

CASE STUDY:

TARGETING BETTER MEMBER OUTCOMES WITH TARGET DATE FUNDS

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PHOENIX CORPORATE
INVESTMENT SERVICES

Part of Phoenix Group

TARGETING BETTER MEMBER OUTCOMES WITH TARGET DATE FUNDS

With increased focus on delivering value, improving diversification and managing the risk journey for Defined Contribution (DC) pension savers, trustees and their advisors are recognising the need for innovative new investment solutions that will contribute to improved member outcomes over the long term.

The flexibility offered by investment only platforms can open up a range of investment opportunities for DC schemes, providing access to the fund structures and investment vehicles they require, and delivering change as market conditions and scheme requirements evolve.

One popular solution is the use of Target Date Funds (TDFs), which can be tailored to meet a wide range of investment objectives, from accessing private market assets to incorporating Environmental, Social and Governance (ESG) considerations into scheme portfolios. Whole of Life TDFs can also provide decumulation options for members as they move towards and through retirement.

In this case study, we'll explore the use of Target Date Funds in DC investment strategies. We'll also look at some of the TDF solutions that platform providers are implementing to address current and future investment challenges while delivering improved outcomes for scheme members at all stages of the savings lifecycle.



UNDERSTANDING THE USE OF TDFS IN DC INVESTMENT STRATEGIES

Target Date Funds are steadily increasing their share of DC assets¹, offering an attractive alternative to commonly used lifestyle strategies.

Simply put, a Target Date Fund (TDF) is a single multi-asset fund managed according to a member's expected retirement window – for example 2035 to 2038 – and is designed to manage investment risk so that risk is reduced as the target date approaches.

Target Date Fund solutions differ from lifestyle strategies in the way they are managed. Lifestyle funds are de-risked according to a process agreed with the scheme's consultant, and changes are typically implemented by the scheme administrator. By contrast, most TDFs have fund managers who proactively manage investments, making strategic and tactical decisions with regard to risk and asset allocation. They take market conditions into account in order to maximise investment returns and enhance outcomes at all stages in the life of the investment.

Target Date Funds have evolved to offer a wide range of investment approaches, including both active and passive strategies, and schemes can choose the product best suited to their needs.

1 Broadridge Navigator UK DC & RI 2022



THE ROLE OF INVESTMENT ONLY PLATFORMS IN DELIVERING TDF SOLUTIONS

Platform providers have a key role to play in implementing TDF solutions, working hand in hand with fund managers to manage change ‘under the bonnet’ and deliver a single, seamless journey for scheme members.

Operational processes: Platforms can combine underlying investments within a blended fund structure like TDFs into a blended hierarchy and/ or white-labelled fund solution. They manage the end-to-end daily pricing and trading cycle, deriving a daily unit price for the TDF that reflects the latest prices received from underlying fund managers. They can also implement automated rebalancing solutions to maintain target asset allocations.

Reporting and governance: A platform’s dedicated reporting function will be able to collate data on the underlying funds within a blended TDF to produce fund performance reports, fund factsheets and other reports that are required on a regular basis, all at the blended fund level. A good platform provider will be able to tailor reporting to the needs of the scheme and offer enhanced governance support.

Legal considerations: For open architecture TDFs that involve multiple investment managers, platforms can further reduce complexity, providing time and cost efficiencies. They can manage all legal agreements and ongoing governance processes with the underlying fund managers (for example, Anti-Money Laundering and operational due diligence), reducing the need for legal resource.

Fee arrangements: Platforms can deliver economies of scale by utilising the strength of their entire book of assets to negotiate the most competitive fund manager fees on behalf of their clients (or ring fence any preferential terms that schemes and their advisors already benefit from). The level of automation offered through a platform’s systems can also facilitate flexible charging structures.

Change management: Platforms can offer valuable expertise, support and resource for transitional activity when making change to the underlying funds within a TDF. A good platform provider will be able to manage new fund additions, the re-registration of assets, in-specie transfers and cash trades on their clients’ behalf, and might also be able to offer a pre-funding or lending facility, which enables trading times to be aligned and helps to mitigate out-of-market risk.

USING TARGET DATE FUNDS TO ACCESS PRIVATE MARKET INVESTMENT OPPORTUNITIES

DC schemes are increasingly looking to diversify their investment portfolios and access private market assets that offer higher potential net returns in order to deliver improved member outcomes over the long term.

