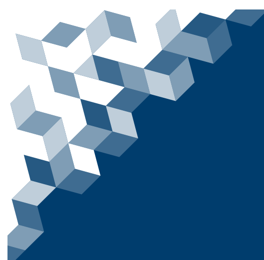
COLUMBIA THREADNEEDLE INVESTMENTS



# INTELLIGENT THINKING

## Is your default fund fit for purpose?

### Are we setting retirees up for failure by default?

**Chris Wagstaff**
Head of Pensions and Investment Education, Columbia Threadneedle,
and Senior Visiting Fellow, Finance Faculty, Cass Business School

## Executive summary

- Addressing the inadequacy of retirement provision has arguably become the biggest socio-economic challenge facing the UK as the aspiration to generate a good financial outcome at and in retirement typically fails to meet the reality by some margin.
- Secular trends, including the time spent in retirement continuing to increase, and the continuing prospect of more modest real investment returns and yields, compromise the ability to achieve a good financial outcome to and through retirement.
- The foundation of a good financial outcome at retirement starts with sufficient saving. However, according to the *Russell 10/30/60 Retirement Rule*, the amount saved during one's working life typically accounts for only 10% of the stream of income paid out during retirement, investment growth on those savings pre-retirement might account for 30%, while up to 60% of retirement income is dependent on investment growth during retirement.
- With most individuals having a low level of numeracy and financial literacy and increasingly having to take more responsibility for their financial futures, when there is a lack of suitable frames of reference, sufficient guidance and advice, means that most people are ill equipped to engage with the complexity of investment decision making.
- Most pension savers passively adopt the default fund.
- There is a misplaced perception that by adopting the minimum contribution rate and investing in the default fund one's retirement needs are taken care of.
- Although many default funds meet the needs of most DC savers, a considerable number do not and so are arguably unfit-for-purpose. Many remain wholly or significantly exposed to equity markets, with little genuine diversification. Additionally, many attract particularly high charges owing to high portfolio turnover and derivatives structures that provide capital protection.
- A fit-for-purpose default fund should be focused on targeting a deliverable inflation-plus absolute return objective, with lower volatility than equities, be robust against a range of market conditions, courtesy of well thought out diversification and genuinely skilful and dynamic asset allocation and active fund management, with the potential to anticipate and swiftly react to changing market conditions.
- Given the enormity of the structural and behavioural challenges and impediments most people face in making an active investment choice, for many utilising a fit-for-purpose default fund arguably remains their best possible option.
- Fit-for-purpose default investment solutions, comprising actively managed and well-diversified multi-asset funds, play a prominent role in managing the principal risks faced by investors at and in retirement.
- If better individual and more socially desirable financial outcomes are to be achieved *to and through* retirement, then not only will the level and coverage of saving need to increase but so will the thought given to the design and construction of what can be considered genuinely fit-for-purpose default funds. After all, up to 90% of the income taken in retirement depends on it.

## The problems of inadequate saving and inappropriate investing

The foundation of a good financial outcome at and in retirement starts with saving sufficient throughout one's working life, ideally from an early age. Indeed, delaying saving for just a few years, or taking a break from saving during one's working life, can have a marked impact on the percentage of earnings that will need to subsequently be saved if one's standard of living isn't to suffer in retirement.[1] Then, of course, there's ensuring that these savings are invested appropriately to generate a stream of real returns in the run up to retirement. The UK falls short on both counts. Indeed, the aspiration to generate a good financial outcome at and in retirement typically fails to meet the reality by some margin. That is why addressing the inadequacy of retirement provision has arguably become the biggest socio-economic challenge facing the UK.

