suggests not all employee benefits consultants do much for their generous upfront commissions once a scheme is up and running.

In some cases, particularly with some online employee benefits packages that include a GPP offering, there is no IFA support at all. The technology for these online-



administered GPPs can be basic, to say the least. Fund switches often cannot be done online – a form has to be faxed or posted to the insurance company via snail mail.

Some online schemes cannot handle one-off single contributions older members may wish to make. The system may sometimes not function, so that the much-vaunted “24-hour access” to contribution records and real time valuations are not always available in practice.

These glitches and shortcomings can discourage DC members from taking an active interest in their pension. Indeed, many simply disengage totally from their pension arrangements, assuming that because the employer set the scheme up, it will provide an adequate income in retirement.

But many DC members are being ripped off because the online benefits consultant receives generous commissions from the insurer providing the fund range – commission paid for by the members through ridiculously high fund charges.

Total expense ratios for some GPPs are shockingly high – some charge 1pc basic, plus the funds’ annual management charges, which can be up to 2pc on top for the more esoteric funds.

Chinnery says: “These issues need to be addressed by trustees, or the employer if there are no trustees. If members were to realise what a poor deal they were getting, they would have grounds for complaint and possibly legal action.”

Certainly, some of the online-administered GPPs sail close to the wind with regard to compliance. Sales staff have been known to tell new recruits to “just tick the default box” when they sign up to an online GPP. No wonder the uptake of the default option is so high! The level of insurers’ commissions to some of these online benefits consultants who purport to be IFAs can also be eye watering if you look at the small print.

“This is what happens when a GPP is set up with no one overseeing it. The employer says ‘I’ve discharged my legal duty by providing a pension and contributing at least 3pc of salary.’ The individual member is left with a pension contract with the insurer, not the employer,” Chinnery says.

“To what extent the employer has any legal responsibility if the GPP provider and administrator make a hash of things is a moot point. But it is time people looked at these things.



Trustees need to monitor their DC investment range as closely as they would a DB scheme

Otherwise there are going to be a lot of disgruntled people going into retirement.”

Targeted funds

Chinnery sees a glimmer of hope in the development of target-driven funds, which are growing in popularity, and diversified growth funds. However, he says it is the way these options are presented and delivered to members by insurance company fund platforms and online employee benefits packages that really count.

Some schemes are opting for target-driven investment, which provides DC members with a framework to focus on their pension investments in light of their specific circumstances and desired retirement income level.

This enables member to state their attitude to risk and reward. They can clarify their target retirement income and use this to drive their investment strategy. Transparency in terms of risk-reward trade-off is essential. Before members invest in a particular solution they should have a clear idea of the possible range of outcomes and how this relates to their pain threshold.

The chosen investment strategy should take into account their appetite for risk, their age, accumulated pension pot to date (including other company

pensions and the basic state pension) and any other assets they may hold.

A calculation is carried out at regular intervals to measure investment performance against the target. If the actual investment performance of the member’s fund beats the target, a suitable proportion of the investments will be switched from equities to a “risk-free” asset.

In summary, Chinnery believes that DC funds need to be reviewed regularly if they are to remain appropriate for all scheme members. DC members are demanding more flexibility, both in how they accumulate their pensions and how they can be taken. The fund range should cater for all members, which means lifestyle funds should not be imposed on members who want to remain actively invested right up to retirement. Particular attention should be focused on the over-45s.

Trustees need to monitor their DC investment range as closely as they would a DB scheme. The risks associated with increasing longevity, lower returns and potentially reduced state benefits apply just as much to DC members as to DB members. The task of governing DC schemes is just as challenging.

Pamela Atherton is a freelance journalist