Research Report
Defined Contribution

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Global Retirement Reality Report Ireland

Smart Defaults — The Case for Target Retirement Funds

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From the results of our 2019 Global Retirement Reality Report (GR3), this paper takes a look at the role Target Retirement Funds (TRFs) can play in guiding members to better retirement outcomes.

Our global defined contribution surveys historically focused on gathering retirement perspectives from pension scheme members. This has provided us with a wealth of observations about member behaviour, the challenges in getting retirement ready, expectations for financial security in the golden years, and, importantly, what we can do to help members achieve better retirement outcomes.

In 2019, we flipped our approach and for the first time conducted our survey with plan sponsors. Our survey results indicated that members and plan sponsors would benefit from defaults which are dynamic, adaptable and intuitive. Using our survey results, this paper takes a look at the role Target Retirement Funds (TRFs) can play in meeting these goals and guiding members to better retirement outcomes.

95%

Of US plans use TRFs as their default since being introduced in the US in the 1990s[1]

20%

Expected share of UK default fund assets to be invested in TRFs by 2027[2]

We'll also share some key features of our newly launched Timewise Target Retirement Funds.

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The Default Fund

The number of savers invested in pension scheme default funds is expected to rise considerably following the introduction of auto-enrolment. In the UK, auto-enrolment increased participation in DC schemes significantly — growing from 55% to 84% from when it was introduced in 2012 to the end of 2017.[3] This, in turn, increased investment in default funds.

Figure 1
Proportion of Savers Invested in Pension Scheme Default Funds

UK Members in the UK's National Employer Savings Trust Invested in the Default Fund[4]	99%
Ireland Active Pension Scheme Members Invested in Default Fund[5]	70%

Evidence shows that take up of the default fund is likely to be high, and we believe well governed defaults contribute to good member outcomes.

A successful automatic enrolment system requires a well-designed default investment strategy. High take-up of the default typically leads to better outcomes.

We believe defaults should have the following features:

- **Dynamic** — with in-built risk management so members are protected from adverse market shocks. Shocks have the potential to knock saver confidence and could undo the good work of auto-enrolment.
- **Adaptable** — evolving to reflect market, regulatory and behavioural changes.
- **Intuitive** — simple to understand. Over half of plan sponsors surveyed state that simplicity and ease of use would be important to their members.

Dynamic

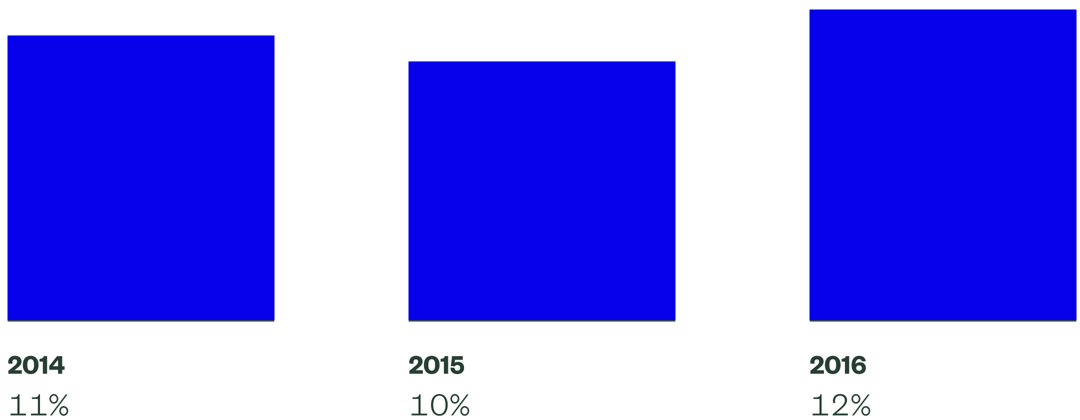
Defaults should vary the level of investment risk taken by members according to their life stage. The further the member is from retirement, the greater their ability to take risk.

However, large falls in financial markets can seriously knock the confidence of DC savers. It is therefore critical that default strategies seek to minimise losses whilst members are saving for retirement.

DC members are only willing to take a small amount of risk with their pension savings.

Irish DC Scheme Members Acceptance of High or Somewhat High Risk in Hope of Higher Returns

Figure 2
How much Risk would you be Willing to take with your Plan to Achieve Greater Returns on your Investment?



We seek to provide members with a smoother retirement journey in our Timewise Target Retirement Funds by using in-built volatility management in three layers:

1. Strategic diversification of asset classes
2. Active asset allocation via the Flexible Asset Allocation Plus Fund
3. Systematic target volatility triggers that de-risk from equities into lower risk assets when volatility rises above pre-determined levels, closer to retirement

See our paper ***Dynamism in Action*** for further details.

Adaptable

Whilst setting a good default is important in achieving good member outcomes, we should expect that things will change over time. For example:

- **Regulation** — 93% of plan sponsors are confident that auto-enrolment will be implemented in the next 3–5 years. Auto-enrolment will change the pension landscape in Ireland significantly, which could lead to markedly increased participation and savings rates, pot sizes, product innovation and more.
- **Member Profiles** — our population is ageing and living longer and therefore we can expect that people will be working longer. 37% of plan sponsors said that the greatest source of change over the next 3–5 years would be member demographics. In addition, member needs may change over time as people increasingly look to DC as a source of retirement income and focus shifts away from DB.
- **Investment Environment** — the investment and economic backdrop will inevitably change over time as market reactions surrounding Brexit, China and Quantitative Easing come into play.

In order to cope with these changes and more, it is crucial that the default is adaptable. Timewise Target Retirement Funds provide schemes with a flexible default strategy managed by investment professionals. The asset allocation is set by experts, and can quickly adapt to market, regulatory and member changes.