Although investing appropriately is typically given less emphasis than saving sufficiently, the *Russell 10/30/60 Retirement Rule* shows, perhaps counter intuitively, for those with defined contribution (DC) savings who draw down, rather than annuitise, their savings as an income in retirement, that the amount saved during one's working life typically accounts for only 10% of the stream of income paid out during retirement. Investment growth on those savings pre-retirement, however, might account for 30%. Even more surprisingly, that means up to 60% of retirement income is dependent on investment growth *during* retirement.[2] So, up to 90% of the stream of income paid out in retirement is attributable to investment growth *to and through* retirement. Obviously, without saving, investment growth cannot materialise. However, the importance of investing these accumulated savings appropriately to and through retirement cannot be over emphasised.

## Secular trends

The challenges posed both by inadequate saving, acknowledging that saving via a pension is just part of the long-term savings jigsaw, and failing to invest these savings appropriately, must be viewed against the backdrop of two secular trends: the time spent in retirement continuing to increase and individuals increasingly having to take responsibility for their own financial futures, as collective passivity cedes to individual responsibility. The latter is a consequence of the ever increasing prevalence of DC workplace scheme provision – as defined benefit (DB) schemes continue to close to new and existing members – and diminishing state pension benefits as people receive their state pensions increasingly later in life. Both trends compromise the ability to achieve a good financial outcome to and through retirement and are further compounded by the continuing prospect of more modest real investment returns and yields, especially if interest rates remain lower for longer.[3]

## Impediments to achieving a good financial outcome at retirement

> "The mind is a cognitive miser. It doesn't like to expend mental energy."
>
> David Brooks
> The Social Animal[4]

However, assuming greater responsibility for their own financial futures doesn't mean individuals should be left to their own devices in determining what a good retirement outcome to and through retirement looks like and how best to go about achieving it. Indeed, most people are woefully ill equipped to do so, given the complexity and multiplicity of the decisions to be made, the alarmingly low level of basic numeracy and financial literacy amongst the UK adult population and a general tendency to avoid making decisions for fear of regret, not to mention overcoming perhaps the biggest hurdle of them all: inertia.

Establishing and realising a good retirement outcome, however defined, is especially problematic given the lack of frames of reference and a paucity of guidance by which to navigate the plethora of financial jargon and evaluate the bewildering array of complex choices (the paradox of choice) and opaque charging structures. This is compounded by a widespread unwillingness or

[1] According to *The Future Book: unravelling workplace pensions*. Daniela Silcock, Tim Pike and Shamil Popat. Published by the Pensions Policy Institute, October 2015. ISBN: 978-1-906284-34-3, p.24, for the median earner in the UK to have a 2/3 probability of replicating working life living standards in retirement, they need to contribute between 11% and 14% of band earnings (£5,824 to £43,000 in 2016/17) between the age of 22 and state pension age, assuming that the UK state pension retains its unique annual index linking in the "triple lock" (the higher of 2.5%, wage growth or the consumer price index). Delaying saving and/or taking a break from saving during their working life can mean this contribution rate could rise to 27%. According to the Department of Work and Pensions in its *Scenario analysis of future pension incomes*, August 2014, p.7, "around 11.9 million adults below State Pension Age are not saving enough to provide an adequate retirement income."
[2] See: The Russell 10/30/60 Retirement Rule. Russell Investments. July 27, 2015.
[3] The neutral, or policy, rate of interest is central to forecasting the sustainable level of returns from risky assets.
[4] David Brooks. The Social Animal. Random House. 2012. p.218.

## Asset Allocation: the pivotal decision in constructing a fit-for-purpose default fund

Getting the asset mix right really is the big investment decision and key to constructing a fit-for-purpose default fund. Indeed asset allocation "explains" between 90 to 94 per cent of the variability, or ups and downs, of pension fund returns over time if a broadly conventional asset allocation policy and conventional active fund management is employed[8]. The more dynamically managed the asset allocation mix – and anecdotal evidence suggested it should be more dynamically managed than it currently is by most – the greater the potential contribution of dynamic asset allocation to the variability of returns. The remainder – the six to 10 per cent – is attributable to market timing and stock selection. Secondly, between 33 and 75 per cent of the *difference* in the variability of returns between funds can be "explained" by differences in their respective asset allocation mixes[9]. Finally, on the basis that active fund management *in aggregate* net of costs is a negative sum game, acknowledging the increased prevalence of "closet trackers" at one end of the spectrum that drag down the average active performance and somewhat overwhelm those very talented active fund managers who exhibit genuine skill at the other[10], means that the asset allocation mix "explains", on average, between 99 and 100+ per cent of absolute pension fund returns[11]. So getting the asset mix and the asset manager who can dynamically manage this asset allocation right really is the big investment decision.

