HAVE YOUR SAY

Modern **times**

Each month *DC World* asks readers for their views.
The topic this month is: How can traditional lifestyle strategies be improved?

Charl P Cronje
Partner
Lane Clark & Peacock

The need for improvement lies not in lifestyle itself but in the three or four decades before lifestyle's automatic switching takes place. Typically the member spends this period in some sort of equity fund, which usually suffers from two flaws. The first is insufficient diversification – arguably even a UK equity tracker is over-concentrated in a few stocks.

The second is excessive downside risk, even over the long term. Most people will be relying on every penny of their DC pension and have less capacity for investment risk than might be thought.

An ideal solution would be something like a modern replacement for with-profits, based not on risk-sharing between individuals according to an opaque set of rules, but on transparent and systematic risk-spreading over time. This can be done using individual risk controls working to optimise the likelihood of achieving prudent objectives at retirement. This type of solution is where LCP has been concentrating its efforts.

Michael MacDonald-Smith
Head of UK defined contribution
Schroders

Traditional lifestyle is an excellent foundation for many UK defined contribution schemes. However, when it is made the default of a scheme its weaknesses become apparent.

By its nature it makes the assumption that all of the members of a scheme are the same. That they all have the same appetite for risk and returns, that they will all wish to use their accumulated savings in the same way and that they will all retire at the same age.

The trend among defined benefit schemes to move away from the peer group and adopt scheme-specific strategies shows the error of pigeon holing every-one into the same strategy.

We should not dismiss lifestyling outright rather we should break the link between default funds and lifestyling. Members should be encouraged, and where appropriate forced, to make an active decision over the investment strategy that they will follow and that includes lifestyle strategies.

Richard Parkin
Director of DC product development
Fidelity Investments

Many proposals have been made to enhance lifestyle strategies such as the use of dynamic asset allocation, where switches are made based on market performance. While this does tend to reduce the variability of results, this is often at the cost of reducing potential upside. Others have proposed very detailed strategies using a large number of funds and frequent switching.

This has a significant impact on dealing costs and, one might argue, introduces spurious detail to an approach that is, by definition, quite generalist.

One of the great attractions of lifestyle strategies is that, in their essence, they are quite simple – take risk when you can afford to do so and gradually reduce the risk as you approach the time you need to take benefits. There is a danger that in enhancing the product, members' lose this simplicity with little compensation in terms of improved benefits.

Paul Watson
Senior investment consultant and head of manager research
HSBC Actuaries & Consultants

One of our immediate concerns with lifestyle strategies has been the conventional use of long dated gilts as the matching asset type for pension purchase. This becomes increasingly less appropriate as annuity insurers include greater allocations to corporate debt in their pricing.

Attempts to use a combination of long-dated gilt and corporate bond funds, based on where insurers seem to be investing, can only loosely approximate how insurers price their annuities.

One solution was to approach a number of the key players in the market to produce a fund with the correct attributes and the first fund of this type was launched in October 2003. However, this is only one side of the problem, with further issues surrounding the sole use of equities as the growth component.

Not forgetting that lifestyling only works if the member retires on their predetermined date, which is often not the case.

NEXT QUESTION:
"Are members and trustees best served by a bundled or unbundled approach?"

PROFESSIONAL PENSIONS

Please email your responses to hmorrissey@msm.co.uk by Friday, July 8
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