50%

Plan sponsors want help selecting the funds for the default.

Intuitive

Savers in different countries are at different stages of embracing the new responsibility that comes with defined contribution savings. In Ireland plan sponsors believe employees and employers bear equal responsibility for ensuring an adequate income in retirement. When we asked members the same question last year, it is clear they are taking ownership of their own retirement outcomes — 74% citing themselves as responsible. But members also pointed to the need for help and guidance.

Irish DC Scheme Members Understanding of pensions and retirement investing[6]

13%

Have a "good grasp"

49%

Can make decisions with advice

Where Irish DC Scheme Members need the most help when managing finances[6]

18%

Managing Debt

49%

Saving and Retirement

Over half of plan sponsors surveyed state that simplicity and ease of use is important to their members. Target Retirement Funds are simple for members because:

- They take a single glide path approach which means members only need to make one decision — the five-year window in which they expect to retire
- Investments are held in a single fund rather than multiple funds that change over time
- Each fund has a single unit price making it easier to present performance and fees

Plan sponsors can focus on engaging members around saving more, when to retire and what to do with savings at retirement.

Plan sponsors comments on gaps in current offerings:

“Complexity and lack of communication.”

“System is not so transparent.”

“New members are not aware about the DC plan. They should educate people about these schemes.”

Plan sponsors comments on selecting a provider:

“They should be employee friendly.”

“Ease of use, member engagement.”

“Transparency, member engagement and ease of access.”

Built for Members

At retirement, Irish legislation allows members to take their retirement income in a number of ways: purchase an annuity, use income drawdown, withdraw a cash lump sum, or take a combination of the three. One option would be to tailor the strategy to member's preferred anticipated retirement benefits, but, in practice, both members and plan sponsors have limited visibility over the choice they will make in the earlier years of their pensions. Also, increasingly the retirement date will be uncertain.

13%

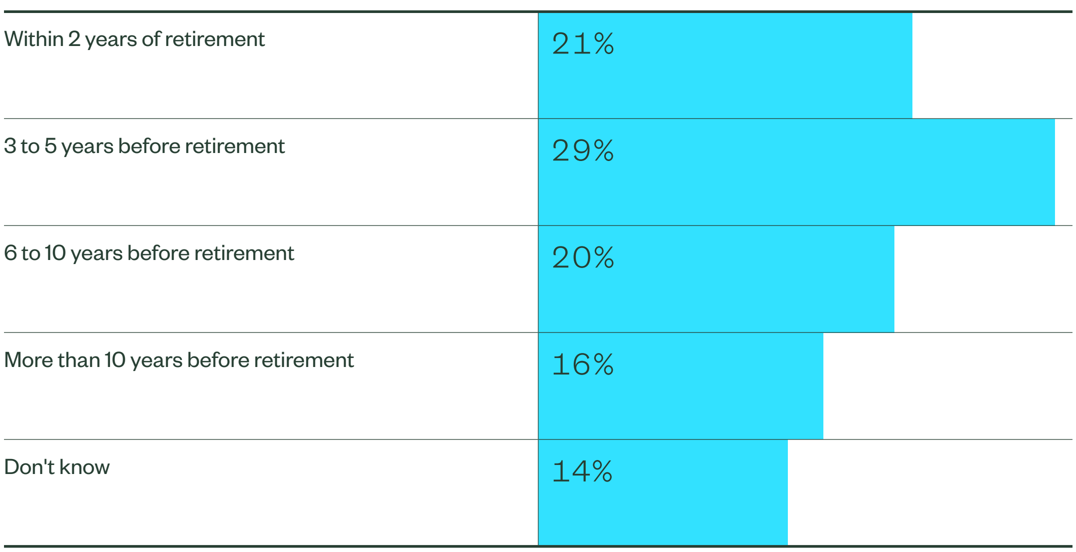
Plan sponsors surveyed had a good idea of how members will take their retirement benefits

65%

Members didn't know, or wouldn't know until five years before retirement, how they will take their retirement benefits

When Will I Know How I'll Access My Funds at Retirement?

Figure 3
Irish DC Scheme Members[6]
Thoughts on How Members Will Access Funds at Retirement



29% 45–54 year olds who felt fully aware of the options available to them when planning for retirement[7]

Smart defaults should keep options open and be robust to the uncertainty that we have observed.

How the Timewise Target Retirement Funds Work

A member will hold a single target retirement fund which corresponds to their expected retirement date. For example, a member who is 30 now, and expects to retire when they are around 66, will hold a 2055 Timewise Target Retirement Fund. The fund will automatically switch between different asset classes to reduce risk as the target date approaches.

Smart Defaults: Timewise Target Retirement Funds

- Expertly managed investment glide path
- Robust risk and return management
- Founded on member focused research
- Simple to communicate and administer
- Affordable and transparent
- Flexible to changing investment and regulatory environment

Contributors/ Contacts

For further information about our Timewise Target Retirement Funds contact: Ireland_Team@ssga.com

Endnotes

Source: Unless otherwise stated, data sourced from State Street Global Advisors Global Retirement Reality Report 2019. Survey of 135 plan sponsors conducted by YouGov between 22nd March–23rd April 2019.

1 Vanguard — "How America Saves 2016."

2 Source: Navigator 2018: UK Defined Contribution and Retirement Income, Broadridge.

3 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/764964/Automatic_Enrolment_Evaluation_Report_2018.pdf.

4 Source: https://fca.org.uk/publication/market-studies/retirement-outcomes-review-interim-report.pdf.

5 IAPF 2014.

6 State Street Global Advisors Global Retirement Monitor 2016.

7 State Street Global Advisors Global Retirement Reality Report 2018.

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