As well as being the biggest decision, it's also the hardest to get right given the challenges of calculating the expected returns and risks – the volatilities and correlations – of all the asset classes considered for potential inclusion in the asset mix. This challenge is further complicated by the asset mix having become increasingly diverse, often including alternative and illiquid assets whose risks and returns are difficult to model. Arguably, as asset classes become more esoteric, so the asset mix should diversify by an asset class' exposure to risk factors than by the name, or descriptor, of the asset class.

So, if a default fund is to be fit-for-purpose, then continually getting the asset allocation decision right is critically important.

inability to pay for financial advice, which is now firmly targeted at the more financially savvy top end mass affluent and high net worth markets rather than the less sophisticated mass market.[5] As such, there remains a deep seated reluctance to engage with pensions and retirement outcomes and the complexity of investment decision making.

Consequently, sub optimal savings levels are arguably compounded by the vast majority of DC pension scheme members, particularly auto enrolees, passively opting for the default fund.[6] Indeed, just as the minimum contribution rates of workplace pension schemes, particularly auto enrolment workplace pension schemes, are widely perceived by members as target saving levels,[7] so default funds are seen as the "recommended" investment medium. For many, not least auto enrolees, the perception is that by adopting the minimum contribution rate and investing in the default fund, their retirement needs are taken care of. The reality is so, so different.

## The default fund

**What is wrong with investing in the default fund?**

Given that as much as 30% of the income stream in retirement is generated by investment growth pre-retirement, it is incumbent on the providers of default investment options and those who advise DC workplace pension schemes on the selection of defaults to make them as appropriate to the needs of an often broad membership base as possible. However, there are issues.

[5] This has been an unintended consequence of the UK's 2013 Retail Distribution Review, which moved the commissioned-based advice model to fee paying and in raising professional standards through professional examinations, saw the number of independent financial advisers fall quite dramatically.
[6] According to The Future Book op. cit. p.23, 85% of DC workplace pension scheme members and 99% of those within master trusts invest via the default fund.
[7] Auto enrolment minimum contributions are typically seen as having been endorsed by the government as being adequate. Rather, low initial auto enrolment minimum contribution rates were deliberately set at the outset to minimise employee opt outs. Increases to these minimums don't come into effect until April 2018 and April 2019.
[8] Gary P. Brinson, L. Randolph Hood and Gilbert L. Beebower. Determinants of Portfolio Performance. The Financial Analysts Journal, Vol 42 No4, July/August 1986. Roger G. Ibbotson. The Importance of Asset Allocation. Financial Analysts Journal, Vol 66 No2, 2010.
[9] Roger D. Ibbotson and Paul D. Kaplan. Does Asset Allocation Explain 40, 90 or 100 Percent of Performance? AIMR 2000.
[10] See: Not all active managers are created equal – what to look for and why. Chris Wagstaff. Columbia Threadneedle Investments. June 2015.
[11] Ibbotson and Kaplan (2000). Ibid.

### The "one size fits all" approach isn't always right for everyone

Although many default funds, principally diversified growth funds (DGFs), meet the needs of most DC savers through judicious active asset allocation and the active management of genuinely well diversified portfolios, by increasingly targeting and delivering inflation-plus returns, low volatility and implicit downside protection, a considerable number do not and so arguably remain unfit-for-purpose. This is evidenced by the wide dispersion of risk-adjusted performance and idiosyncratic risks attached to default fund strategies. Indeed, many remain wholly or significantly exposed to equity markets, with little genuine diversification, rendering them unsuitable for all but those with smaller pension pots, a long-term investment horizon or a strong risk appetite.

