CHOOSING THE RIGHT FUND FOR THE ACCUMULATION PHASE

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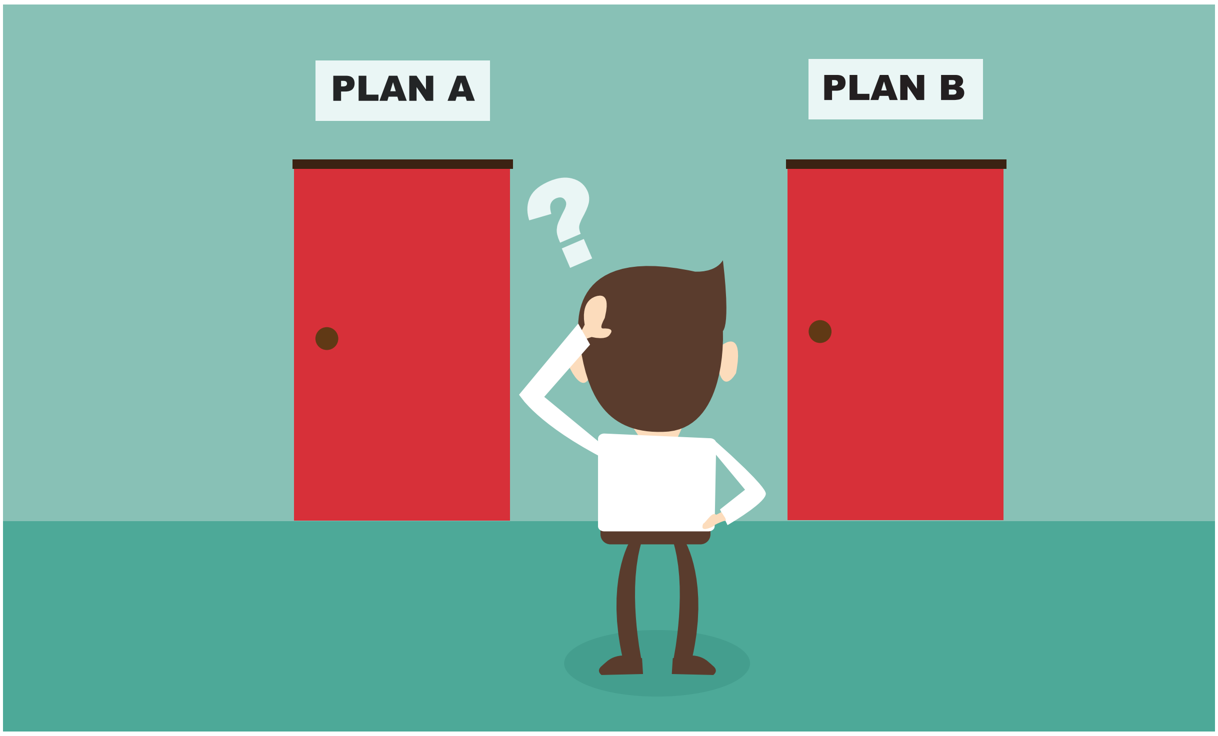
Budget flexibilities along with a charge cap mean many employers may start to reconsider the default investment fund offered to members.



It's often been said that change is constant and it's certainly been true in the corporate pensions market over the last few years. Whether it was RDR, auto enrolment, or the changes resulting from the DWP command paper, employers have had to deal with more than their fair share of change. So when George Osborne made his budget announcement there may have been a collective sigh of relief that pension freedoms were aimed squarely at the individual.

But with an increasing proportion of UK savers contributing to a pension scheme through their employer, it was never going to be that simple. Employers have an important role to play in ensuring that those heading towards retirement are best placed to make the most of their newfound pension freedoms. But it doesn't necessarily mean that they need to rush out and change their default fund straight away.

From April over 55s will be able to withdraw some or all of their pension savings, or take several smaller lump sums over numerous years, with 25% of each withdrawal being tax free. They're likely to follow one of three different retirement journeys. People with smaller pots may take it all as cash, some will still purchase an annuity – potentially a little later in life, and we expect the majority to draw on part of their pot over time, potentially saving and drawing down intermittently.

So what does that mean for employers? The key thing is keep calm and don't rush. The reality is we really don't know how people will react to the new freedoms so it might be wise to wait.

For many schemes the de-risking element will remain the same, the area that needs attention is the 'at retirement' aspect where individuals will have greater choice.

The immediate need is for those about to retire. This is likely to be a small portion of workforces, but it's important that providers can support them in their choices. As long as this is the case there's no need to rush to change default funds immediately.

Understanding the needs of a whole workforce is key when considering default funds and keep in mind that not everyone will want the default option. So think about what can be done for those who want something different.

Target Date Funds (TDF) are more common in the defined contribution world and, interestingly, have been employed by NEST. Conceptually, lifestyling and TDFs do the same thing – growth phase followed by de-risking approaching retirement. Lifestyling achieves it through a series of funds (that can be individually benchmarked) whereas TDF is a 'one fund' concept with a more sophisticated asset mix (eg non-traditional asset classes). This may cost a little more; potentially has variable annual fees depending on the mix; may be higher risk; and may be difficult to benchmark or justify performance.

There's a wide-spread appreciation of the risk-reduction benefits of some multi-asset funds. A quality pension scheme default has to balance the aim of achieving good member outcomes alongside ease of understanding, and at an appropriate cost. The introduction of too many and, perhaps, esoteric assets may run the risk of compromising these principles.

It's also worth considering paying a little more for an 'active' or 'managed' fund versus a 'passive' one, which will adjust to the market conditions offering a little more protection. There are also self-investor funds or bespoke lifestyling where advisors pick a number of funds for you. That approach is a little more expensive but you gain the benefit of an advisor's experience. The key thing is to take your time to understand the options, and see how people respond to the new freedoms.

Getting the right default is obviously important however it's only part of the equation. We have seen many 'triple defaulters' in the past (members who default into their workplace scheme, into the default fund and then ultimately into an annuity) and although many of the budget changes are designed to drive people towards being more engaged with their pension savings, workers are going to be expected to make more complex decisions than ever before (and at an earlier stage).

While the law doesn't require employers to give support for the new freedoms, it's become apparent from auto enrolment that many people lack basic financial understanding, and may look to their employers for support when making these decisions.

While the industry is improving access to information and advice, there's definitely a role for employers and advisers to support and encourage engagement with these resources for the financial wellbeing of their workforce.