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Latest developments in DC investments

November 2017

Private and Confidential

Speakers

Hugh Nolan
Scheme Actuary
Chair of DC Committee

Simon Cohen
Investment Consultant
Chair of Investment Committee

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Agenda

Latest developments in DC investments:

- ESG
- Default funds
- Pre-retirement phase
- Illiquid assets

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Environmental, Social and Governance (ESG)

AKA Socially Responsible Investment (SRI)

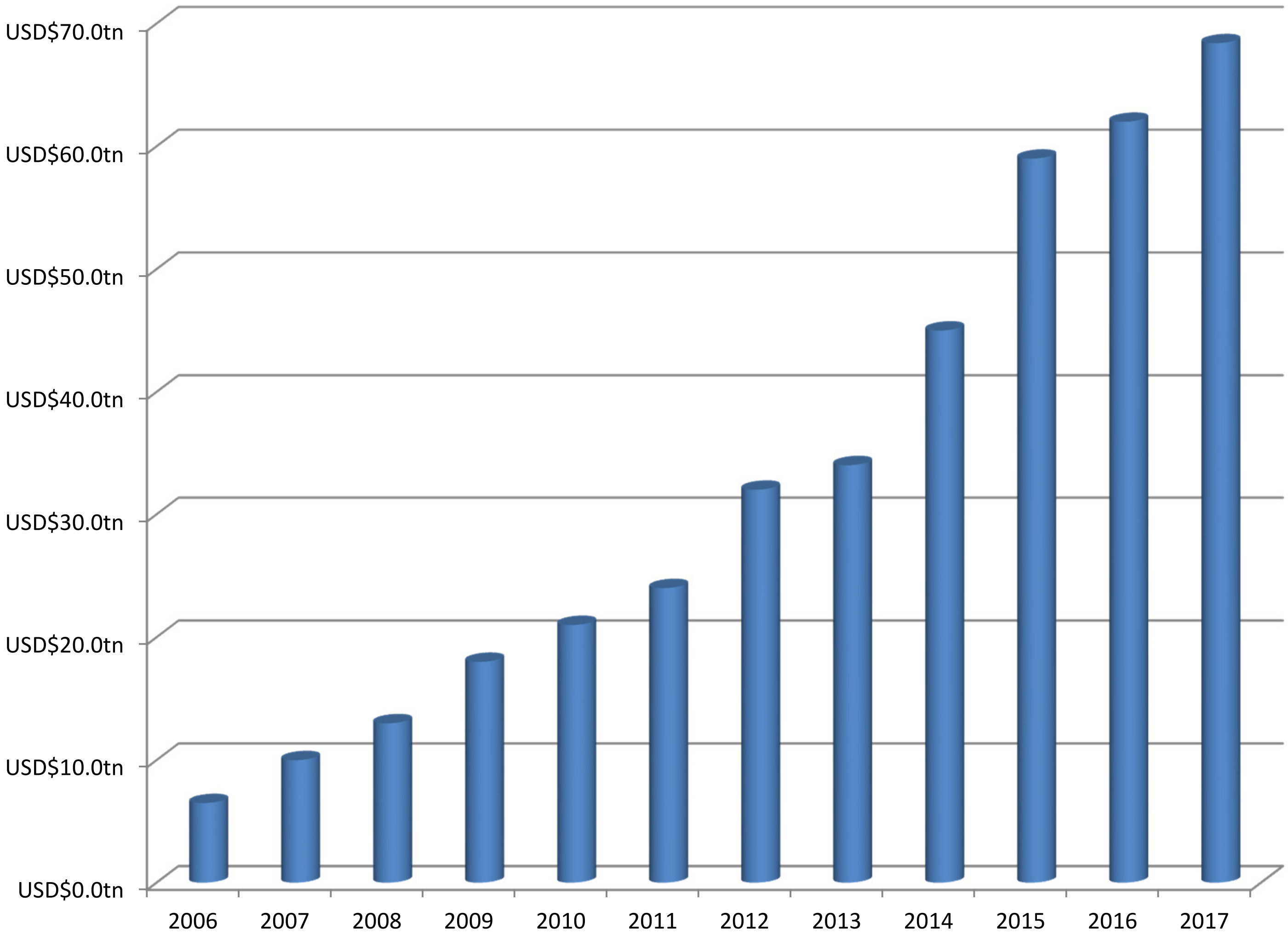
ESG/SRI Assets at 1/1/2016:*

$22,900,000,000,000

+25% over 2 years

*according to the Global Sustainable Investment Alliance (GSIA)

Principles for Responsible Investment (PRI)



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Why ESG?

