Default Fund Design and Governance in DC Pensions

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Defined Contribution
Investment Forum

NAPF
Securing the future of pensions

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Foreword

Default funds have become an increasingly common feature in defined contribution (DC) workplace pensions, and the introduction of automatic enrolment reforms from October last year has only intensified the focus on them. The default fund is the fund that members see their contributions invested in should they fail to make an alternative investment choice. With the vast majority of existing and future savers now expected to remain in the default, successful design and governance will be critical to driving good member outcomes at retirement.

Recent industry research has suggested that, even where they remain in the default, not all members are disengaged. Some may have considered the alternative investment options and made an active positive choice to stay invested in the default fund.

Whether members are engaged or disengaged, those employers and trustees looking to act in the best interests of their employees and members will wish to assure themselves the default fund they have in place is the most appropriate for their membership profile. This will include a review of the investment and performance objectives, the trade-off between risk, return and volatility within the asset allocation, the appropriate level of member charges, and the approach to de-risking ahead of retirement.

This latest research with our members is based on focused discussions on how they have gone about reviewing and overhauling their default fund design. The results have been very encouraging. We have spoken to a number of trust- and contract-based schemes, both single-and multi-employer, and have identified key trends and design features. We have also taken the opportunity to ask them for their advice for others who may be going through the same process.

In recent years they have all undertaken a fundamental review of their default fund. The trigger has usually been part of a wider drive to consolidate their pensions offer, either in preparation for a change in the membership profile under automatic enrolment, or because they had a sense that their existing default fund was no longer fit-for-purpose. We have also spoken to a number of investment consultants to gain insight into their perspective on the emerging market trends and the behaviour they are seeing from their clients.

There are key themes within the research around how employers and trustees make the trade-offs between costs and value; the importance of active governance and supervision; the drive to simplify communications; the growing use of white-labelling to give decision makers flexibility to change their default; increasing innovation in de-risking; and the timetables and processes needed to see a default fund design review through from start to finish.

I hope this report provides a helpful and practical peer guide to those running DC pension schemes and gives new insights into the motivations of trustees and employers when taking decisions about the appropriate default fund for their employees and scheme members.

I would like to thank the members of the DC Investment Forum *www.dcif.co.uk* for their support in producing and disseminating the research, and Spence Johnson (as managers of the DCIF) for their support in the co-production of this report.

Joanne Segars

Chief Executive, NAPF

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Members of DCIF:

Executive Summary

This report focuses on eight case studies of DC pension schemes that have been through the process of DC default fund creation, review or improvement. The triggers and motivations for reviewing the default fund have varied between schemes: ranging from the closure of an employer's defined benefit (DB) scheme to new or existing members; to the rapid approach of automatic enrolment and the need to design a default fund suitable for a wider group of employees; to just a sense that the original set up for the default fund was the first bite of the cherry and that members would be much better served by a different arrangement.

From these eight case studies we have highlighted 15 default fund **design trends** as seen through the case studies, 15 default fund **design features** used and recommended by those we spoke to, and 15 pieces of **design advice** from the case studies to those employers and trustees yet to review or redesign their fund structures. Our selection of the key themes are:

On design trends:

- **Member costs and value –** whilst many of the schemes we spoke to had renegotiated their DC investment strategy and fund structure with lower charges there remained a strong focus on value over cost and, ultimately, retirement outcomes. Trustees and employers are looking to combine underlying funds to deliver good returns but with reduced risk and volatility and within what they consider a reasonable cost envelope – the headline charges to members on the default funds in the case studies ranged from 30 basis points (bps) to 76bps, and averaged 50bps.

- **Monitoring and reviewing –** active governance and supervision of the default fund is now seen as essential – all of the schemes we spoke to planned to monitor their default fund investments on at least a quarterly, and in some cases monthly, basis.

- **Communications –** engaging members is seen as a vital element of default design – with a growing awareness of the challenges of DC those schemes we spoke to were very aware of the need to simplify the design, to de-jargon pensions at all levels, and to make communications and planning tools available for members online.

On design features:

- **Growing use of white labelling –** white-labelling was increasingly popular in response to the challenges of making changes in the past: "This means we can choose quality managers and then make changes very easily because we don't need to spend large sums of money writing to members about every decision, so we feel much less constrained."

- **Derisking over a longer period –** the consistent trend was to start derisking and engaging members with retirement sooner: "There is a different balance of funds every year from 40 years before retirement. It is a very long glide path, the point is you can use it to increase or decrease risk."

- **Actively managing risk –** the schemes we spoke to were making concerted efforts to step up their governance on DC: "It's not good enough to 'set and forget'. You can't be an absentee, you need to be there. "

On design advice for those about to go through the review process:

- **The redesign process can take more time than you think –** the time taken in practice to complete their redesign varied from 1-3 years and averaged over 2 years: "Don't underestimate the work involved. Start the process early! The time this process takes is not to be underestimated, it takes at least two years."

- **Governance matters –** the changes to the default fund are not the end of the process: "The redesign is not just about a fund, it's about the way you then monitor it in future, and who does this and how. In other words it's the whole governance thing."

- **Build your design first and foremost around member needs –** rather than fixating on short-term issues: "Spend all of your time, or the vast majority of your time on understanding your members, and try and spend as little time as possible hiring and firing fund managers."

We hope that this report provides a helpful and practical guide to those running DC pension schemes and gives new insights into the motivations of trustees and employers when taking decisions about the appropriate default fund for their employees and scheme members.

1) Background

Automatic enrolment and DC default fund regulations and guidance

Whilst default funds have increasingly become a feature of the DC pensions landscape, under automatic enrolment legislation[1] the attention to them has increased. Employers now have a duty to auto-enrol certain workers into a qualifying workplace pension. In order to qualify for automatic enrolment, the scheme must have a default investment option in place, so that employees do not need to make any active choices in order to save for their retirement. The default investment option can therefore be defined as an investment vehicle that is automatically selected for the individual, unless the individual opts for an alternative fund.

In May 2011, the Department for Work and Pensions (DWP) published guidance[2] on offering a default investment option in contract-based and trust-based DC automatic enrolment schemes. This guidance covered default design, investment governance and recommendations on communicating investment information. The main recommendations from this guidance are listed in Figure 1, right.

This work on default options has been subsequently developed by the Pensions Regulator (TPR). TPR's Code of Practice for trust-based DC schemes follows the DWP's guidance, but also sets out greater detail on the processes that trustees should follow when selecting or reviewing investment strategies. The separate guidance document accompanying the Code sets out how schemes should communicate investment strategies to members.

- **The default option should be aligned with an overall objective that takes account of the suitability of the option, its affordability and potential risks.**
- **The investment strategy should manage risks by diversifying asset allocation.**
- **The investment strategy should take into account, on reasonable grounds, the retirement profile of members.**
- **Members should not be locked into the default option.**
- **The default investment option should be reviewed at least every three years, with the performance of funds checked informally regularly.**
- **Information on the default option, including the charging structure, should be clearly communicated to members.**

Figure 1 – The DWP's guidance on default options

Default funds today

As noted, a default fund is what a DC scheme member will have their and their employer's contributions invested in if they do not actively select an alternative investment option.

There are many different types of default fund and the design of default funds and their popularity has evolved over time. In this report we have summarised them under three broad headings: Old style, Lifestyle and Alternative style.

Old style – The Old style approach has been used for 20 years or more[3]. Old style default funds are very often single funds. There is no statistical evidence for this, but anecdotally we understand that most of these are passive and active equity funds, and With Profits funds. There is often no derisking phase (see Lifestyle below) in these defaults. It has previously been estimated that 65% of very small schemes are still using this old style approach to default fund design. Only three of the case studies in this report were using an old style default fund before the redesign they describe, and this reflects in part our selection of somewhat larger schemes for this exercise who are more likely to have already reviewed their scheme for automatic enrolment.

Lifestyle – The second broad type of default fund is Lifestyle, which has been introduced in the last 10 years (or 'Lifecycle': in the UK the terms Lifestyle and Lifecycle tend to be used synonymously). Lifestyle is described briefly in the box to the right. This approach is used by around 90%[3] of larger schemes that have a default fund, and is the approach most frequently recommended by investment consultants. Six out of eight of our case studies used a Lifestyle approach as the basis for their redesign, and all were advised by investment consultants. Three of these schemes already used a form of Lifestyle in their previous default fund design.

Alternative style – The third broad type of default fund could be called the Alternative style. By this we mean new Alternatives to Lifestyle. These Alternatives have emerged in recent years, and encompass a range of innovations in default fund design, the most frequently mentioned being target date funds, but other alternative style developments include 'outcome oriented' default funds, risk based funds, and structures which offer LDI (Liability Driven Investment) for DC. Within our case studies two are users of alternative style approaches, both using target date funds in their default fund design.