### Charges

Then, of course, there's the issue of charges. Many default funds attract particularly high charges, especially those with a high portfolio turnover, hence transactions costs, and those which employ derivatives within their portfolio structures to provide capital protection.[12] High charges without commensurate risk-adjusted returns simply eat away at the saver's capital.[13] Against the backdrop of more modest investment returns, more than ever value for money remains key.

### Inappropriate lifestyling

Additionally, despite the advent of pension freedom and choice, the default position for many DC workplace pension schemes is still to employ "lifestyling". This is typically where five to 10 years before the member's stated or assumed retirement age, the member's pension pot is automatically invested or phased into a cash and/or fixed income fund on the assumption that the pot will be annuitised, which increasingly it won't. Given that default pathways now need to reflect a less well defined destination point, the imperative should be how best to preserve the value of the member's pensions pot until they are in a position to choose their desired path in retirement. Indeed, given the Russell 10/30/60 Retirement Rule, the potential opportunity cost of moving into less volatile assets for those who intend to draw down, rather than annuitise, their pension savings when the size of the pensions pot is at or near its peak, is enormous.

## Fit-for-purpose default funds

In order to think about what a fit-for-purpose default solution should comprise, looking at what it shouldn't is perhaps a good place to start.

### Inappropriate risk aversion

Firstly, it is critical that default funds take sufficient investment risk, even those targeted at new auto enrolees, many of whom wouldn't have had any experience of investing before. Often automatically enrolled into a low risk default fund, these novice investors are provided with the emotional comfort of the fund avoiding any market draw downs in their first few years of investing. However, although correctly intentioned,[14] these savers are arguably saddled with potentially significant opportunity costs by not taking investment risk precisely at the point when it should be taken, i.e. with a long-term investing horizon and a small pensions pot. Indeed, assets that traditionally experience high short-term volatility are those that deliver superior long-run risk-adjusted returns.

### Loss aversion and downside protection

Similarly, default fund solutions that seek to address the more immediate loss aversion fears of long-term investors are arguably misplaced. *Loss aversion*, or *prospect theory*, describes the asymmetric motivation to avoid losses, given evidence that most investors derive greater displeasure from a loss than they do pleasure from an equivalent gain. The extent of this loss aversion will depend on a number of factors, such as whether losses have recently been made and the magnitude of those losses. As such, loss aversion isn't stable over time.

Default funds with explicit downside protection typically employ complex derivative strategies to address this aversion to losses. However, arguably these solutions are a prime example of "academic lift and drop". That is, when a behavioural intervention is applied to a real world practical problem without proper testing. Indeed, this hedging fails to accurately reflect an individual's loss aversion at any one point in time and will either have an explicit cost that directly impacts the fund's performance or an opportunity cost in terms of putting a cap on the potential upside of the fund. Neither is appropriate for a long-term investor, who must assume an element of risk in order to generate return, especially against the

[12] Transactions costs and costs arising from employing derivatives fall outside of the mandated 0.75% OCF charges cap applied to those default funds used for auto enrolment.
[13] There is no evidence to suggest that funds with high charges generate superior risk-adjusted returns.
[14] This investment policy was implemented on the back of qualitative research that suggested poor investment performance is associated with embezzlement, and market downturns are blamed on bad fund management.

backdrop of lower prospective investment returns. Despite this, many solution providers persist with these capital protected solutions, which can simply end up delivering nothing more than a cash-type return.

### What a fit-for-purpose default fund comprises

Indeed, if default fund design is to meet the needs of a broad membership and not to result in being approximately wrong for everyone, then it should be focused on targeting a deliverable inflation-plus absolute return objective, with low volatility, be robust against a range of market conditions, courtesy of well thought out diversification and genuinely skilful and dynamic asset allocation and active fund management, with the potential to anticipate and swiftly react to changing market conditions. When properly constructed, managed and with a competitive charging structure that offers value for money, such default funds are hard to beat.

