COMMUNICATOR
Our experience. Your advantage.

September 2007
Issue 1

In search of the ideal DC Plan

In this issue

Meeting clients' training needs

How salary sacrifice can boost members' retirement income

Pension Plans - The next generation

Institutional vs. retail investing

WELCOME
to this edition of DC Communicator

As we go to print we are planning our next round of DC-specific investment/governance seminars. Earlier in the year the events we held in Glasgow and London certainly hit the spot with clients. The feedback was both very positive and helpful. I would particularly like to thank those who travelled from Northern Ireland and Aberdeen for making their several hours round trip. If you were unable to attend these events, your Relationship Director will be pleased to take you through the content or organise a similar session for a group of your senior colleagues.

TRENDS SINCE A-DAY

Since A-Day last year, the three biggest trends we have seen are:

1) Conversion of plans from trust based CIMPS to contract based GPP or Stakeholder plans;

2) Increase in contributions, particularly through bonus or salary sacrifice; and the,

3) Addition of more fund choices from our multi-manager platform.

No two retirement plans are the same but across our client base we can see how thinking develops, which themes emerge, how different methods of delivery succeed – or fail - and what works better and why. I and my team of relationship directors are here to assist you and your business get the most out of your employee retirement plan – why not talk to us?

The purpose of DC Communicator is to look at the issues which concern you. I would therefore encourage you to let me know what you would like to see in future issues.

Regards

Alan Salamon
Head of DC Client Management

Meeting clients' training needs

Having recognised the growing demand for DC specific training, three relationship directors from the DC Client Management Team (Amy Bell, Andy Hughes and Andy Worby) recently travelled to Glasgow's Malmaison Hotel to present a half day investment training seminar aimed at DC governance committees and trustees of DC schemes.

From left to right: Andy Worby, Amy Bell and Andy Hughes .

THE NEED TO IMPROVE MEMBER UNDERSTANDING

Twelve clients attended, representing a variety of different industries and types of DC plans (International, GPP, Stakeholder and CIMP). The seminar gave a brief overview of the issues and trends facing those involved in selecting and reviewing investment choices within DC Plans. Integral to this was an analysis of members' investment styles throughout the DC market, reviewing why the majority struggle to understand basic investment principles and why most fail to appreciate the impact this may have on their retirement income.

INVESTMENT STYLES, STRATEGIES, RISK AND MORE…

The session continued by explaining a number of the key investment asset classes and their opportunities for DC before moving onto styles of fund management, alternative methods of measuring investment performance and the challenges and opportunities attached to investment risk. The morning concluded with a review of investment strategies which included a discussion about members' asset allocation and lifestyling before a well deserved lunch over which the lively debate continued.

LOOK OUT FOR A SEMINAR NEAR YOU

Since the Glasgow event we have repeated the seminar on two occasions in London.The training is free of charge to current clients and provides CPD opportunities for both the PMI and CII. We are always interested to receive your feedback on the suitability of content and locations for client events and would encourage you to get in touch with your Relationship Director.

In search of the ideal DC plan

Client – "We are an independent board. We make our own decisions in the interests of our members. We set our own investment strategy! But tell me," – and here the assertion drops to a whisper – "off the record and just as a matter of interest, what is everyone else doing?"

In short, the answer is thinking about change, particularly with reference to investment strategies and member communications.

INVESTMENT STRATEGIES

- Schemes using long phasing cycles within lifecycle strategies are looking to shorten them, while schemes using shorter cycles are looking to stretch them; and,

- Schemes that use all-equity funds in the growth phase of lifecycle are looking again at the concept of balanced funds (which they discarded some years ago), while those who stayed with the balanced approach are now looking at all-equity funds.

- Schemes with a handful of funds wonder if they should offer more, while those offering a wide range are concerned that too much choice leads to paralysis or the need for too much oversight.

- Clients seeing no switching between funds worry that not enough is being done to promote the need for members to take more responsibility for their investment strategy. On the flip side others fear that lots of activity would indicate their members are engaged in the risky strategy of chasing markets.

These often opposing activities are being generated by a perceived need to make changes on the basis that any action taken will be positive. However, change for change's sake can be counterproductive and not necessarily in the members' best interests.

THE NEED FOR MEMBER LEVEL FOCUS

Trustees and governance boards are seeing ever more clearly that DC investment is fundamentally different from that of DB. Consequently, to promote member participation and appreciation, clients are changing their focus. They have recognised the importance of focusing their DC investment strategy and education policy at the level of individual members as opposed to the collective level of the scheme.