Lifestyle

Lifestyle is an approach to default which has many variants, but it can be summarised like this: a member is invested over their lifecycle in a combination of four funds, and the combination changes with the members age or perceived distance to retirement.

As they grow their savings in what is often referred to as the growth phase, members will tend to be invested predominantly in equities or higher risk funds.

As they get closer to retirement, often 5-10 years before their selected or default retirement date, the member is 'derisked' to avoid loss of assets close to retirement, which means that they will gradually, according to a pre-planned switching mechanism 'glide path', have their assets transferred into less risky funds such as bonds and cash. 95% of respondents to the NAPF Annual Survey 2012 said that they had a form of derisking in place for the default.

[1] Pensions Act 2008
[2] Guidance for offering a default option for defined contribution automatic enrolment pension schemes, DWP, May 2011
[3] "DC market Intelligence 2013" Spence Johnson
[4] 'Larger' schemes are defined as those with more than 1,000 members. 'Smaller' schemes are those with fewer than 1,000 members. Very small schemes are those with fewer than 100 members.
[5] State Street Global Advisers, July 2013.

Some other key features of DC default funds and the market are summarised below:

Default funds are not usually one fund but several. Although the term 'default fund' is commonly used, and we have used it in the title of this report, members in a scheme employing Lifestyle approaches as we describe it above (and this therefore means most members in larger schemes) are invested in a combination of several underlying funds rather than just one. In the rest of this report we refer to 'default fund' in the singular, but we generally mean it in a multi-fund sense.

Not all DC pension schemes with active or deferred members have default funds. A default fund is a legal requirement for a workplace DC pension that is being used for automatic enrolment, and this new regulation is an important driver of changes in the DC market today. In total, an estimated 15%[3] of workplace DC schemes still do not have a default fund. This varies by type; according to analysis by Spence Johnson[3] 7% of larger schemes still did not have one in 2012 according to one measure, and 17% of smaller schemes[4]. Among NAPF members, the equivalent ratio is 9% among Annual Survey respondents and just 6% among Pensions Quality Mark (PQM) holders. With all schemes being used for automatic enrolment required to have a default fund in place for members the proportion of schemes with active members without one is expected to decline over time and be increasingly restricted to legacy schemes.

Most members use the default option. Across all workplace DC schemes it has been estimated[3] that 72% of members invest via the default fund. However this varies by type of scheme. Smaller schemes average 65%, while larger schemes tend to be 80%. Among NAPF members, the ratio of members reported by schemes to be saving into the default is 83%. Among our case studies the proportion varied from 40% to 85%. The differences in the popularity of large and small scheme defaults may be because most smaller schemes are much older than larger ones, and in many cases were established before default funds existed and became mainstream. There are currently many more smaller schemes than larger ones in the UK pensions landscape.

Default does not necessarily mean disinterest. Recent research[5] suggests that, of those that do invest via the default fund, around half choose the default fund because on considering the alternative funds they conclude that it is the best option for them. If this research is correct, only half of DC scheme members in default funds are truly 'inert' in the sense that they are placed in the default fund because they fail to make any choice at all.

Default funds account for a growing proportion of DC assets. Default fund assets are believed to represent 70% of DC workplace pension scheme assets today, but according to one projection they will account for 83% of all DC assets in 10 years. This places additional urgency on scheme fiduciaries to ensure that default funds will deliver good member outcomes.

DC default funds' assets are growing fast. The pool of assets within DC workplace pension schemes is growing fast: one estimate is that the total DC assets in default funds today will grow in size by 3.5 times over the next ten years[3], equivalent to an annual growth rate of 13.5%. One case study told us that its DC default fund assets are growing at 40% per annum at present, albeit from a small base. This presents very strong arguments for attention to be given to default fund design.

Target Date

In a Target Date Funds structure a member actively identifies his/her desired retirement date, and is then accordingly placed in one fund (one of a stable of such funds, one for each age cohort) which targets that (or a nearby) date. The assets of the fund are then grown and derisked according to an agreed glidepath to retirement.

In practice a member may see little difference between Target Date and Lifestyle – they may both invest the member's assets and then de-risk them in quite similar ways. However there are some important differences. Two examples are:

- in Lifestyle the strategic investment decisions are made by scheme fiduciaries and their advisers, but in Target Date they tend to be (though are not exclusively) made by a third party; and
- in Lifestyle a member's assets are switched between funds over time, while in Target Date they remain in one fund and this has administrative/cost implications.

Research methodology and aims

Given the growing importance of the DC default fund in the pensions landscape, this research project explores the experiences of our fund members in reviewing, and in many cases overhauling, the design of their DC investment strategy and default fund. The aim of the research is to share and disseminate practical examples of the processes that trustees and employers have followed when reviewing their investment strategies and default fund designs for DC schemes, and the governance they have put in place around monitoring the performance of the fund and communicating the fund to their members.

This research was carried out in two stages:

i) Detailed case study interviews were held with the trustees, employers or scheme managers running eight DC pension schemes that had undergone a significant review of their investment strategy and default fund design in recent years. Six of the eight were single company schemes, two were multi-company. Two were contract-based, the rest were trust-based. In addition, two other schemes were interviewed but were not used as case studies. All the schemes interviewed had reviewed their DC default fund since 2009. They were predominantly larger schemes in terms of membership: the smallest had around 2,000 members, the largest had around 40,000. The discussion guide for those interviews is at Annex A.

ii) Follow-up interviews were also held with four investment consultants to explore some of the key themes emerging from the case study interviews and to gain a broader client perspective. The discussion guide for those interviews is at Annex B.

The emphasis of the research is not on identifying the 'right' or 'best' approach, or saying that one default fund design is better than another, but to demonstrate the variety of approaches within the DC landscape and some of the opportunities and challenges that reviewing the default fund has thrown up.

Our aim has been to turn the findings into a practical default fund guide that can be used by schemes yet to start or complete their own redesign process. We hope that trustees and employers running DC pension schemes find this research of help in understanding the processes their peers have followed in reviewing their default funds. We also hope it provides useful insight to investment consultants and fund managers into the motivations of trustees and employers when taking strategic decisions about the appropriate DC default fund design for their employees and members.

[5] Recent unpublished research from State Street Global Advisers (SsgA)

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2) Headline findings

Design trends: 15 default fund design trends as seen through the case studies

We have identified some key changes that appear to be taking place in the way that default funds are designed based on what we learned in our eight case study interviews, and supported by broader based interviews with a handful of leading investment consultants. The 15 changes we identify here are provided under the headings covering the Redesign process, Default features (by which we mean features of the fund structure itself), the Annual charges to members, and the important topics of Engaging with members and Reviewing the arrangement.

More granular details of these trends are available in the Case Studies themselves in Section 3 of this report.

		What we see in the Case Studies	Selected Views of Investment Consultants
Redesign process	1. Calls to action	Automatic enrolment is driving change. Six of our eight case studies were prompted to action by the new regulations, but there were other factors including concerns about the inadequacies of old arrangements.	"Automatic enrolment is not the only driver – we think there are a lot of schemes out there that have still got something which is very dated, which needs improving and they really should do something to improve them."
	2. Decision process	It takes a long time to redesign a default fund. The case studies took on average over two years to complete their redesign, this varied from one to three years.	
	3. Decision stages	A series of steps are now seen as essential for good design. Our case studies stress the importance of investing time in understanding members and their desired pension outcomes before making default design decisions. They also invest much time in co-ordinating the investment beliefs of the fiduciary group.	"The first step in redesigning a default fund would be getting a full understanding of your membership." "It's vital that you understand your investment beliefs before you get into investment design."
	4. Decision-makers	The decision importance is reflected in the seniority of the decision-makers. The decision-making tended to be led by an Investment Committee, or an equivalent group. In many cases the redesign was given input at sponsor board level (HR or Finance Director in particular). Consultants contributed to the decision in all but two cases.	
	5. Costs of redesign	Fiduciaries are seeing these costs as manageable. One case study calculated the total cost of the default fund redesign to be 27bps per member, and was told in a consultation with members that this was acceptable.	