## Making an active decision by self selecting investment funds

### Why is there a lack of appetite to self select investment funds...

Very few DC workplace pension scheme members self select investment funds. Aside from the widely held perception amongst DC scheme members that the default fund must have been well thought through, be fit-for-purpose and therefore the most appropriate fund through which to save, the lack of engagement by members to self select investment funds is largely a consequence of the impediments to informed decision making already considered and choice overload stemming from the sheer number of funds typically made available. The complexity of investment decision making, opaque choices, a low level of numeracy and financial literacy, inertia, and the lack of frames of reference to guide and inform and the advice gap all play a part. Indeed, under such circumstances, individuals tend to use mental short cuts, or succumb to heuristics, to simplify the complex reality of the decisions to be made, which invariably results in sub optimal decision making. As a consequence of all of these impediments, anecdotal evidence suggests that many of those individuals who have attempted to make active investment decisions without the requisite tools, guidance or advice haven’t fared at all well. Indeed, statistics regularly point to well over half of those making investment decisions more generally, as seeking little, if any, financial advice.

### ...and does it matter?

However, there is a still a need to think about how best to help those individuals who are motivated and capable, but not particularly well equipped, to make an active investment decision that may better fit their unique and ultimately changing circumstances. Indeed, as default funds must accommodate DC members of all ages, with differing terms to retirement, and risk appetites, better outcomes could potentially be achieved by certain of those, motivated to make a conscious, or active, investment decision that better reflects their individual circumstances and preferences. Again, focusing on those key behavioural traps to avoid is a good place to start.

### Avoiding behavioural traps

### Trap 1

The first trap the individual should avoid is basing portfolio construction around their revealed risk and return preferences today and failing to revisit these and the appropriate positioning of the portfolio as their goals and circumstances change. Indeed, in succumbing to status quo bias and inertia, there is a widespread tendency amongst savers to stick with their original choice of funds ad *infinitum*.

### Trap 2

Secondly, revealing these preferences will be heavily influenced by the way in which the individual frames, or positions, the decision problem to themselves or how it is framed to them, including the metrics used within the decision making process. For instance, using volatility as a measure of risk, rather than the risk of a permanent diminution of capital, and confusing the former with the latter, is potentially harmful for an investor with a long-term investment horizon, as it may result in them taking too little risk, to the detriment of risk-adjusted returns. After all, relatively high daily volatility and short-term “paper” losses typically translate into a much more muted and palatable annual volatility number and potential long-term *gains*.

### Trap 3

Once constructed, the investor must avoid, so-called, *myopic loss aversion*. That is, over monitoring their portfolio if they’re not to start believing the portfolio is riskier than it really is, again by confusing volatility with a permanent loss of capital. The consequences of myopic loss aversion are, once again, to move into potentially inappropriate lower risk funds or asset classes. Closely linked to this is obsessing over short-

term performance, not least short-term relative performance, when the focus should be on growing wealth through good medium to long-term absolute performance if defined investment goals are to be realised.

**Trap 4**

Then there's the need for individuals to avoid being *overconfident* in their ability to time market moves between funds, asset classes and strategies. As the old adage goes, "Time in the market is more important than timing the market." That's not to say the portfolio shouldn't be regularly rebalanced, costs permitting. It should. Indeed, evidence points to *at least* an annual review of asset allocation adding value. Of course, in order to facilitate switching between funds, which is increasingly performed online, the process must be made hassle free, given that the merest detail which complicates the process can result in inaction. Broken down into simple, manageable steps, the switching process should include just-in-time education and clear illustrations of how the portfolio's characteristics will change if a fund switch is implemented. Once again, the investor must guard against overconfidence getting the better of them. Invariably overconfidence leads to excessive switching between funds, asset classes and strategies, resulting in transaction costs eating away at returns, often significantly so, against the backdrop of more modest returns.

