Commentary

Asset Class
**Defined Contribution**

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# Target Retirement Funds: Achieving Better Outcomes for Members

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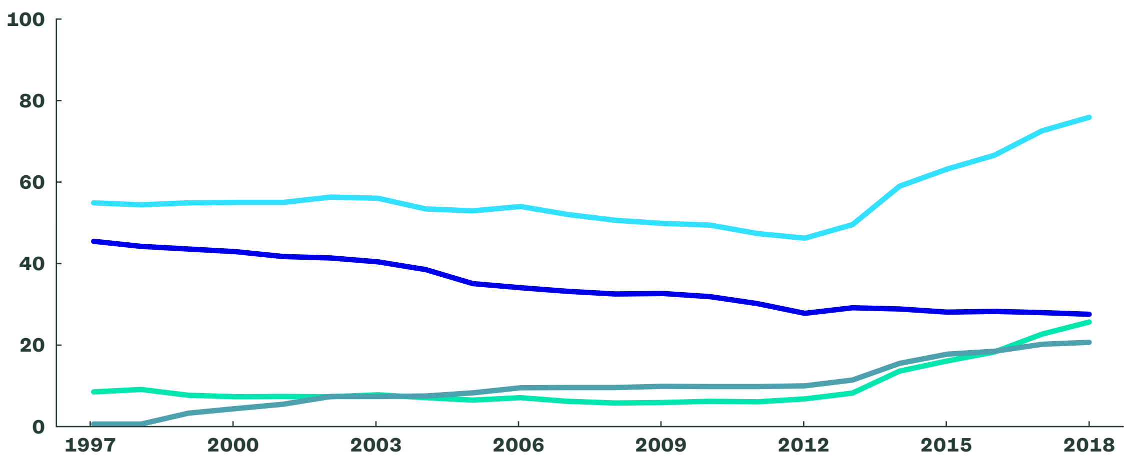
- Automatic enrolment can have a powerful effect in increasing pension scheme participation
- A successful automatic enrolment system requires a well-designed default investment strategy
- This paper looks at the role Target Retirement Funds can play as the default strategy in guiding members to better retirement outcomes
- We draw on examples from the UK which has seen exponential growth in both DC participation rates, as well as assets into Target Retirement Funds — a journey which we can see Ireland embarking on in the coming years
- We also look at lessons from the US which has a well-established Target Retirement Fund market

Figure 1
**Increased Pensions Coverage Driven by the Start of Auto-Enrolment In 2012**
Proportion of Employees with Workplace Pensions (by Type of Pension, UK, 1997 to 2018)




Occupational Defined Benefit
Occupational Defined Contribution
Group Personal and Group Stakeholder
Any Pension

Source: Office for National Statistics — Annual Survey of Hours and Earnings, as of 31 December 2018.

## What are Target Retirement Funds?

- Target Retirement Funds (TRFs) are designed to be the default fund for people saving for retirement
- They exist in "vintages", grouping members in cohorts by approximately when they will retire
- As the members in the fund approach retirement, the portfolio manager will de-risk the fund

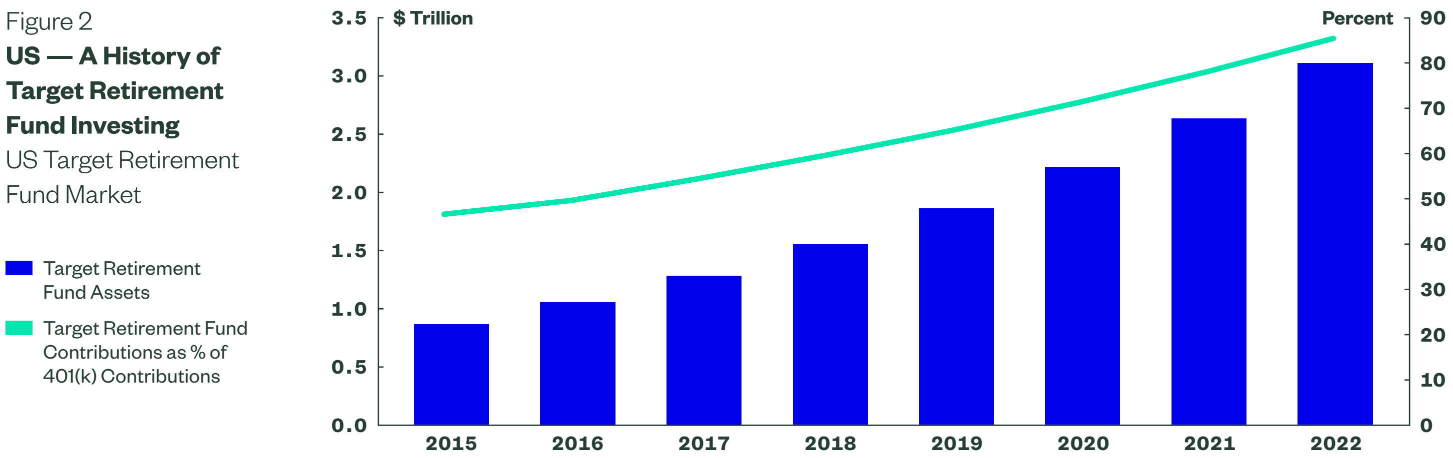
## Target Retirement Funds — A Global Default

TRFs came into prominence in the US in the 1990s and have since seen growth in other markets, such as the UK.