		What we see in the Case Studies	Selected views of Investment Consultants
Default features	6. Default design type	Lifestyling is still the most popular structure. 6 of our 8 case studies use a lifestyle structure, the remaining two use target date.	"We're not seeing that much interest in target date, to be honest, target date is lifestyle with a different label, and it's just picking a different date really."
	7. Derisking	The derisking period used is getting longer. The case studies begin to derisk their members on average 16 years before retirement – this varies from 5 to 40 years.	
	8. White labelling	This is growing in popularity. Half our case studies white label their default fund.	
	9. Fund choice	Choice is being limited. In five of the case studies the default fund is one of fewer than three choices presented to members, the other two choices tending to be higher and lower risk variants of the default.	
	10. Funds used	Diversified Growth Funds (DGFs) are built into virtually all Lifestyle structures. Five of the six case studies using Lifestyling use a DGF (or two in one case) in their growth phase.	"DGFs are becoming pretty much the norm now, certainly with our clients."
	11. Active management	Active management is both growing and shrinking. All the case studies use active investment management in some form – usually a DGF – but none employ an active equity fund.	"When it's the company taking the risk in DB they are inclined to go for active equity funds, but when it's members taking the risk they are less willing to take the risk."
Annual cost to members	12. Annual charges	Default fund costs are tending to gravitate to 50bp. The costs borne by members in our case studies varied from 30-76bp, and averaged 50bp. The cost of the default fund covers both investment and administration fees. In most cases the scheme sponsor paid advisory costs itself and did not pass on these costs to members.	"We tend to use as much as we can of higher cost options such as DGFs and play that against passives within a default portfolio. This means you make best use of your risk budget and you get the best return opportunity for a given risk level and cost outlay."
	13. Value vs Cost	Focus is also on outcome rather than price. One case study raised its cost from 33 to 76bp in order to accommodate what it believed to be investment strategies that will bring members a better retirement outcome.	"Yes, I think there is a definite push to lower cost. But the low cost message is a trend that is not good. We want to encourage clients to think about the whole member outcome, and then they can decide whether it's worth the higher cost to members."
Engaging and reviewing	14. Investment reviews	Active supervision of the default fund is now seen as essential. All of the case studies monitor their default fund investments on at least a quarterly, and in some cases monthly basis.	
	15. Communications	Engaging members is seen as a vital element of default design. Case studies refer to the need to simplify the design, to de-jargon it at all levels and to make communications and planning tools available online.	

Design features: 15 default fund design features used and recommended by the case studies

We have highlighted here a selection of those features of the default fund that were specifically identified by our eight case studies as being 'key' to their design, and those elements of which they were most proud. Many of these features, such as the use of increasing diversified growth funds, will not appear to be newsworthy to those who are familiar with the current practices among larger schemes. However others, such as longer derisking periods of up to 40 years, may be more surprising and worthy of further investigation in the case studies themselves at the end.

		Comments by Case Studies
Redesign process	1. Get clear on your investment beliefs	"Getting your fundamental investment beliefs in shape as a Trustee body is vital. Until you do this you can't make any decisions about the default fund."
Default features	2. Use white labelling	"This means we can choose quality managers and then make changes very easily because we don't need to spend large sums of money writing to members about every decision, so we feel much less constrained."
	3. Derisk over a long period	"There is a different balance of funds every year from 40 years before retirement. it is a very long glide path, the point is you can use it to increase or decrease risk."
	4. Use Diversified Growth Funds	"A DGF Fund is introduced to reduce volatility from 20 years out from retirement."
	5. Offer default funds alongside higher and lower risk alternatives in context of risk choice	"We have built a suite of different lifestyle products; Cautious, Balanced and Adventurous. Balanced is the default fund of this suite."
	6. Reduce volatility	"We aim to meet the objective of keeping the volatility lower and therefore not frightening people with huge swings one way or the other in terms of returns."
	7. Think flexibly about the pre-retirement phase	"At the point of retirement there is still some allocation to equities to give members some sort of flexibility around when they might want to annuitise."
Annual cost to members	8. Ensure low costs	"We have arranged the costs and charges to be lower than the equivalent active fund."
Monitoring and reviewing	9. Actively manage risk	"It's not good enough to 'set and forget'. You can't be an absentee, you need to be there."
	10. Keep up to date	"Be open to innovation and ideas about the latest thinking, for example about behavioural economics, or ways of understanding your members, or the latest way of accessing cheaply a wide variety of asset classes."
Communications	11. Give members planning tools	"We have created a tool which allows the risk profiling of the membership and aids their fund selection."
	12. Communicate using nudges	"We have a nudge feature to enable people to be coaxed into new decisions without inundating them with information."
Member features	13. Have straight through processing	"A direct contractual relationship with the administrator means that changes to their fund are effectively done in real time for the member."
	14. Check on retirement dates	"The provider contacts the member about seven years out and checks that the assumptions about when they're retiring are accurate."
	15. Auto-increase contributions	"The scheme automatically steps members up to the maximum contribution rate through each annual salary review."

Design advice: 15 pieces of advice from case studies to schemes yet to redesign their funds

In each interview with the eight case studies we invited them to tell us what they had learned from their long and complex processes that they could pass on to others who still had to complete or start their own journeys. The 15 key pieces of advice below are our selection of these suggestions. More can be found in the case studies in Section 3.

		Comments by Case Studies	Selected views of Investment Consultants
Redesign process	1. The redesign process will take more time than you think	"Don't underestimate the work involved. Start the process early! The time this process takes is not to be underestimated, it takes at least two years."	"The single most important suggestion I can offer is: give yourself time to do it before your staging date."
	2. It requires project management skills	"Understand that this is a complex exercise. It must be approached from a project management perspective with clearly defined timescales to aid coordination between the moving parts."	
	3. Governance matters here	"The redesign is not just about a fund, it's about the way you then monitor it in future, and who does this and how. In other words it's the whole governance thing."	"The design is not just the fund, it's also the funds plus trustee body." "The most value we add in the DC space I think is around giving guidance on governance and why the governance matters."
	4. Build your design first and foremost around member needs	"Spend all of your time, or the vast majority of your time on understanding your members, and try and spend as little time as possible hiring and firing fund managers."	
	5. Don't assume that your Adviser will have all the answers	"Don't assume that an investment consultant is all-knowing and will meet your objectives without guidance. It is important to make your expectations very clear."	
	6. Stand your ground with your suppliers	"If something is really important to you, then be prepared to explain why to the supplier so that they understand, because otherwise you can find yourself just being fitted into 'Well our system doesn't do that' type answers."	
	7. Default fund design in the context of automatic enrolment	"The pensions and investment part of the process, although important, takes only a fraction of the time. Understand that this is primarily a HR and payroll exercise."	

Default features	8. Create a pre-retirement option for members	"Creating an income drawdown option is very important and we're working on how we can build that."	
	9. Consider illiquid investment options for members	"There is definitely a place for illiquid assets in a large default fund. Surely your default investment money is the longest term money that there is, so the fact you don't have daily liquidity is neither here nor there."	"I see no reason in the future why you shouldn't build a DC growth portfolio that looks like a DB."
	10. Consider use of guarantees in default design in future		"I think the guarantee is an interesting one, we haven't seen anyone put it in place or come out to market yet, but particularly in that pre-retirement phase there'll be a lot of value to members in having a guarantee."
	11. Wait till you get bigger then introduce more sophisticated features		"Large clients aren't particularly large yet, you might talk about a large DC scheme being £200 million. But that's still reasonably small in what you can do in the investment space."
Annual cost to members	12. Look at costs, but don't lose sight of value	"There's a lot of focus on cost and cost is very important; but value has to be important as well – and don't ignore value for the sake of cost."	
Engaging and reviewing	13. Don't ignore the future	"Think very carefully about the flexibility for the future and how that is going to be incorporated in what you offer, not only in how you manage the overall product but in terms of how the pension generally is combined with other reward structures."	
Communications	14. Communication with members is a vital aspect of the redesign	"It's important to be open and transparent with the membership about the rationale behind decisions, especially when increases in cost are involved."	"I think if you're going to change something as big as the default then you should spend a huge amount of time on the communication because it's no good making it great, if members don't then understand what you've done."
	15. Members will want to be informed, don't assume they are not interested	"Don't overestimate the appetite of the members for information."	

3) Case Studies

Atkins

Type of scheme:	Trust-based
Number of DC members:	15,000 members, 7,500 active members
Assets in the DC fund:	£270 million
Company overview:	Atkins is one of the world's leading design, engineering and project management consultancies.
Pension overview:	Entirely DB until 2000 when a DC section was set up within the trust. Between 2007 and 2009 DB ceased accrual and all employees were moved across to trust-based DC.

Past Default Arrangement

The previous default fund used a 50/50 Global/UK equity fund for the growth phase, with derisking over five years that brought in a bond fund and a cash fund.

Call to action

One of the calls to action was the realisation that approximately 90% of the members, and roughly 85% of the assets, were in the default. This concentration in the default fund caused the trustees to reassess whether the default fund was truly fit for purpose.

New Default Arrangement

Investment consultant: Towers Watson
Platform provider: Friends Life
Administrator: Friends Life

Structure of default: The default is a lifestyle fund but with a very long glide path that begins 40 years out from retirement. The fund is constructed using 5 building blocks; an adventurous investments fund, a balanced investments fund, a cautious investments fund, a consolidation investments fund and a cash investment fund. These are not themselves single funds but built from a number of underlying funds.

Core funds: 53% is DGF split across two diversified growth funds for those in the growth phase.

Cost: Varies (76bps AMC for default) The company pays all advisory fees.

"We've gone from a default of 33 basis points, to a default of 76 basis points…it's about the added value; the difference between the performance and the charge."