From this recognition emerges three further points for consideration:

First, with DC member horizons stretching for the whole of their lifetime – 30, 40, 50 years or more – possibly encompassing many employers and personal retirement plans – the funds offered must allow members to exploit this long-term timeframe.

Second, DC members should be targeting as big a fund as possible for retirement - in line with their appetite for risk. The DC plan is not about matching assets with any employer or plan driven liabilities which frequently influences fundamentally different investment styles. This means members must be able to strike a balance between going for growth and protecting what they have already. The fund range must therefore be broad with plenty of scope for growth and consolidation.

Third, the success of a DC scheme will require members to understand the choices open to them, what they mean and what assistance they are given to help make decisions.

Together these three points are prompting governance boards to look more closely at fund choice and investment education, not just as a one off review but as a regular and planned activity over the longer term.

These topics are typical of what Fidelity's Relationship Directors are discussing with clients with the aim of bringing a sense of structure and evidence to the debate. Please use us as a sounding board for your own ideas or ask us what we are seeing across the industry. Later articles will look in more detail at the widening range of funds being made available and the risks of lifecycle strategies.

A sacrifice worth considering

Over the last 12 months you will probably have come across a number of references to the benefits of salary sacrifice. Having produced our own factsheet and case study examples it is currently one of the top ten subjects clients are asking us about. Following discussions many of you have now got the ball rolling towards establishing your own schemes.

For those unfamiliar with the concept, salary sacrifice is a tax efficient way of making pension contributions on behalf of employees. Companies are using the strategy as a legitimate tool to lessen the impact of National Insurance (NI) costs whilst at the same time enhancing the value of the pension scheme, increasing employee loyalty and boosting the value of their individual pension pots at retirement.

WHAT IS SALARY SACRIFICE AND HOW DOES IT WORK?

The principle is that the employee gives up the right to receive part of their salary (or bonus for bonus sacrifice) in return for a non-cash benefit. In a pensions scenario the employee agrees to give up the right to receive a sum equivalent to the amount that they would normally contribute to their pension. Because the amount sacrificed is no longer being paid as salary, the employer is no longer required to pay the 12.8% NI contribution on it. This saving could be paid into the employee's pension at no extra cost to the employer and make a considerable difference to the long-term value of the employee's pension pot. A further benefit is that the employee also saves NI on the sum sacrificed, up to 11% (depending on their earnings).

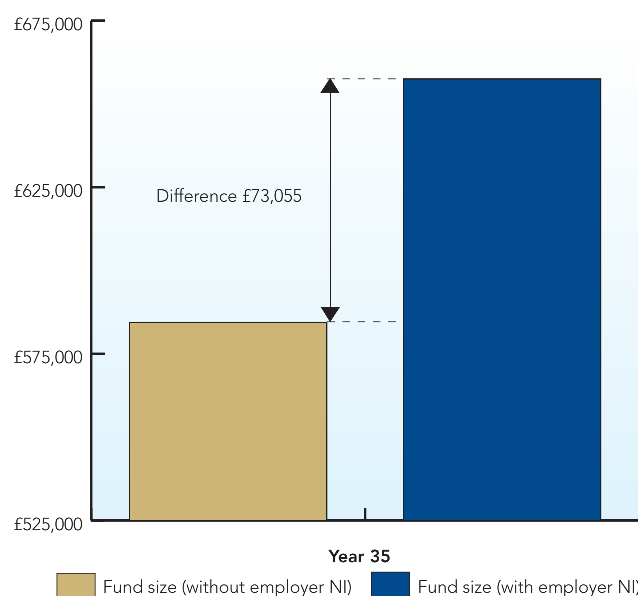
A LITTLE GOES A LONG WAY

To illustrate the benefits of salary sacrifice the graph shows an example of a pension fund belonging to a 30 year-old (retirement age 65) currently earning £25,000. He has chosen to sacrifice 10% of his salary (on which the employer will save 12.8%) in order to fund his pension. If the employer were to add the 12.8% NI saving to the pension fund on an ongoing basis, the difference in the final pension value is a significant £73,055. Based on current annuity rates this would mean an extra annual retirement income in the region of £5,310 for the employee†.

Salary sacrifice isn't suitable for all employees, particularly low earners, because it can affect statutory benefits. Furthermore, as it must be set-up to meet HMRC guidelines, professional advice is recommended. If you would like to be sent a copy of our salary sacrifice factsheet or discuss the matter further please contact your Relationship Director.