**Use of TRFs in the US:**

- **1990s** TRFs were introduced in the US in the 1990s and now 95% of US plans use TRFs as their default investment strategy.[1]
- **2006** The Pensions Protection Act was introduced, which offered a safe harbour (reduction in liability) for plan sponsors who provided a qualified default investment strategy. TRFs were specifically named as a qualifying strategy. Many plan sponsors saw the benefits of TRFs, which seamlessly transitioned members through their retirement journey. As a result, TRFs now capture the majority of new contributions in DC plans in the US.
- **2019** The SECURE Act was introduced, which proposed auto-escalation of employee contributions to 15% of salary and greater tax incentives around saving for retirement. We expect positive momentum and growth in TRFs to increase as a result of this initiative.

Figure 2
**US — A History of Target Retirement Fund Investing**
US Target Retirement Fund Market




Source: Cerulli — US Defined Contribution Distribution Report (2017). Assets and contributions beyond 2017 are forecasts. The above targets are estimates based on certain assumptions and analysis. There is no guarantee that the estimates will be achieved.

**Use of TRFs in the UK:**

- **2012** Automatic enrolment was introduced in the UK, mandating employers to automatically enroll their employees into a pension scheme. Between 2012 and 2019, participation in DC schemes grew from 55% to 88%.[2] This in turn, increased investment in default funds such as TRFs.

- **2014** 'Freedom and Choice' reforms were announced in the UK, removing compulsory annuitisation and allowing members to choose how they would use their pension savings in retirement (e.g. cash lump sum, annuity or income drawdown). While these measures were designed to offer members more choice and flexibility, many were left feeling confused.[3] Hence, many UK schemes found it better to have a default design such as a TRF which kept members' options open and was robust to the different choices members might make at retirement.

- **Today** According to Broadridge[4]:
  - 20% of UK default fund assets are expected to be invested in TRFs by 2027
  - 23% of schemes surveyed are considering switching to TRFs
  - TRFs are used by several UK Master Trusts, including the National Employer Savings Trust (NEST), where 99% of members are in the default fund

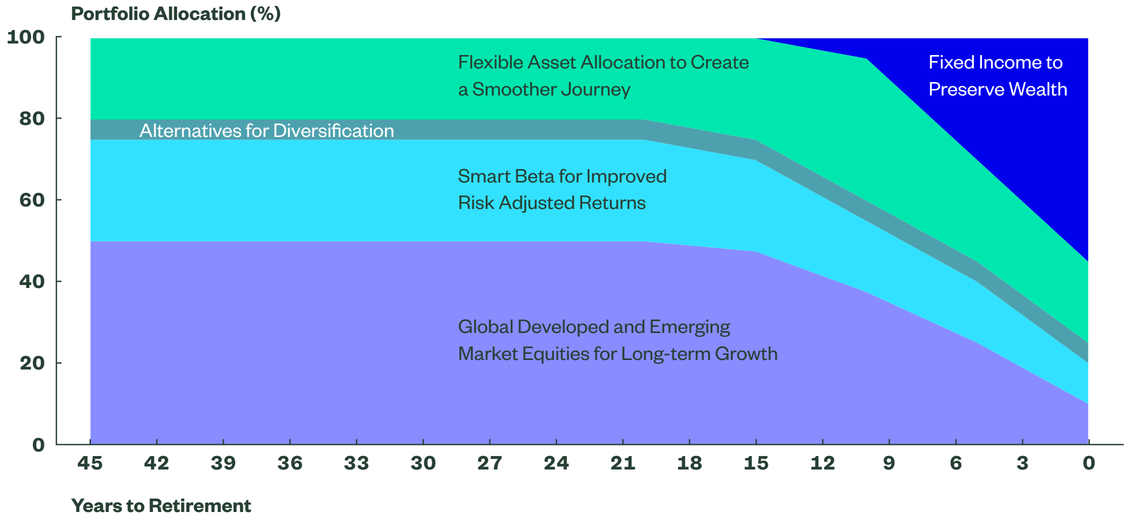
## Lifestyle versus Target Retirement Funds

In the UK and Ireland, DC schemes have historically used lifestyle funds as the default investment strategy.

TRFs offer several advantages over traditional lifestyle strategies:

| Lifestyle Strategy | TRF | Advantages of TRF |
|---|---|---|
| Member holds several funds | Member holds a single fund | Simple to communicate |
| Targets a specific retirement date | Groups members into age cohorts | More flexibility around when a member will retire |
| Administrator switches from fund to fund | Manager switches assets in fund | Quicker, more reliable, lower cost and easier to implement |
| Asset allocation usually preset | Asset allocation can be dynamic | Asset allocation responsive to market conditions, aiming for a smoother journey |
| Blackout period may be required if the glide path changes | No administration impact from glide path change | Easier to make changes to investment strategy |

Figure 3
**Example Target Retirement Fund**




Source: State Street Global Advisors, as at 31 March 2020.
The information contained above is for illustrative purposes only.

## Conclusion

Target Retirement Funds have been a popular default investment strategy for many DC schemes globally.

If you would like a default solution that is:

1. Carefully designed, managed and governed by investment professionals
2. Quick to adapt to changes in regulation, member needs and market conditions
3. Simple and easy to communicate to your members

...then Target Retirement Funds could be for you. Please get in contact to find out more about the State Street Global Advisors Timewise Target Retirement Funds.

## Contact Us

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## Endnotes

1 Vanguard, "How America Saves" (2016).

2 Department for Work and Pensions, "Workplace Pension Participation and Savings Trends of Eligible Employees Official Statistics: 2009 to 2019" (2020).

3 Ignition House, "New Choices, Big Decisions" (2017).

4 Broadridge, "UK Defined Contribution and Retirement Income Navigator" (2018).

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