**Trap 5**

With a unique set of investment goals to achieve, and despite the tendency for individuals, as social animals, to act on the actions and opinions of others, the individual also needs to somehow avoid overly aping others' investment decisions. For instance, one solutions provider, arguably succumbing to "academic lift and drop"[15], has sought to enable investors with similar personal characteristics and portfolio sizes to anonymously share their investment decisions with others. While making such decisions social could encourage better decision making for some, poor decisions are also likely to be emulated with potentially significant long-run costs for others.

**What could be done?**

In helping people make better, more informed investment decisions so that they may build and better position portfolios around their own unique goals and changing circumstances, pension schemes, solution providers and advisers have a key role to play, in providing a more focused fund offering, better framing the decision problem, using appropriate metrics and wordings, breaking down the decisions to be made into simple, manageable steps, and providing just-in-time education that signposts common mistakes and how they should be avoided. Much of this can be facilitated by the use of well thought out, online interactive decision trees and/or robo advice. Indeed, online interactive decision trees that steadily take the individual through the myriad of decisions they need to take to successfully construct a suitable portfolio are one of the simplest and most effective guidance tools to employ for this purpose. However, much remains to be done.

In view of the enormity of the above structural and behavioural challenges and impediments to making an informed, active investment choice, for most utilising the default arguably remains their best possible option. Yet another reason why a considerable amount of thought and action needs to be devoted to the design and construction of fit-for-purpose default funds.

## The problem of managing at and in retirement risks

**Navigating potentially hazardous risks**

These risks comprise quantifying the likely time to be spent in retirement (longevity risk – which is typically underestimated as a consequence of *availability bias*[16]); guarding against (ever more frequent) financial market corrections from which the investor's capital may never recover (drawdown risk); and unexpected inflation that erodes the real value of the investor's capital. If not managed well, these risks can add up to an uncomfortable retirement or, worst case, lead to the retiree outliving their savings. Fearing the consequences of this latter scenario, can in many cases lead to the retiree living too frugally – a problem that was identified in the Murray Review.[17] Of course, determining what constitutes a sustainable level of income withdrawal, given the prospect of historically low interest rates remaining lower for longer, is yet another risk to manage.[18]

[15] This is when a behavioural intervention is applied to a real world decision problem without proper testing.

[16] Availability bias is the tendency to seize on information that falls easily to hand, rather than that which is more difficult to access – the latter typically being more informative. For instance, the publicity around the "celebrity death spike" of early 2016 has been high in the nation's consciousness, with three out of our four show business stars that passed away during the first four months of 2016 having been born shortly after the end of the second world war. This has seen many people anchor their life expectancy to this exceptional series of events, despite the very small sample size of the cohort in question. If information around what percentage of the population of a similar age to these celebrities remain alive and in good health could be accessed more easily, then a more realistic assessment of longevity would result.

[17] See: *The Retirement Phase of Superannuation.* Financial System Inquiry Final Report. November 2014. Commonwealth of Australia 2014. ISBN 978-1-925220-14-8.

[18] See: *Retirement Income Market Data, October – December 2015.* Financial Conduct Authority. April 2016 p5 and *Safe Withdrawal Rates for Retirees in the United Kingdom.* Morningstar. May 2016.

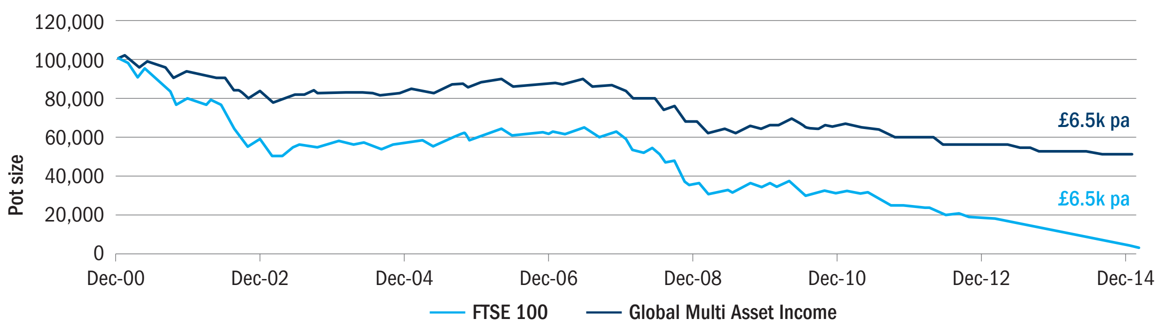
## The dangers of investing in an undiversified manner and taking an unsustainable level of withdrawals at and in retirement