Key features

1. **White labelling** means the Trustee can choose quality managers and then make changes very easily because they don't need to spend large sums of money writing to members and confusing them about every decision. As a result they feel much less constrained.
2. **The nudge feature** is designed to enable people to be coaxed into new decisions without inundating them with information.
3. **The lifetime journeys** offering a holistic approach so people can have something that's relevant across their career.

Default improvements

The default is now a holistic journey which provides an investment path that's relevant to members across their whole career.

The quantity of information provided to the member is controlled, they only provide a fairly minimal amount of information but there's lots more available if desired.

"We estimated at the start that the redesign process would cost the average member 33 basis points. At the end we were able to tell them that it had actually cost them on average 27 basis points."

Governance Bodies

The Atkins trustee board did not wish to overstretch its resources. As a result the Trustee looked very carefully at where active management would add value within their investment portfolio and focused their attention there.

Timeline

This was a three-year process for the Trustee. The formation of investment beliefs began in 2009 and lasted until early 2010. The process finished in 2012.

The Trustee worked very closely with the sponsor and received financial and practical support from the company throughout the process. The issues surrounding DC pensions go well beyond the remit and capabilities of a trustee requiring a fully 'joined up' solution to be delivered by the sponsor and the Trustee (members don't understand or care about the difference).

Making the change

The first step was establishing the Trustees' core beliefs. That was by going through a guided workshop exercise where the advisers probed with questions to come up with a document that summarised beliefs.

The next thing was to conduct member segmentation to understand what the membership looked like and what their needs might be. This included an analysis of the age distribution, salary distribution, and attitudes to risk, especially in relation to age and DB pension entitlement.

The Trustee then looked at member outcomes, investment options and the underlying levels of risk associated with them. This led to them looking at diversification and the potential for DGFs as a vehicle for diversification.

Monitoring

Suppliers
The monitoring process is still just starting to evolve. Currently there is a one day per year meeting when the active managers are brought in and do face-to-face presentations. They've also been developing with Towers a monitoring process which is based on short quarterly reports, with the six monthly and annual reports being bigger and more in-depth.

Outcomes
Each year Atkins ask their membership if they wish to increase their contributions. The level of uptake had remained steady for the last 4-5 years. Since the change in the DC arrangement the uptake has doubled.

Communication and Tools

The previous approach assumed that as Atkins had a highly intelligent workforce of technologists they could give them lots of information and offer a lot of choice. This 'fell flat on its face'.

The focus of the new default communications strategy is to very carefully manage how much information is sent to members. "We're keeping the amount of information we send pretty light." It is critical that this approach dovetails with encouraging the membership to find more information out should they desire it and making that as easy as possible for them to do so.

"The whole point of having an active manager is that you've got a real need to deliver something, you've therefore got to be confident that it's delivering and you need to be on your toes ready to move if it isn't."

Lessons learned

1. Don't underestimate the work involved.
2. Don't overestimate the appetite of the members for information. Providing appropriate information, in the correct context and at the right time, is key. This needs to be tailored to the members' needs and therefore it is unlikely that insurance company's standard information will fit the bill.
3. It's important to be open and transparent with the membership about the rationale behind any decisions to change the scheme, especially when increases in cost are involved.

Bank of America

Type of scheme:	**Trust-based**
Number of DC members:	**12,200 members, 5,000 active members**
Assets in the DC fund:	**£586 million (£76 million DB)**
Company overview:	**Bank of America is one of the world's largest financial institutions. Its UK operations are based in London and Chester.**
Pension overview:	**Bank of America had DB accrual up until 1990. It was amongst the first of the big companies in the UK to go from DB to DC.**

Past Default Arrangement

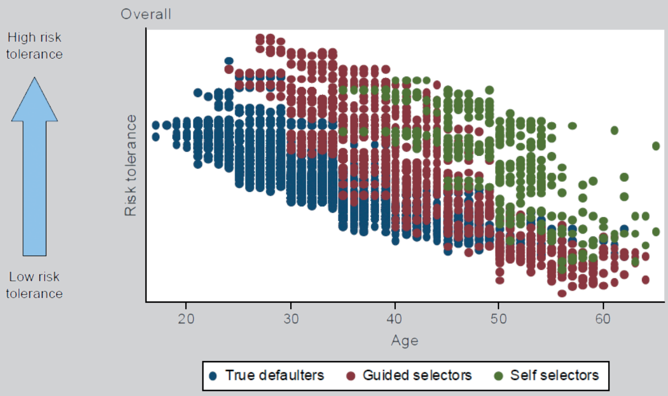
Bank of America (BoA) had more than 40 funds on its platform, many of which were no longer open to any future investment. This gave rise to the problems (and costs) of requiring members to disinvest and reinvest. This was also very difficult for the Investment Manager to monitor.

"We want to be a leading player, not followers. We want members to be thinking 'Whatever else, I am a member of a top class retirement plan and looking forward to my retirement.'"

Key features

1. **White Labelling** allows the investment subcommittee of the trustee board to make decisions and change the underlying fund managers as required which gives greater flexibility.
2. **Automated Straight Through Processing (STP)** between the administrator, the platform provider and fund manager reduces the risk of errors in the investment and disinvestment process.
3. **Online** The online focus for all communication with members allows them to action their changes in real time.

Distribution of member risk profiles by age



Call to action

A major prompt to change the DC arrangement came when BoA experienced losses in a cash fund from non-cash investments which the trustees hadn't been aware of. This prompted a re-evaluation of their DC approach and the first action was to appoint Towers Watson as replacement to their investment consultant.

New Default Arrangement

Investment consultant: Towers Watson
Platform provider: Fidelity
Administrator: Capita

Structure of default: BoA built a suite of different lifestyle products; Cautious, Balanced and Adventurous. Balanced is the default lifestyle approach. It is a graduated lifestyle fund with a combination of DGFs, equities and corporate bonds in the growth phase.

Core funds: A selection of equity funds (both passive and active), a DGF option (with two underlying managers) and property, bonds and cash.

Cost: 85% of assets are in funds which charge less than 35bps, with the rest in active funds and DGFs charging a maximum of 95bps.

Default improvements

1. Significantly increased member engagement.
2. A much clearer presentation to members of outcomes. The trustees believe that members have a greater understanding of what their pension could be in retirement.
3. The processes are real time. A member pushes a button, they get informed it's happening, and they get something back the following day.
4. Instead of having a classic ten years out when you start derisking, they start at 25 years out. The options meet the members' needs and a longer derisking period avoids unexpected reductions as members approach retirement.

Governance Bodies

The scheme has a trustee board which BoA put a lot of focus on. They felt that in workplace DC it is the strength of the trustee board and the controls that they put in place that provides the covenant to the member.

In addition to the board of trustees there is an investment sub-committee who are very actively involved and an audit and administration sub-committee.

Timeline

The process began in 2009, was pursued in earnest in 2010 and went live in 2011. There were formal quarterly meetings but there were full time dedicated staff working on this every day of the week, reporting to an implementation sub-committee of the trustee board.

Making the change

"We asked Towers Watson to investigate where our members are based, their age, income and their appetite towards risk. This is where you start to create straw men, and that really helped us to design lifestyle options and the default fund. We got to the idea of the risk tolerant based default from this."

The analysis revealed there were self selectors, guided selectors and true defaulters. The plan was to provide enough information to members so they would be confident about becoming guided or self selectors. This plan succeeded with the default fund (the Balanced fund) actually containing fewer members than the Growth fund.

Another important step was the selection of the platform provider. The trustees felt that it was important they saw the investment platform work in practice in a STP environment, so made site visits to each of the prospective platform providers' back offices.

Monitoring

Investment
There is a meeting every quarter where investment performance is reviewed. Unit prices are updated daily so members are able to get up to date values at all times. More regular investment performance reporting will be introduced in due course. There is already in place a process to flag any concerns.

Members
Capita monitor the decisions of the members and ensure members are alerted and aware if they are moving to riskier investments than they are currently in.

Communication and Tools

The trustees decided that whilst hard copy documents could be required they should be avoided. Passwords were sent to smartphones via text, QR codes were used to provide a link between any paperwork and online guidance. This focus on online communication came hand in hand with the desire for real time control.

"We changed the terminology: it's not a pension, it's planning for retirement."

"Underlying this whole change process was a group of good trustees looking after the governance of the plan so that the members receive what they are looking forward to in retirement."

Lessons learned

The success BoA and the trustees have had in moving members from passively choosing the default fund and making an active choice from amongst the lifestyle and self select funds is testament to the power of good design and communications and active involvement of the trustees.