Trendy?

Herd instinct?

Responsible?

Enhanced returns?

Risk management?

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What is ESG? – HSBC's key issues

Environmental	Social	Governance
Carbon emissions	Human capital management	Bribery and corruption
Energy efficiency	Health and safety	Business ethics
Climate change risk	Supply chain labour standards	Anti-competitive practice
Water stress	Product safety and quality	Financial system instability
Biodiversity and land use	Chemical safety	Corporate government
Raw material sourcing	Product suitability	Minority shareholder rights
Environmental impact	Privacy and data security	Culture and values
Toxic emissions and waste	Demographics	Responsible tax practices
Packaging material and waste	Digital divide	
Electronic waste	Financial exclusion	
Clean tech	Access to healthcare	
Green buildings	Nutrition and health	
Renewable and alternative energies		

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What is ESG? – RLAM's Sustainable Funds

Avoid

human rights abuses
tobacco and armaments manufacture
products which involve experiments on animals*

Along with

animal fur products
pornography
irresponsible gambling
irresponsible drinking
worker exploitation or exploitative consumer practices

*except for those conducted for the benefit of human or animal health

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Ethical investment returns

Index results to 29/9/17	3 years	5 years
FTSE4Good Developed	8.10% pa	11.70% pa
FTSE 100	7.70% pa	9.10% pa
FTSE 250	11.90% pa	14.10% pa
FTSE All Shares Index	8.50% pa	10.00% pa

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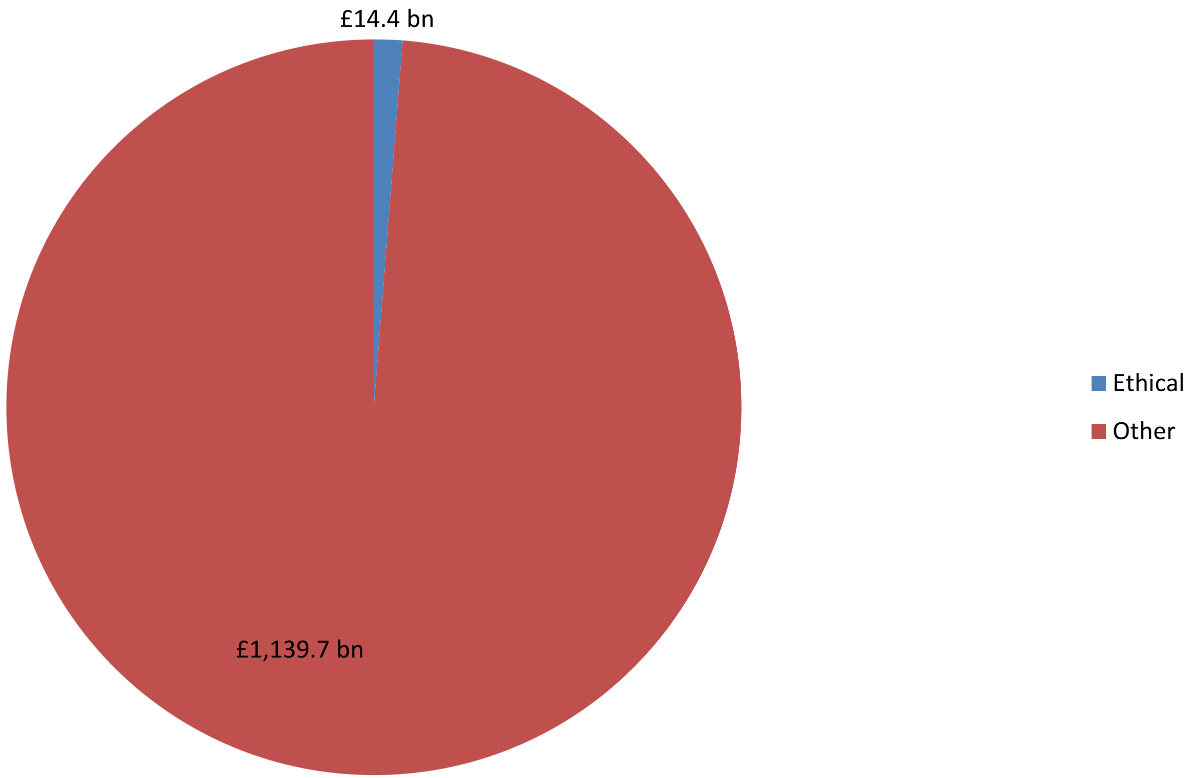
How much is actually ESG?