If an investor had invested £100,000 in a relatively undiversified FTSE 100 index fund at the start of 2000 and had then withdrawn £6,500 per annum – increasing these withdrawals by 2% each year to approximate the effect of price inflation – this £100,000 pot would have almost ran dry by the end of 2014. However, if the same investment had been made in an actively managed and well-diversified global multi asset income fund, and the same withdrawals had been made each year, then around half of the investor's capital would have remained intact. This is illustrated in Figure 1.

If, however, instead of a £6,500 annual withdrawal, a £4,000 annual withdrawal,[19] again escalating at 2% per annum, had been made over the same time horizon, then the FTSE 100 fund would have been worth about £69,000 at the end of 2014, while the global multi asset income fund pot would have more than retained its original nominal value at around £116,000.[20] This is illustrated in Figure 2.

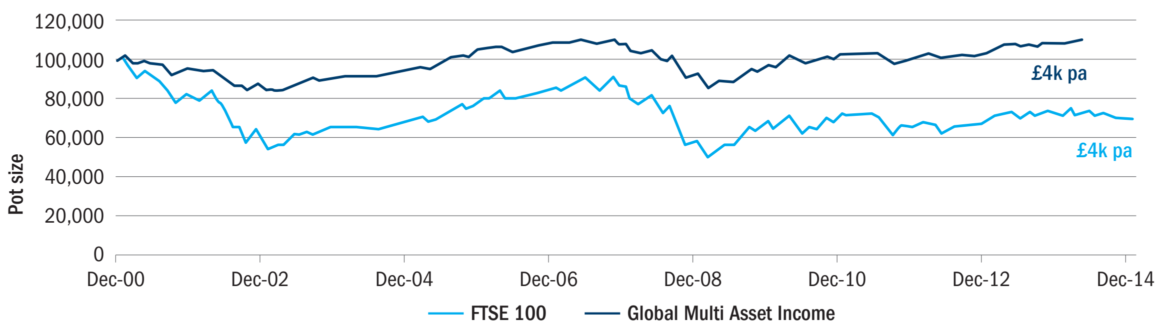
These simple examples illustrate two key points: the dangers of, firstly, investing in an undiversified manner (exacerbated by a passive approach that cannot position the portfolio for prevailing or expected market conditions) and, secondly, taking a somewhat unsustainable level of income withdrawals, especially now against the backdrop of historically low annuity rates and the prospect of more modest long-run investment returns going forward. Both threaten the early depletion of the investor's capital.

**Figure 1: Taking 6.5% annual withdrawals, indexed at 2% per annum, from a FTSE 100 index fund and an actively managed global multi asset income fund**




Source: Columbia Threadneedle Investments (31 January 2015)

**Figure 2: Taking 4% annual withdrawals, indexed at 2% per annum, from a FTSE 100 index fund and an actively managed global multi asset income fund**




Source: Columbia Threadneedle Investments (31 January 2015)

For illustrative purposes only

[19] A frequently applied rule of thumb is to take a 4% annual withdrawal from capital as, other things equal, that should provide the investor with a sustainable level of income for around 25 years – the length of an average retirement.

[20] Source: Columbia Threadneedle Investments. The residual capital sums, before charges, were respectively for the £6,500 annual withdrawals: £4,404 and £50,097; and for the £4,000 annual withdrawals: £68,853 and £116,107.