Heineken

Type of scheme:	**Contract based GPP**
Number of DC members:	**2,100**
Assets in the DC fund:	**£27 million**
Company overview:	**Heineken UK is the country's leading cider and beer producer. Heineken International is a Netherlands based brewing company with over 125 breweries in more than 70 countries.**
Pension overview:	**Heineken has a closed £2.6bn DB plan with 41,000 members. Their DC scheme, the Heineken UK Flexible Retirement Plan, is the scheme for all future pension provision.**

Past Default Arrangement

This is the first DC scheme Heineken has set up since its move from DB.

Call to action

Heineken closed its DB plan to future accrual in July 2011 and set up its contract-based DC offering as part of the same consultation. Sustainability was a key focus, with future-proofing for automatic enrolment an important sub-goal.

"Corporate social responsibility and engaging with colleagues in an appropriate way is at the heart of the organisation."

New Default Arrangement

Investment consultant: KPMG
Platform provider: Standard Life
Administrator: Standard Life (bundled platform)

Structure of default: Heineken offers three main lifestyle fund choices; balanced, opportunity and aggressive. Balanced is the default fund. De-risking into cash and fixed income begins 10 years out of retirement. 50% of the growth assets are in a passive 50/50 global equity fund (of which 50% is UK, while the rest is split equally between Europe ex UK, Pacific ex Japan and Japan), 30% in a DGF and 20% in an active corporate bond fund.

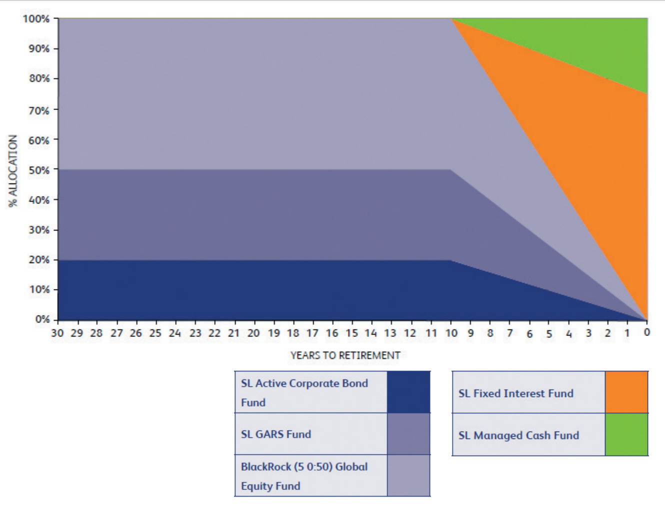
Cost: Growth element AMC is 45bps and TER is 56bps.

The company meets all of the advice costs.

Key features

1. **'Implied consent'** to switch managers, asset allocation or glide path using white labelling of all the core funds, not just the default. This incurs a cost, but the flexibility and governance it brings is deemed commensurate.
2. The scheme **automatically steps members** up to the maximum contribution rate over three years, with step ups coinciding with annual salary reviews
3. The provision of **a tool which explains the concept of risk appetite** is used to aid the membership's fund selection.

Lifestyling structure



Default improvements

The approach to governance and engagement with the members is actively considered. Heineken's fund monitoring takes a broader view and considers purchasing power which is more meaningful than simply the investment return. The committee has spent a lot of time considering how to communicate with the membership. Fund security and pricing have also been reviewed.

Governance Bodies

The DC governance committee looks after the lifestyle profile and core fund range, and reviews the provider's performance. The committee has a member-nominated representative as well as an independent member.

A project was put in place to select the provider, which included representatives from pensions, payroll, procurement, the Heineken employee council and the company's advisers, KPMG.

Timeline

The review of DB began in late 2009 and Heineken worked for the best part of a year looking at options. Preparatory work for consultation took place over the second half of 2010 and the consultation to move to DC began in January 2011. At that point there had already been a lot of thought put in to scheme design and provider selection. Then there was a three-month consultation, with the final position agreed in April. This left three months to finesse the communications and launch DC in July 2011.

Making the change

The first stage was selecting the provider. Heineken put an RFP out to 12 providers, which was whittled down to three. These three presented to Heineken and it was a very close call so follow-up site visits were also required.

The selection of the default was made using a combination of qualitative and quantitative information. There was modelling of expected return and volatility but also a lot of qualitative consideration of the funds including how they compared as a full fund range.

Heineken repeatedly road tested its communications before launch, with a sounding board of colleagues. Each iteration led to clarification of the key messages. Investment in particular was a key focus of the testing.

Monitoring

Suppliers
KPMG work with Standard Life to produce quarterly monitoring reports. This includes an update of how fund investment performance has tied into purchasing power i.e. consideration is given to inflation and changes in annuity costs.

Outcomes
Outcomes are key, so Heineken also looks annually at member behaviour. The aim is not to second guess members' requirements but to seek to identify any areas where further communication or support may be appropriate i.e. are members investing 1/100 across one hundred funds, are younger members notably conservatively invested or are those near retirement still in highly volatile funds.

Communication and Tools

"For face-to-face road shows we tested the delivery of our whole presentation but the investment in particular had to be adapted three times before it went out and every single time we took information out. The key was to simplify, simplify, simplify."

"Whilst there is a small explicit cost for the white labelling, that is fundamental to the implied consent structure. It was really striking how much the membership valued this feature. They like the idea that there's someone whose day job it is to look at the funds."

Lessons learned

1. The detail of automatic enrolment, especially with regard to payroll timing, was very complex. It's predominantly a payroll project but until you've gone through it you don't fully realise the extent to which that is true.

2. It is important to be really explicit with your suppliers around what you require for your members, and it's worth persevering for what you want even if the initial response is 'Our system doesn't work like that'.

3. Heineken considered a NEST-style foundation section to their lifestyle funds, where for the first two or three years there is less risk to build a base of assets at the design stage. It proved too difficult to structure that into the default because most providers' systems only allow for phasing towards retirement, not at outset.

Molson Coors

Type of scheme:	**Contract based GPP**
Number of DC members:	**~1,900**
Assets in the DC fund:	**£40 million**
Company overview:	**The Molson Coors Brewing Company was formed by a merger of Coors Brewers and Molson in 2005 and is the world's seventh-largest brewer by volume.**
Pension overview:	**Molson Coors have a large closed DB scheme with circa 17,000 members. The business has since grown smaller in terms of headcount and now has about 2,000 employees in the UK, now entirely in DC.**

Past Default Arrangement

The existing default fund was a pure global equity stocks and shares fund with BlackRock. The main fund for the growth phase was the BlackRock Aquila Global Equity 50/50 with a lifestyle that moved into a pre-retirement fund in cash 6-7 years before retirement.

Call to action

Planning for automatic enrolment led to an evaluation of the workforce and the recommendation of a new default.

New Default Arrangement

Investment consultant: Mercer
Platform provider: Mercer Workplace Savings/ Friends Life
Administrator: Friends Life

Structure of default: Lifestyle fund with a tailored derisking phase which can begin from 5 years out with a reduction in equity exposure and the introduction of gilts and cash (tailored to annuity purchase or drawdown).

Core funds: In the growth phase of the default fund the asset allocation is actively managed. In normal market conditions there is a target allocation of 50% to Mercer's DGF with the rest in BlackRock equity funds. The allocation at the time of writing was 37% UK, 13% global equities.

Cost: AMC is ~43bps, with a platform levy of 8bps.

"I'm a passionate believer that having an actively managed default fund is the way to go because somebody is consciously making those decisions."

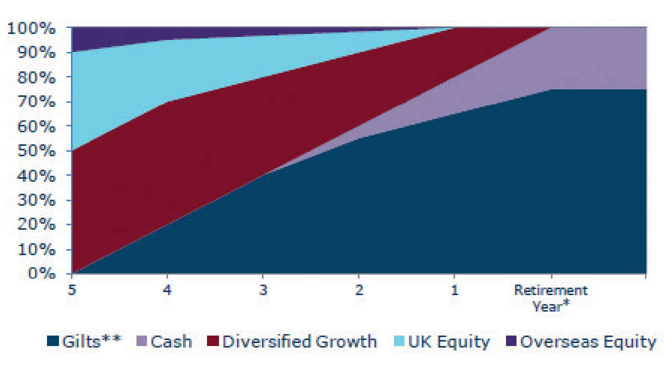
Key features

1. Friends Life will **contact the member** about 6 years out and check that the assumptions about when they're retiring are accurate. The member may alert the provider that in fact they wish to retire sooner or later than they initially stated or that they wish to target income drawdown rather than annuity purchase.
2. Around the default fund there is still the traditional flexibility of self-selecting but there's a middle ground where **members can exert some control** over the level of investment risk without going it alone.

Default improvements

Molson Coors believe that having a default fund with actively managed asset allocation is the way to go because that way somebody is consciously making allocation decisions on behalf of the members.

Lifestyling structure



Governance Bodies

Molson Coors have a DC governance committee which is Advisory and receives all the advice. They issue a recommendation report to the Board but then the UK company Board makes the final call.