Target Date Funds can incorporate a wide variety of investment structures, for example listed holdings that are publicly traded, unlisted holdings that are not publicly traded, or private credit / private equity funds. Trustees and their advisors have a huge amount of choice when it comes to building a diversified investment portfolio and tailoring the asset allocation to meet the needs of their scheme.

TDFs are structured in such a way that changes to underlying funds can be made seamlessly, and from a member's perspective they are still invested in a single fund that best meets their needs. Each TDF can include an allocation to private market assets that is appropriate for the selected retirement window, with risk exposure reduced as members approach retirement.

Although private market assets tend to be less liquid, and therefore more difficult to access, fund managers and platform providers are working together to overcome many of the perceived operational challenges facing DC schemes and Master Trusts in this area.

Platforms can facilitate access to less liquid private market investments by managing non-standard dealing and pricing requirements, including trade notifications and liquidity constraints, while still providing the administrator with a daily price at the blended fund level for the TDF.

Incorporating private market assets within a blended fund solution like a TDF can also support the scheme's liquidity requirements. Daily cash flow can be invested or disinvested from traditional collective fund vehicles or Exchange Traded Funds (ETFs), with monthly or quarterly rebalancing occurring with the illiquid assets at the appropriate trading points.



USING TARGET DATE FUNDS TO INTEGRATE ESG CONSIDERATIONS

As responsible investing grows in importance, trustees are looking for ways to incorporate Environmental, Social and Governance (ESG) considerations into their portfolios to meet the evolving priorities of schemes and their members.

The flexibility offered by Target Date Funds can smooth the path to responsible investing, supporting changes to the underlying asset allocation to reflect emerging requirements. For example, schemes can invest in companies that have strong ESG ratings and exclude those with poor sustainability credentials. They can also engage in thematic investing where this aligns with member values, and promote ESG best practice through voting and engagement.

Working together, fund managers and platform providers can make changes under the bonnet of each Target Date Fund that members invest in, ensuring the underlying assets continue to reflect its overarching ESG characteristics and objectives. This can be achieved without disruption to the scheme administrator, trading blackout periods or additional member communications.

A good platform can also provide pre-funding for transitional activity, mitigating out of market exposure when TDF asset allocations are updated. This is done by funding any settlement timing differences between buy and sell trades, so that all deals can be placed on the same day.

Private markets can also offer meaningful opportunities for ESG-focused investment, giving pension schemes the opportunity to invest in long term sustainable projects such as solar energy plants, windfarm facilities or reforestation, while generating strong returns for savers over the long-term. These investments can be incorporated into the Target Date Fund structure with pricing and liquidity requirements managed by the platform.

ESG considerations will continue to grow in importance as pension savers consider the role of their investments in securing the sustainable future they want to see. Target Date Funds – accessed via a platform – can offer an agile and flexible solution to responsible investing that continues to meet the needs of schemes as their priorities evolve.



IMPLEMENTING WHOLE OF LIFE TARGET DATE FUND SOLUTIONS

As growing numbers of DC savers approach retirement, schemes will increasingly need to tackle the decumulation conundrum and consider how members access an income from their savings.

The 2015 introduction of DC pension flexibilities placed the responsibility for decision making firmly on members, but there is currently an advice gap and many members are making choices that may ultimately lead to poor financial outcomes in retirement.