## Impediments to effective decision making

Against the backdrop of the vacuum of advice, guidance and the lack of frames of reference by which to gauge what is feasible and realistic to achieve at and in retirement, many undertaking this decision making are those who possess a low level of numeracy and financial literacy. Moreover, as individuals enter their 60s, their financial literacy and cognitive ability often starts to decline, not least as a result of the onset of dementia. This impedes effective decision making in retirement at a time when the decision burden has increased immeasurably.

Older generations also tend not to access the technologies that many younger generations take for granted and which enable much to be achieved with minimal effort. Additionally, as the Financial Conduct Authority identifies, as we age we tend to rely less on reasoned, deliberate thinking and more on gut-feel and things learned from experience.[21] This process is further compounded by many individuals having little experience of making proactive investment decisions, having passively selected the default investment option when saving for their retirement.

Moreover, as we noted earlier, without a frame of reference or access to advice, individuals tend to use mental short cuts, or succumb to heuristics, to simplify the complex reality of the decisions to be made, invariably resulting in sub optimal decision making. Indeed, freedom and choice has the potential to give people a positive retirement experience but only if, and it is a big if, the appropriate guidance, simple and intuitive tools, frames of reference and decision making frameworks are provided to enable more informed decision making. After all, as DB benefits disappear, people receive their state pension ever later in life and increasingly become solely reliant on their DC pension pots to support their standard of living in retirement, so the consequences of making a wrong decision at and in retirement will rise exponentially over time.

This once again highlights the critical importance attached to providing fit-for-purpose default investment solutions comprising actively managed and well-diversified multi-asset funds to manage the principal risks faced by investors at and in retirement.

## Conclusion

We noted at the beginning of this paper that addressing the inadequacy of retirement provision is one of the biggest socio-economic challenges facing the UK. This is evidenced by the aspiration to generate a good financial outcome at and in retirement typically failing to meet the reality by some margin. Although a consequence of sub optimal levels of saving and poor savings coverage, it is most notably attributable to inappropriate investment decisions being made and the prevalence of poorly constructed default funds.

If better individual and more socially desirable financial outcomes are to be achieved to and through retirement, then not only will the level and coverage of saving need to increase but so will the thought given to the design and construction of what can be considered genuinely fit-for-purpose default funds. After all, 90% of the income taken in retirement depends on it.

[21] *Ageing population and financial services. A collection of perspectives.* DP16/1. The Financial Conduct Authority. February 2016.

To find out more visit columbiathreadneedle.co.uk

**Important information: For internal use and for Professional and/or Qualified Investors only (not to be used with or passed on to retail clients).** Past performance is not a guide to future performance. The value of investments and any income is not guaranteed and can go down as well as up and may be affected by exchange rate fluctuations. This means that an investor may not get back the amount invested. Threadneedle Opportunity Investment Funds ICVC ("TOIF") is an open-ended investment company structured as an umbrella company, incorporated in England and Wales, authorised and regulated in the UK by the Financial Conduct Authority (FCA) as a Non-UCITS scheme. This material is for information only and does not constitute an offer or solicitation of an order to buy or sell any securities or other financial instruments, or to provide investment advice or services. The research and analysis included in this document has been produced by Columbia Threadneedle Investments for its own investment management activities, may have been acted upon prior to publication and is made available here incidentally. Any opinions expressed are made as at the date of publication but are subject to change without notice and should not be seen as investment advice. Information obtained from external sources is believed to be reliable but its accuracy or completeness cannot be guaranteed. Issued by Threadneedle Investment Services Limited. Registered in England and Wales, Registered No. 3701768, Cannon Place, 78 Cannon Street, London EC4N 6AG. Authorised and regulated in the UK by the Financial Conduct Authority. Columbia Threadneedle Investments is the global brand name of the Columbia and Threadneedle group of companies. **columbiathreadneedle.com**

Issued 05.16 | J25237