Timeline

Work evaluating the risk profile of the membership began around the end of 2011. In June/July 2012 the existing consultant advised a bespoke default fund with Prudential (the platform provider at the time). Molson Coors then made the decision to go with Mercer just before Christmas 2012 and then staged in 2013.

Making the change

Towers Watson conducted a study of the Molson Coors workforce which included member segmentation of risk appetites.

The next stage in the process was conducting a mini-tender for an investment Adviser. The end result was a move from Towers Watson to Mercer.

Molson Coors selected Mercer's Workplace Savings Solution as they felt it was the right product and much better value than a bespoke option they had been offered before.

Monitoring

Suppliers
Mercer effectively are the fund manager for the fund and they have discretion to change the underlying fund managers if they wish.

Molson Coors reserve the right to bring in a third party Adviser to conduct a light touch review and benchmarking exercise to evaluate the Mercer set-up against the market on a rolling 3 or 5 year basis.

Outcomes
Molson Coors conduct an annual employee survey across the business. A section of this is very benefits-focused.

Communication and Tools

In the past there was no real ongoing education for the DC members, with the company still wrapped in a DB world. So they have tried to put in place a much more consistent long range education support programme to accompany the new scheme. The aim is to empower members. They're telling members that this is Defined Contribution and they have a responsibility, but that Molson Coors is there to help them with support and tools.

"I think if we'd started a year or six months earlier a lot of things might have been done differently."

Lessons learned

1. Don't ever underestimate how much time it takes to get a decision out of people.
2. Don't be afraid to really challenge your Advisers.
3. With more time and unlimited budget they would have liked to have conducted a wider market review, with more regular monitoring. But overall they are very happy with the end product.

National Employment Savings Trust (NEST)

Type of scheme: Multi-employer master trust

Number of DC members: 400,000

Assets in the DC fund: £20 million

Company overview: NEST was created as part of the Government's workplace pension reforms to help employers meet their new responsibilities under automatic enrolment.

Challenges of scale

In traditional Lifestyling an individual would be switching in and out of funds as they approach retirement. With millions of members these switches create a significant cost. With a target date fund you get rid of these millions of switches and change it to hundreds of switches which with millions of people can save a lot of money in reduced trading and transaction costs.

"It's not just about the destination, the journey is important."

Key features

1. **Active risk management.** It's not good enough to 'set and forget'. You can't be absentee, you need to be there.
2. **Getting your fundamental investment beliefs in shape** is vital. Until you do this you can't make any suitable decisions about the default fund.
3. **Be open to innovation** and ideas about the latest thinking and market developments, for example about behavioural economics and ways of better understanding your members, or the latest way of accessing cheaply a wide variety of asset classes and risk premia.

Call to action

The Pensions Act 2008 established new duties on employers. These duties mean that for the first time employers will have to enrol their workers into a qualifying workplace pension scheme. To ensure that every employer could access a suitable scheme NEST was established.

New Default Arrangement

Structure of default: NEST uses a target date fund structure. Its default has three phases: Foundation, Growth, and Consolidation.

The Foundation phase aims to beat the rising cost of living but minimises the chance of losses.

The Growth phase aims to grow pots much faster than the cost of living and takes on more managed risk.

The Consolidation phase begins about 10 years out from retirement and focuses on preparing for retirement whilst maintaining investment growth above the cost of living.

Core funds: Equities through a UBS equity tracker fund. A DGF through Blackrock's Aquila Life Market Advantage Fund. Then SSgA's bond index funds, an RLAM corporate bond fund, LGIM hybrid property fund and a BlackRock cash fund.

Cost: 30bps AMC with a 1.8% contribution charge.

NEST's trustees' investment beliefs

Belief 1: 'Understanding scheme members, characteristics, circumstances and attitudes is essential to developing and maintaining an appropriate investment strategy.'

Belief 2: 'Taking investment risk is usually rewarded in the long term.'

Belief 3: 'Diversification is the key tool for managing risk and return.'

Belief 4: 'That as long-term investors, incorporating environmental, social and governance factors in the investment process is in the best interests of our members.'

Belief 5: 'Risk-derived asset allocation is the biggest determinant of long-term performance.'

Belief 6: 'Passive management where available generally delivers better value for money than active security selection.'

Belief 7: 'Analysis of both economic conditions and market regimes should be used to drive strategic decisions.'

Governance Bodies

The Trustee is the main governing body, which delegates much of the strategic delivery to an investment committee. They now meet quarterly but at the outset of developing the scheme they were meeting almost monthly to get through the quantity of member information and to develop their investment beliefs, fund objectives and investment strategy.

Timeline

Consultation with the industry, employers, member representative groups, international peers and finance academia began in 2009. Trustees arrived in July 2010 to have at least a year of managing money before automatic enrolment began. The fund manager selections began in 2010 and the first managers were appointed in January 2011. The process of procuring new managers is ongoing. NEST started investing money for the first time in July 2011.

Making the change

The process began with a consultation exercise with industry bodies including international peers in 2009. This pointed to areas where additional research into likely member behaviour, for example, was required.

The trustees gathered for the first time in 2010 to create their statement of investment principles. To do this the trustees spent time in a series of workshops developing investment objectives and investment beliefs.

Once these were in place, the trustees agreed that there should be different phases of risk profiles, and that age was a reasonable proxy for doing this. Individual lifestyling was seen as uneconomic and inefficient so the target date fund concept was arrived at.

Monitoring

Suppliers
The Investment Committee have agreed a risk map which is a series of 12 different high level risk indicators that are focused on metrics like economic, liquidity and inflation risk. Once a month the Executive will look at all of the data available and determine the risk environment. A traffic light system indicating the various elements of the risk environment helps the executive and the Investment Committee in determining how much of the risk budget should be used and how this impacts the asset allocation.

Outcomes
NEST wants to get away from focusing on short run investment returns, because they drive poor decision-making. Instead they're interested in looking at a fuller picture of risk-adjusted returns, including measures such as VaR, drawdown and efficiency ratios. The challenge in their asset allocation decisions is about getting close to the efficient frontier by taking enough rewarded risk to beat their return objectives. All of this must be done in a cost-effective way.

"The big advantage that small schemes will have is that they should have a better knowledge of their membership, particularly if it's a single employer scheme."

Communication and Tools

One of the challenging revelations that NEST found in their research was that they should try and move away from traditional approaches for communicating investment and risk – indeed their research has suggested that using the words 'investment' and 'risk' is immediately off-putting for most who will be saving through automatic enrolment. Most new savers when asked are unfamiliar with many investment and pension concepts, though fundamentally what they want to know is intrinsically linked to investment performance.

The three main things that people are interested in when asked about their DC pensions are 'What do you do with my money?', 'Is it safe?' and 'What will I get at the end?' Answering these questions in a more meaningful way are the things that NEST focus on in their member communications.

Lessons learned

Spend a lot of your time on understanding your members, what you're trying to achieve, what you think about the way financial markets and global capital work.

Spend less of your time quizzing your fund managers about their performance over the last quarter. Try and spend as little time as possible hiring and firing fund managers and instead focus on delivering the right kind of performance to meet your members' needs, not what any benchmark or other provider is doing.

Pensions Trust

Pension Quality Mark READY

Type of scheme:	**Multi-Employer Master Trust**
Number of DC members:	**40,500**
Assets in the DC fund:	**£500 million**
Company overview:	**Pensions Trust is a provider of pension solutions to not-for-profit organisations.**
Pension overview:	**Pensions Trust has a large core DB business and wants to continue to be a relevant provider of pension solutions to those organisations as they are required to auto-enrol and are likely to move into DC.**

Past Default Arrangement

The past arrangement used to combine DB and DC assets together in a unitised relationship. The growth phase used a broadly equity allocation moving to 25% cash and 75% index-linked gilts in the last five years leading up to retirement. Previously Pensions Trust were charging 60bps for the core DC product and were administering it in-house.

“We’ve built on a wealth of experience, we’ve been running DC schemes for 25 years now.”

Key features

1. **The focus is on the default.** This isn’t a low cost, back up option, it’s what Pensions Trust feel is the best option.
2. Even at the point of retirement **there is some allocation to equities** to give members some sort of flexibility around when they might want to annuitise.
3. Over time there will be less and less distinction between the ethical target date funds and the standard target date funds. **Pensions Trust is committed to bringing responsible investing as a principle** right to the heart of everything they do.

“The target date fund structure can be used to do just the same things as a lifestyle. But if you are keen to introduce new investment ideas and techniques as they become available, and have a large number of members and schemes, it is much easier to do that in a target date fund structure.”

Call to action

It was increasingly clear that DC was the future of pensions in the UK and therefore Pensions Trust needed a credible DC offering. This was developed with the market for automatic enrolment in mind, as well as what Pensions Trust felt was an attractive product for their target market.

New Default Arrangement

Investment consultant: Mercer (in part)
Platform provider: Alliance Bernstein
Administrator: JLT

Structure of default: The default is structured through target date funds which are operated in three-year batches. The investment that is underlying this is largely equities in the growth stage, followed by a de-risking path from five years out from retirement.