† Source: The Annuity Bureau. Scottish Equitable annuity rate of 7.286% (male aged 65: no escalation) as at 30.05.07.

The difference that adding employer NI savings can make to employees' pensions



The figures in the graph are based on contributions that are paid annually, assumed fund growth of 7% p.a. and zero management charges. Salary inflation of 4.3% p.a. (average annual earnings increase according to National Statistics between Feb 1997 to Feb 2007) has been included.

WHO'S WHO

Andrew Worby

Andy Worby has 25 years of pensions' experience. He is a holder of the Investment Management Certificate and for 8 years has been working as a Fidelity Relationship Director. Andy has two sons and enjoys the countryside and (good) wine when work and family allow the time.

Amy Bell

Amy has 10 years of DC pensions' experience, over four of which have been with the Fidelity Client Management Team. Amy holds the FPC and G60 certificates and is working towards APMI. Prior to Fidelity, Amy worked predominantly on SIPP and SSAS clients for two benefit consultancy firms.

Amy coaches swimming in her spare time and when not trying to keep teenagers afloat she occasionally swims in competitions herself.

Pension Plans – The Next Generation

Having spoken at this year's NAPF conference, Roger Servison, President of Fidelity's Strategic Initiatives Group, also presented to a number of you at our Cannon Street offices in London. Roger shared his experiences from the US to give a fascinating insight to *The Challenges of Helping People Prepare for Retirement.*

In America, assets in DC exceed those in DB, with approximately three-quarters of workers now invested in a DC scheme. By analysing three decades of DC provision in the US, Roger highlighted a number of strategies that could help improve prospects for future retirees. This included addressing the problem of unsuitable asset allocation and the issue of increasing longevity eroding the value of pensions in payment.

ENCOURAGING ACTIVE ASSET ALLOCATION BY DEFAULT

The chart opposite is based on over ten million participants in Corporate Defined Contribution plans administered by Fidelity's affiliate company in the US. It shows that many people still adopt a black and white position towards equity investing and this often does not correlate sensibly to age.

Many people in their 50s still invest all of their assets in equities whilst many people aged 40 or less are still investing a high percentage of their assets in cash or fixed income securities. This also suggests that few people are rebalancing their portfolios over time. In contrast, the blue band running down the chart is the exposure to equities in a typical lifecycle strategy, with the yellow band showing a range of plus or minus ten percentage points from this benchmark. Relatively few people are in this position.

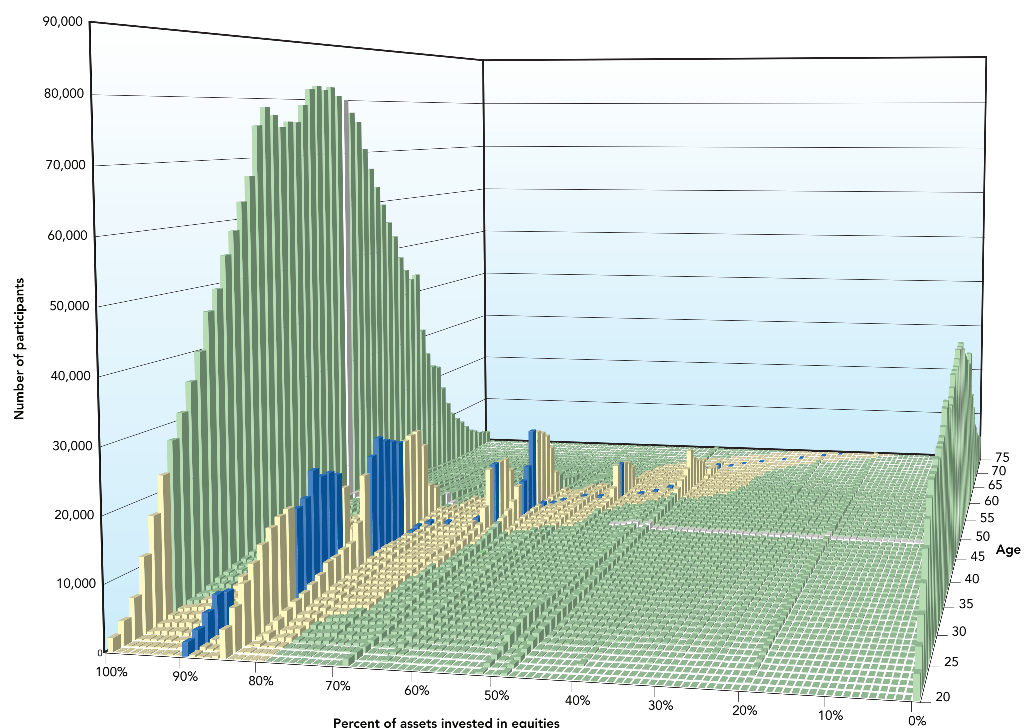
To correct this imbalance Roger highlighted the importance of adopting an actively managed lifecycle default fund, where the member's asset split evolved over their working lifetime. By exposing themselves to a higher percentage of equities early on in their careers, investors have a more realistic chance of making adequate capital gains. Equally, a move towards bonds nearer retirement would allow gains to be locked in. However, maintaining an element of equity exposure throughout retirement would, he said, need to become a more common feature in retirement planning as retirees look to their investments to provide a better income for longer.