Investment Association research of UK investors



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ESG in practice

Red Line Voting

amnt Association of Member Nominated Trustees

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Default fund take-up

Conventional wisdom says 90%-95%

Fidelity say 80% of their policyholders

NEST say 99% of their members

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Member Surveys – JLT EB

1 in 4
50-65s don’t know
when they will retire

79%
of 60-65s have not
taken advice

36%
of 60-65s can’t estimate
pot value

1 in 10
40-65s don’t know how
to check pot value

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Member Surveys – Royal London

71%
of 25-34s didn't opt-out
of AE scheme

8%
more re-enrolled after
initially opting out

74%
of these will stay in
after April 2018

62%
will stay in even after
April 2019

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Member Surveys – Decision Technology

1 in 3
don’t know their
pension provider

90%
don’t know what funds
they are in

4 out of 5
had no idea of
pot value

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Common default funds

Lifestyle
- traditional annuity protection
- choice of target
- segmentation

Diversified funds

Target date funds

With-profit funds

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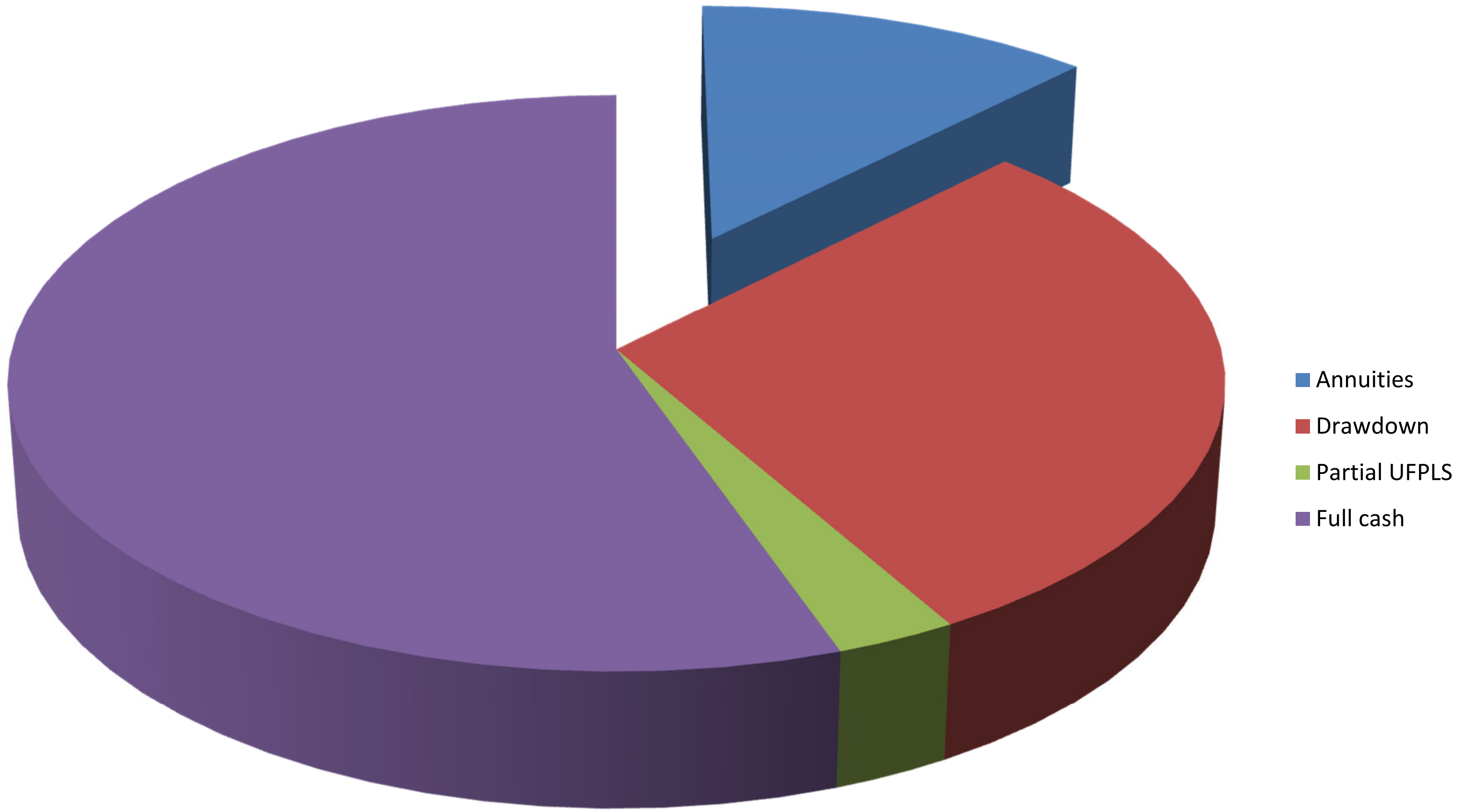
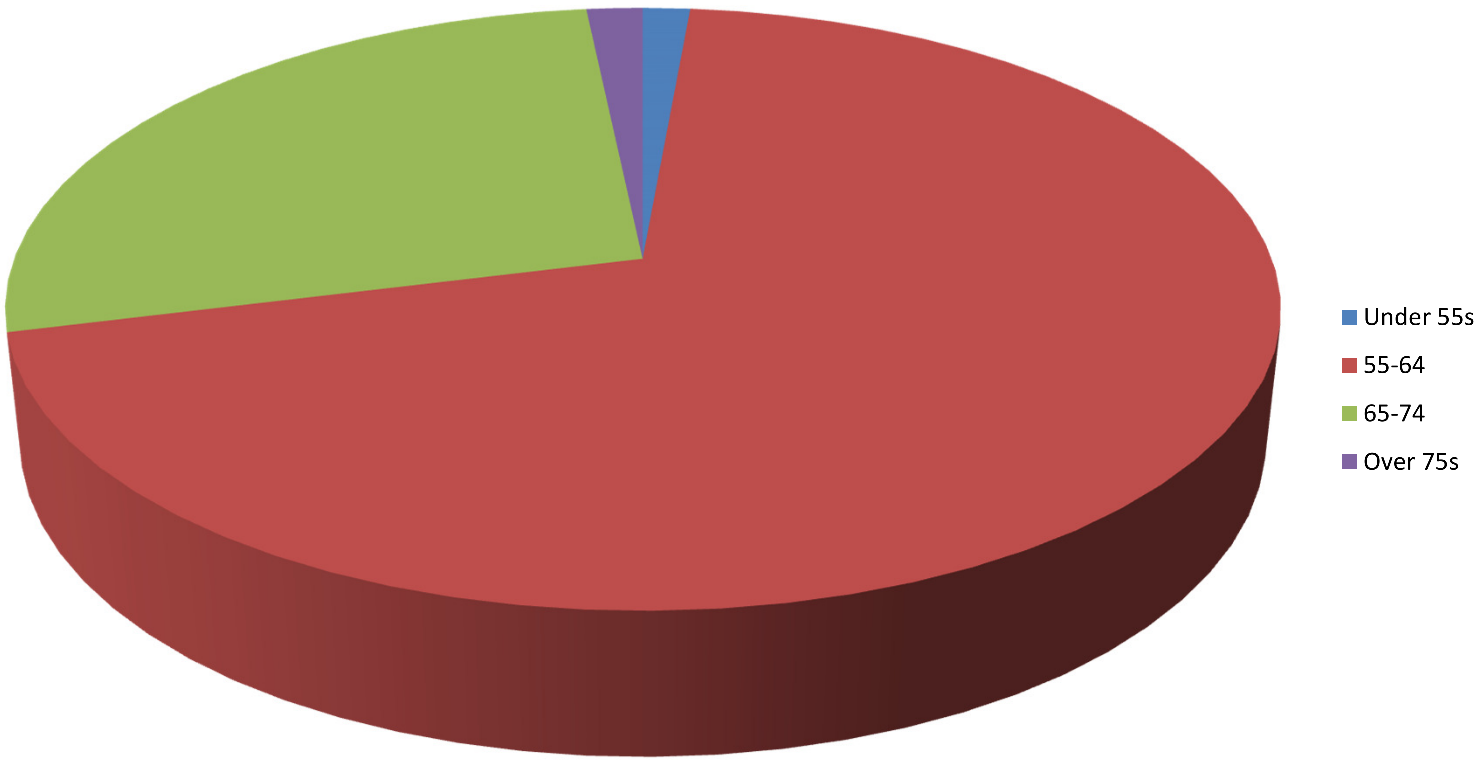
Freedom and Choice – FCA Analysis