Core funds: Global equities fund, a diversified growth fund, a pre-retirement fixed income fund and a cash fund.

Cost: The overall charge is 45bps, and that includes investment and admin for the standard default funds.

Default improvements

A target date fund structure offers a number of benefits to the Pensions Trust. Given the large number of members spread across a large number of employers flexibility and the ability to deliver at scale were key to the design. Pensions Trust felt that a target date fund structure made sense as it is flexible enough to incorporate new ways of doing things and new investment methodologies as they come about.

Governance Bodies

Pensions Trust have a Board of Trustees that, to a certain extent, act more like the Non-executive Board of a pensions company rather than a traditional pension scheme Board of Trustees. The Executive is largely responsible for developing strategy and then the Board discuss and approve the strategy. The Board is 50% elected from members and 50% elected by the employers, with two co-optees on top of that.

Timeline

The Pensions Trust began looking at their DC arrangement in 2011 and the Smarter Pensions platform, which now holds all of their DC schemes, went live in the first quarter of 2013.

Making the change

A number of workshops were held to decide what the structure of the DC product and the default offering should look like.

These decisions needed to be made within constraints on cost. There was an eye on the competitive environment for employers approaching automatic enrolment which couldn't be forgotten.

Time was another important constraint for this process. The staging dates of some of their biggest employer members was a clear deadline to meet.

Monitoring

Outcomes
The focus is not placed on annual performance but outcomes. Pensions Trust have aspirations about how they might monitor member outcomes in future once they are able to build enough scale. A five year plan is in place detailing refinements for monitoring outcomes. This includes ideas around how monitoring the investment ties into the expectations of retirement income for members.

Communication and Tools

The first goal is getting employers engaged and then cascading information down to the membership, working in conjunction with the employers.

From an employer's point of view the communication is largely online, with lots of guidance. It uses straight-through processing so they can update things 24 hours a day.

From the member perspective it's designed to be very user-friendly. There is a lot of member engagement online, with excellent communication to help them understand. However, Pensions Trust are clear that they don't expect members to have to make complicated investment choices.

"We changed the terminology: it's not a pension it's planning for retirement."

Lessons learned

1. There's a lot of focus on cost and, whilst cost is very important, value has to be important as well. Don't ignore value for the sake of cost.

2. Don't ignore the future. Think very carefully about the flexibility for the future and how that is going to be incorporated in what you offer – not only in how you manage the overall product but in terms of how the pension can be combined with other reward structures.

"There's a lot of focus on cost... don't ignore value for the sake of cost."

Trinity Mirror

Type of scheme:	**Trust-based**
Number of DC members:	**3,700 members in the existing original or enhanced sections, and 1,100 eligible for the foundation section**
Assets in the DC fund:	**£73 million**
Company overview:	**Trinity Mirror is one of the largest multimedia publishers in the UK. It has over 5,000 team members in over 60 locations nationwide.**
Pension overview:	**The bulk of Trinity Mirror's DC assets are in their existing DC section which has a lifestyle default called Lifestyle 7. The foundation section is new and has its own default fund, the Lifestyle 5 fund.**

Past Default Arrangement

The previous default fund's growth component was 100% equity focused and was invested 50% in UK equities and 50% overseas.

Call to action

At the point the DB schemes closed to future accrual there were probably only 600 active DC members, this increased to about 3,500 in 2-3 months. Automatic enrolment prompted another review for the new foundation section of the membership.

"Lifestyle 5 meets the objective of keeping the volatility lower and therefore not frightening people by huge swings one way or the other in terms of returns."

New Default Arrangement

Investment consultant: Towers Watson
Platform provider: Fidelity
Administrator: Fidelity (bundled platform)

Structure of default: The default fund for the original and enhanced sections is known as the Lifestyle 7 fund. It begins derisking seven years from retirement. The default fund for the foundation section of the membership is known as Lifestyle 5. Five years out, there is a linear drop to 75% bonds and 25% cash at the point of retirement.

Core funds: Lifestyle 7 uses a BlackRock 70/30 overseas/UK equity fund which is currency hedged as its growth assets. The growth assets for Lifestyle 5 are 100% allocated to a BlackRock ALMA passive DGF.

Cost: Lifestyle 7 TER = 30bps. Lifestyle 5 TER = 50bps.

Key features

1. Both the Lifestyle 5 and Lifestyle 7 funds rely on passive management of the underlying investments.
2. For Lifestyle 5 the costs and charges are lower than the equivalent active fund.
3. We think – and we can only say 'think' because we don't know at this stage – it will meet the objective of keeping the volatility lower and therefore not frightening people with huge swings one way or the other in terms of returns.

Default improvements

1. Within the Lifestyle 7 the global equities fund is now currency hedged and more global (70:30 vs. 50:50).
2. Trinity Mirror learned from behavioural finance research conducted by NEST and introduced the use of the DGF fund in their Lifestyle 5 for the foundation section. This fund should bring lower volatility and avoid the big swings.

"We considered DGFs for the default fund, but the 95bps that we would have to pay for most of them was too much, far, far too much."

NAPF
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Governance Bodies

Following the closure of the DB schemes in 2003, Trinity Mirror could have made the decision to go contract-based. However the company decided that the trustee model suited them and the way they work. Instead, in 2010, when the DB schemes closed to future accrual, the board of trustees was expanded and an independent chairman appointed.

Timeline

Trinity Mirror began looking at their DC arrangement in October 2010. This was pursued with more earnest in 2011 including a salary sacrifice exercise and an analysis of the workforce into different categories. Once the staging date was known there was more haste and a steering group was set up in April 2012. The HR and payroll administration group was set up in July 2012 with a lot of hard work undertaken between then and the May 2013 staging date.

Making the change

For the Lifestyle 7 fund the first decision was to focus on the underlying funds rather than the structure of the default arrangement. The vast majority of the assets would be in the BlackRock 70/30 fund so understanding that was key.

The Trustees probably spent a year to 18 months really understanding the 70/30 fund and getting to know exactly what it was, exactly how it operates (especially the currency hedge) and meeting BlackRock and the people that would manage the money.

A big stage in the establishment of the Lifestyle 5 fund was the selection of the right DGF. Balancing the additional cost with the objectives of the plan made selecting the right fund critical. Trinity Mirror and the trustee felt the BlackRock fund had the right balance.

Monitoring

Suppliers
Trinity Mirror will monitor and benchmark the fund investment performance. Lifestyle 5 uses a LIBOR plus benchmark for the ALMA fund. Lifestyle 7 looks at an all-world index for its 70 global part and then FTSE for the UK component.

Outcomes
There is a segmentation exercise planned which will analyse which section the membership are in, what age they are, how much they're contributing, how much they've accrued, and where the money is going. It will also split out the regional hubs of the membership, as well as by job function.

Communication and Tools

The communications are sourced from Fidelity which offer a one-size-fits-all. They use the standard communications with some tweaks for their needs. It saves doing a lot of work and the need for a workforce managing system.

"It's hard for trustees to get under the skin of some DGFs if you describe them by saying: 'this week it has 40% in equities, but next week it might have 2%.'"

"Anybody in the pensions world that thinks that this (automatic enrolment) is a pensions exercise can forget it. It's an HR and a payroll and admin processing exercise."

Lessons learned

1. Understand that automatic enrolment is primarily a HR and payroll exercise. The pensions and investment part of the process, although important, takes only a fraction of the time. It is therefore essential to get a good payroll manager and a good HR manager who understand what it takes.
2. Start the process early! The time this exercise takes should not be underestimated, it takes at least two years.

Warburtons Pension Scheme

Type of scheme:	**Trust-based**
Number of DC members:	**5,700 members, 4,500 active members**
Assets in the DC fund:	**£40.4 million**
Company overview	**Warburtons is the largest bakery in the UK operating 12 bakeries and 14 depots with over 4,500 employees.**
Pension overview	**Warburtons has a DB scheme which has been closed to future accrual since 2011. They have reviewed their DC schemes twice recently, once in 2010 prior to the closure of the DB scheme and once in 2012 ahead of automatic enrolment.**

Past Default Arrangement

The previous default fund was a lifestyle fund which included a global equity fund, a bond fund, a multi-asset growth fund and a cash fund.

Call to action

With 1,800 more members poised for automatic enrolment Warburtons wanted to conduct a review of the existing fund platform and default arrangement and check it was fit for purpose. They also wanted to simplify the fund structure by introducing white labelling.

"The review began in July 2012 and needed to be complete by the 1 November, It was quite a tight window of opportunity ahead of automatic enrolment."