INNOVATIVE FEATURES TO HELP AVOID FUND EXHAUSTION IN RETIREMENT

Other features seen as central to the success of future retirement planning include auto enrolment, to boost take-up levels and auto contribution increases, in order to escalate levels of savings in line with salary increases. Roger was also keen to point out that insurance products that contributed to the costs of long-term care would also go some way to making DC schemes a more attractive proposition.

The seminar was well received by all those who attended and triggered some interesting discussion over coffee afterwards. We will of course keep you posted about similar events that you may like to attend.

Asset allocation decisions of DC members



Source: FESCO Corporate Defined Contribution data as at 31.03.2007

The benefits of a more retail approach

The traditional institutional investor is a defined benefit pension scheme which sets risk and performance benchmarks for their fund managers, usually over 3 year time horizons. In contrast, retail investors usually invest in funds which are not strictly constrained by benchmarks and therefore allow a greater degree of investment flexibility. It follows that retail investors generally accept greater volatility in order to gain potentially higher returns.

What we are seeing now is a realisation amongst some plan sponsors that over the long-term DC members need higher fund returns than employers were happy to see on their DB plans (where a member's actual target pension was not the aim of the investment strategy).

As well as adding retail style funds (unconstrained by the benchmark) to DC plans, there is a move to relax risk controls within institutional funds. Consequently, the gap between institutional and retail style investing is narrowing. It seems perfectly logical for an employee spending many decades within a DC savings environment – probably with several employers – to consider a greater exposure to unconstrained investing.

What types of funds are suitable for your members? It largely depends on the level of volatility that members are comfortable with, their target for retirement and how much they can afford to contribute. While these values and targets are impossible to personalise for every individual, it is possible with thought and planning to cover many of the bases for most employees.

We will see a growing trend for unconstrained investing within DC plans and this is an area your Relationship Director will be happy to discuss further with you.

Fidelity DC Client Management Team

Alan Salamon
Head of DC Client Management
01737 837528

David Alchin
Relationship Director
01737 836478

Nicky Barker
Relationship Director
01737 836877

Amy Bell
Relationship Director
01737 837638

Georgie Edwards
Relationship Director
01737 837592

Andrew Hughes
Relationship Director
01737 837691

Martin Speakes
Relationship Director
01737 837167

Andrew Worby
Relationship Director
01737 836354

Samantha Dixon
Senior Manager, Business Team
01737 836355

Lana East
Associate, Business Team
01737 834426

Rita Galbraith
Assistant Manager,
Business Team
01737 837622

ROY AND BILL'S DILEMMA...

Fidelity International Limited (FIL) was established in Bermuda nearly 40 years ago and provides asset management services to investors outside of the Americas. Fidelity International Limited (FIL) and its respective subsidiaries form the global investment management organisation that is commonly referred to as Fidelity or Fidelity International. Unless otherwise stated all products are provided by FIL, and all views expressed are those of Fidelity. Fidelity only gives information on its products and does not provide investment advice based on individual circumstances. The document may not be reproduced or circulated without prior permission and must not be passed to private investors. Past performance is not a guide to future returns. The value of investments may go down as well as up and an investor may not get back the original amount invested. Issued by Fidelity Investments Life Insurance Limited (FSA registered number 186526) a firm authorised and regulated by the Financial Services Authority. Fidelity Investments Life Insurance Limited is a member of the FIL group of companies and is registered in England and Wales under the company number 3406905. The registered address of the company is Oakhill House, 130 Tonbridge Road, Hildenborough, Tonbridge, Kent TN11 9DZ, United Kingdom. Fidelity's VAT identification number is 395 3090 35.
IPF706/23007/PDF/MCS1756