From the UK, ideas for better outcomes for DC participants

By Editor Test *Wed, Oct 12, 2011*

Would gradual annuitization from age 65 to 75 be better for DC plan participants in the UK than gradually switching from equities to government bonds from age 55 to 65?

The 'lifestyling' approach used by many defined contribution (DC) plans in the United Kingdom is producing smaller retirement account sizes for savers than ever before, and could be replaced by more innovative alternatives, a new report has found.

According to research conducted by Cass Business School and sponsored by BNY Mellon, the lifestyling approach—where investors' accounts are automatically switched out of equities into government bonds in the 10 years preceding retirement—is now inadequate given the fall in equity markets and annuity rates.

"The equity bear market and the decline in annuity rates over the last 10-15 years has had a devastating effect on the final pensions of DC savers who have relied upon the mechanical lifestyling approach. A more enlightened and more flexible approach to the DC accumulation phase is definitely needed," said Cass Business School professor of asset management Andrew Clare.

The 'Outcome Orientated Investing for Retirement' report argues that DC pension schemes should adopt a "dynamic" investment strategy that enables investors to receive a tailored investment solution and therefore a greater chance of achieving pension targets.

The strategy should be outcome-driven, recognize investors' attitudes to risk and take a flexible approach to the decumulation phase, the report said.

In the research, Cass Business School and BNY Mellon focus on a 'momentum' strategy and a 'contrarian' strategy.

In the 'momentum' case, the report found that DC schemes should increase their allocation to equities for the coming year if the asset class performs well. If the equity return in the previous year is more than 16%, the allocation to the asset class should be increased by 5%; if the equity return is less than 4%, the allocation should be reduced by 5%.

The 'contrarian''strategy stipulates that, when equities perform well the previous year, a decreased allocation is appropriate. According to the research, both strategies work well, as they lead to an improvement of the replacement ratio.

"To some extent, you could deal with the pension problem just by putting more money in." said Clare. "But it's not sensible to put more money into a structure that's not working. Fix the structure first – then put more money in if that's what you want. We need to think about every DC member as if they were a mini-DB scheme."