New Default Arrangement

Investment consultant: KPMG
Platform provider: Fidelity
Administrator: Fidelity (bundled platform)

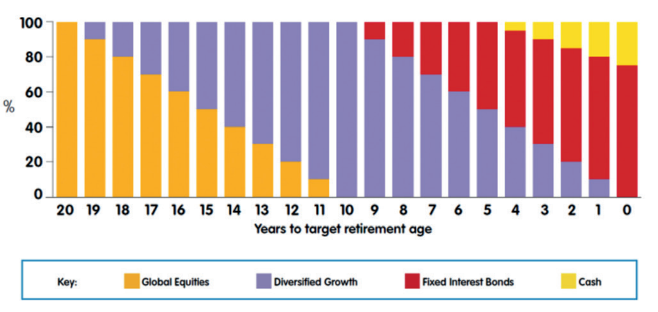
Structure of default: Warburtons decided to stick with a Lifestyle structure as their default fund but introduced DGF to better manage the risk associated with the growth phase. The growth phase of the fund begins with a global equity allocation which then steadily moves into a diversified growth fund when 20 years out from retirement. 10 years from retirement the fund begins to allocate assets to a fixed income fund and then allocates to a cash fund when 4 years from retirement.

Core funds: Global equities fund, a diversified growth fund, a pre-retirement fixed income fund and a cash fund.

Key features

1. The **allocation to the core funds** is changed every 6 months from 20 years out from retirement.
2. **A DGF fund** is introduced to reduce volatility from 20 years out from retirement.
3. There are now **two clear options** for the members: a 20-year lifecycle fund and a 15-year lifecycle fund.

Lifestyling structure



Default improvements

1. The global equities fund is now currency hedged and more global (30:70 UK: Global vs 50:50).
2. The DGF fund is now a 'true DGF' with a more diverse range of asset classes.
3. White labelling brings more flexibility to change the underlying funds and aids members understanding.

Governance Bodies

Warburtons has one trustee board which oversees both the DB and DC sections of the plan. This board was responsible for overseeing the selection of the default structure. It was assisted by a subcommittee which was involved in the selection of the core funds.

Timeline

Warburtons had undertaken some major projects to aid the move from DB to DC. Further work then began in summer 2012 in preparation for automatic enrolment. The decisions from this second review were implemented in November 2012 ahead of the staging date in May.

Making the change

The first step was for Warburtons to review its third party Adviser and a decision was made to appoint a dedicated DC consultant to the DC plan.

The result of this process was the appointment of KPMG as its DC investment consultant. KPMG were then heavily involved in the design process and selection of the funds.

The selection of the DGF manager was an involved process which included meeting three prominent DGF providers and rating them on a number of criteria including the investment approach, the team, performance, amongst others.

Monitoring

Suppliers
The DC provider, in this instance Fidelity, is reviewed on an annual basis. Ongoing monitoring of the investment performance is conducted on a quarterly basis with KPMG providing a detailed report on a number of aspects of performance.

Outcomes
KPMG have introduced a new performance report which focuses on the impact on members' pensions. This report focuses on the member outcome and on how the last quarter's performance has impacted the average member retirement pot, and therefore retirement income.

Communication and Tools

"Communications can be a challenge for us because we've got a lot of members split across 26 sites. And 80% of our members don't have access to a computer at work."

Warburtons created two 'bitesize' booklets; *The Pensions Guide* and the *Investing Made Easy Guide* to aid their communications to their members.

Warburtons worked hard to take out all of the jargon where they could and tried to simplify things. They also introduced lots of pictures and lots of graphics to avoid using lots of words.

"Make sure you have clear objectives for the review and work with a dedicated consultant who understands DC investments to ensure the best outcome for your members."

Lessons learned

1. Understand that this is a complex and time-consuming exercise. It must be approached from a project management perspective with clearly defined timescales to aid coordination between those involved.
2. We were constrained in what we wanted to do on the design of the funds due to capacity problems with our pension provider ahead of AE. Engage with them early to ensure they can accommodate changes to the investment funds.

4) Concluding Remarks

For many of the schemes we spoke to, the work they have carried out so far to review their default fund design is a not only a major step but part of an on-going process. Active governance of the default, on behalf of scheme members, is seen as essential. The introduction of automatic enrolment last October has focused minds both on the need to protect disengaged savers, and the need to demonstrate that due diligence has been carried out around the design and suitability of the default fund.

Those we spoke to were also acutely aware of the pace of innovation in the DC investment landscape, and already had an eye on new opportunities or further changes they would want to make to their scheme over the next few years. In some cases that involved carrying out further research with their members, or reviewing their legacy pension arrangements with a view to moving other employees over into the new default. In other cases it included considering alternative asset classes they would like to add to their investment strategy in future, further tailoring their communications, or focusing on an aspect of their default fund, such as de-risking, that they thought would be ripe for further review.

With such strong and growing attention on quality, governance and member outcomes in DC pensions, we hope this report provides some fresh and helpful insight into the processes some of our members have followed when reviewing and redesigning their default fund design.

Annex A – discussion guide for interviews with scheme representatives

1. Your Pension arrangements
- Very brief overview of all of your pension schemes – DB and DC
- Overview of the activities of your firm and employee structure and how these influence your pension arrangements
- The general policy of your firm towards pensions – how important?
- Your DC scheme (and exactly which one we are discussing today?) in more detail – structure (TB/CB) membership, assets, arrangements, take-up rate

2. Past DC default arrangements
- Your past DC scheme default arrangements
- Participation of the members in the default
- What prompted the decision to change your default arrangements? Did automatic enrolment act as the prompt for example? Did members have any views?

3. New default arrangements
- Your new default structure
- The investment objective
- Provider selected
- Type of default structure
- Investment approach used (active passive, single strategy/multi-asset etc)
- Funds used
- Costs charged, and who pays what (company/member)
- Asset allocation changes over time / glide path structure

4. Decision process and the decision-makers
- Who chose this default redesign, what in governance terms was the body that made the decision, but what other third parties were also involved?
- When was the decision made, over what period, how much time did you have to invest?
- What was the decision-making process you went through – how did you break down the decision into stages, and why?
- What information and advice did you rely on in particular when making the decision, for example in selection of a particular fund?

5. The default improvements
- How this one will be better from the past one
- Who will benefit from the new structure – members/company

6. Switching from one default to another
- How will you switch from one default structure to another – ie will members be migrated, or will the new structure only be applied to new members?

7. Ongoing monitoring
- How will you monitor how the arrangements help members meet their retirement objectives?
- How will you monitor investment and also administration performance in future?
- At what performance levels might you deem that performance of your suppliers is unsatisfactory in future?
- How will you determine and measure the success of your new arrangement?
- Who will be involved in this monitoring?
- What will be the flexibility for future changes for example in fund providers?

8. Advice to others
- What mistakes did you make along the way?
- What would you do differently if you were to do this again?
- What advice would you share with another scheme that is about to start this same process?

Annex B – discussion guide for interviews with investment consultants

1. **Default fund change process –** What is the process you advise a client to follow when making changes to their default fund, and how long does this process tend to take in total?
2. **Current best practice –** On average what is the structure and asset allocation that your clients most often select for their new default fund?
3. **Past mistakes –** What mistakes have you most often seen being made in DC default fund design by your clients in the UK in the past?
4. **Customisation –** How much do company-specific factors (i.e. demographic profile of members, employee turnover etc.) require you to tailor a default fund design that is unique for that one client?
5. **Segmenting of approaches –** How would you summarise the differences between the default fund recommendations you make for your smaller company clients as opposed to larger companies, and between trust-based as opposed to contract-based schemes?
6. **Price –** How important is the price charged by providers when weighing up the pros and cons of different default fund structures for your clients?
7. **Fund selection –** How do you select the right funds, for example how do you help clients select between the 40 odd DGFs that exist?
8. **Platform –** You probably recommend use of a platform, but which one do you select and what benefits does this offer to clients and members?
9. **White labelling –** What does this entail and what is the importance – if any – of this in default funds?
10. **Other important considerations –** What else are important considerations for trustees and employers to bear in mind when they are re-designing their default schemes in your experience?
11. **New approaches in future –** What new approaches to default fund design are you seeing emerging – if any – which may help DC pension scheme members to achieve better outcomes in future? Target date and guarantees for example?
12. **Alternatives –** Is there any scope for alternatives or illiquid funds in default funds in future?
13. **Governance for review –** How should schemes best arrange their governance structure to review their default fund design and to make sure their default fund remains fit for purpose over time, and how often should it be reviewed?
14. **Changes –** Once clients review, how often in your experience do they then go on to make changes to default funds in coming years?
15. **Performance review –** What are the biggest mistakes trustees and employers make when monitoring the performance of their default funds?
16. **Role of consultants –** Where do investment consultants add the most and least value in terms of default fund design, in your view?
17. **Other issues –** What have we not asked you about in relation to default funds that we should have done?
18. **One main point –** What one piece of advice from everything you have mentioned here would you give clients setting out to make changes to their default funds?

Securing the future of pensions

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