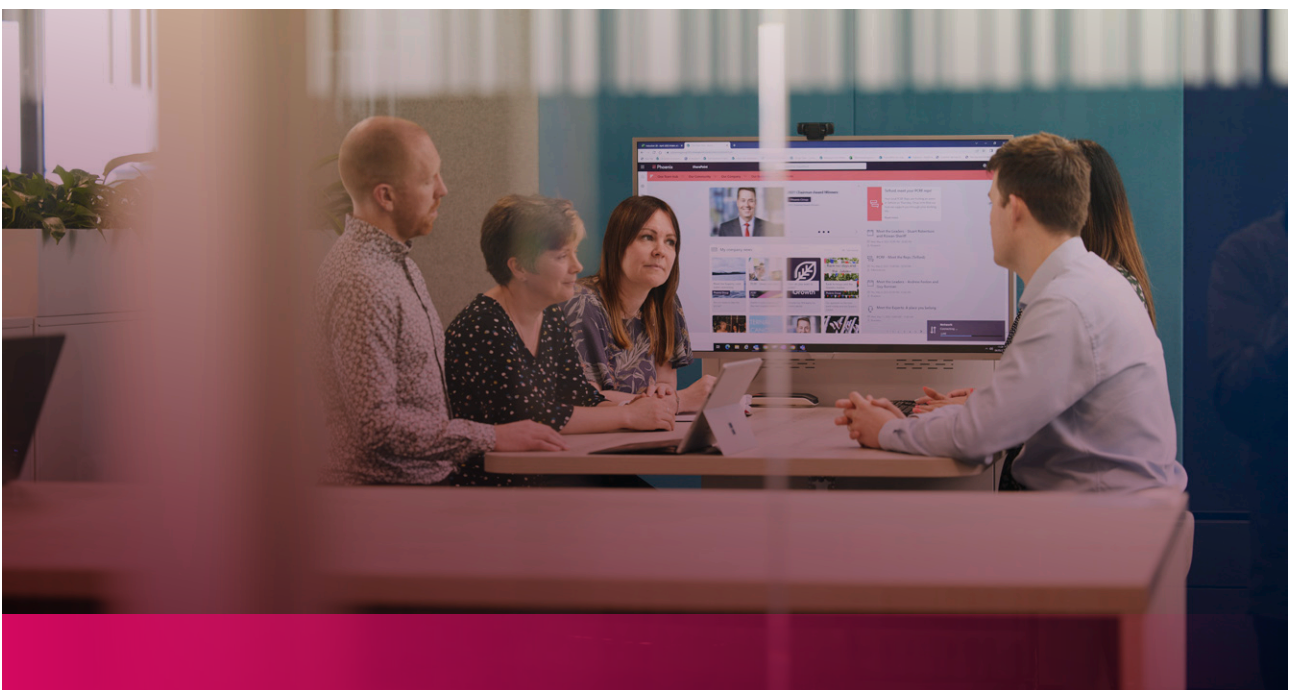
The availability of suitable default options will be key to addressing this challenge, and platform providers recognise the importance of supporting trustees who have a duty of care towards scheme members, and Master Trust clients for whom it is a commercial imperative.

An example of a suitable default option is the use of Target Date Funds by fund managers and platform providers to provide schemes with 'to and through' default solutions, replacing the retirement cliff edge with a more gradual transition into the decumulation phase of a member's savings journey.

Once members reach their retirement window, they can remain invested in income-paying TDFs and benefit from in-scheme drawdown options while continuing to pay into their DC pension pot. Investments can be managed to meet a range of at-retirement priorities, including income generation, growth, flexibility and capital preservation.

As an operational enabler, platforms can manage any adjustments to pricing, trading and accounting functions to accommodate income-paying funds as part of the Target Date Fund structure, reducing the burden on schemes and their administrators.

In this way, schemes can use Target Date Funds to provide whole of life solutions and deliver a seamless default journey for DC savers and retirees.



“ At AllianceBernstein we’ve been successfully delivering Target Date Fund (TDF) solutions in the UK for more than 14 years. We believe that investing in this way is easier for DC savers and it can significantly improve the outcomes vs older conventional approaches. Members have access to a robust age-based default design that’s professionally managed daily and always kept up-to-date. We focus on managing risk and maximising investment returns to a retirement window that gives members flexibility at- and in-retirement.

We partner with best-in-class platform providers like Phoenix CIS to enable the efficient implementation of TDF strategies, allowing us to offer a customised and flexible DC default solution that’s anchored to member demographics. The investment mandate can evolve over time within a fund structure that never needs to change. This enables us to deliver a low-cost, high value solution that meets the evolving needs of the UK DC market, and ultimately leads to improved outcomes for members at all stages of their investment journey. ”

Michelle Inskip

Managing Director – Defined Contribution, AllianceBernstein



“As a leading platform provider, Phoenix CIS is committed to delivering the flexibility and innovation our clients need as they navigate evolving priorities and challenges. Target Date Funds are a popular option, and we have extensive experience of building customised TDF solutions on our platform. We can support our fund manager partners to implement the fund structures they require and deliver change when it’s needed.

We can leverage platform capability to give members exposure to a much wider range of investment opportunities within a blended fund structure like a TDF, from private market assets to sustainable and impact investing. We can also support our clients with the delivery of post-retirement solutions, and tailor these to the needs of their scheme. It’s this agile, forward-thinking approach that will be so crucial to securing good outcomes for DC savers. ”

*Jess Williams
Head of Corporate Investment Services, Phoenix Group*

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