FCA Analysis – Age at first withdrawal



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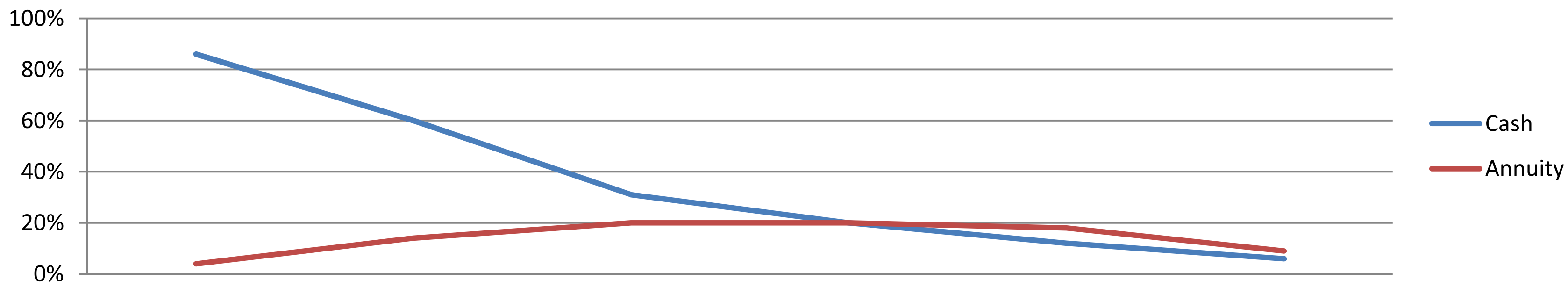
FCA Analysis – Impact of pot size

Pot band	Cash	Annuity	Other
Under £10k	86%	4%	10%
£10k to £30k	60%	14%	26%
£30k to £50k	31%	20%	49%
£50k to £100k	20%	20%	60%
£100k to £250k	12%	18%	70%
Over £250k	6%	9%	85%



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Pre-retirement phase

Target retirement age
Start of phasing period

Target outcome

Timing of switches

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Growth phase

Cautious, Balanced or Adventurous

Glide path

15 years to retirement age

Pre-retirement fund

Balance between growth and capital protection

Growth phase

Diversified Growth Fund (DGF)

Glide path

10 years to retirement age

Retirement Countdown Fund

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Foundation phase

Growth phase

Consolidation phase

Decumulation options

Decumulation dangers

- Invest poorly
- Spend too slowly
  - Live too long
- Spend too fast
  - Die too soon
- Fraud

Phases

up to mid 70s
mid 70s to mid 80s
over mid 80s

Building blocks

Income drawdown fund
Cash lump sum fund
Later life protected income

Not traditionally used in UK DC schemes

Illiquidity

what if a member wants to retire, leave or transfer and can't sell their holdings?

Member understanding

how can we explain the risks?

Valuation

how can these assets be valued accurately when they aren't actively traded?

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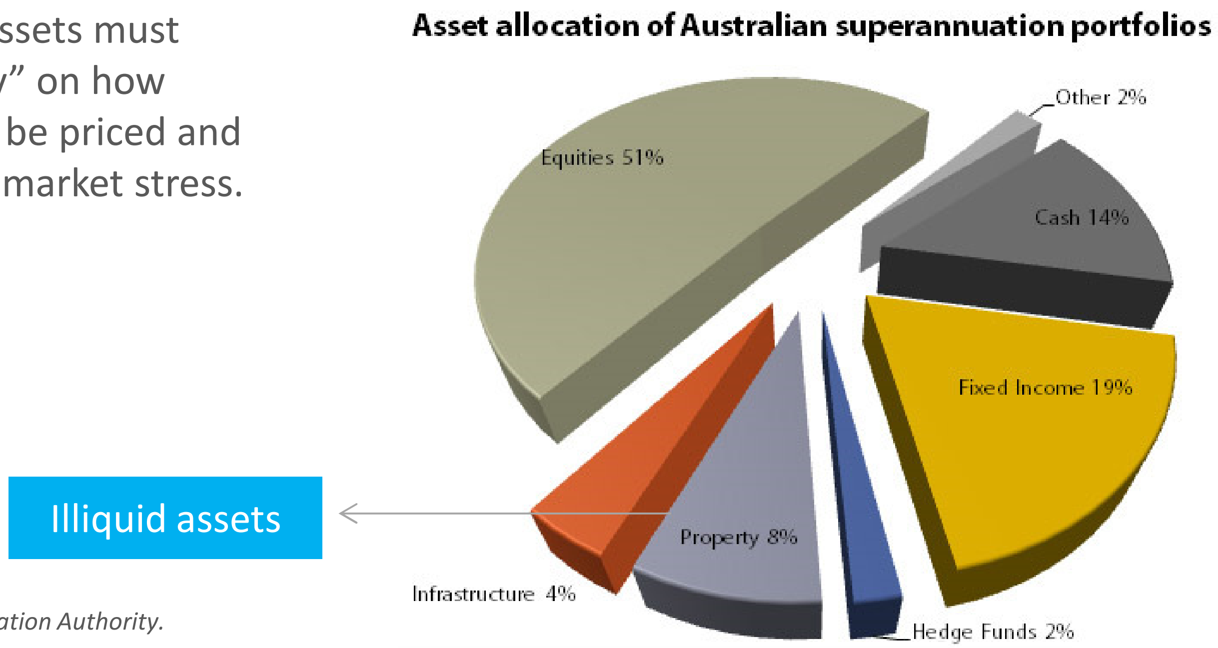
Illiquid assets – what works elsewhere?

- Large Australian "super trust" DC structures already make wide use of illiquid assets.
- Recognises diversification and illiquidity premium.
- Have the scale to implement.
- Australian market more pragmatic on "treating members fairly", seeking portfolios that improve overall returns for the fund rather than just the impact for each and every member.
- Funds using illiquid assets must have a "pricing policy" on how illiquid assets should be priced and managed in times of market stress.



Source: Australian Prudential Regulation Authority.

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Illiquid assets – all is not lost

- **Supportive regulation:** TPR Investment Governance guide states "too high a proportion of liquid assets may impact the level of investment return, and limit opportunity for diversifying your portfolio."
- **Scale and consolidation:** scale allows illiquid assets to be managed alongside liquid assets to best manage cashflows in DC schemes. Master Trusts and so on expedite this.
- **Administration providers:** providers are under pressure to innovate and are at risk of 'disruption'. Illiquid assets could be allowed for by developing pricing mechanisms to achieve a daily price.
- **Product development:** some fund managers have launched or are developing solutions that, in theory, provide UK DC investors with access to private and / or illiquid markets.

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Questions

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