Schroders

FTSE Default DC Schemes Report

May 2017

Schroders' 2017 FTSE DC report reveals investment diversification continues to grow – now at its highest level in four years as allocation to UK equities falls

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This edition of the Schroders' FTSE Default DC schemes report is our eighth analysis of the defined contribution (DC) pension landscape among the top listed companies in the UK. The aim of this report is to shine a light on default DC schemes during the accumulation phase in order to examine their different asset allocation strategies. Auto-enrolment has added around 4.7 million DC members to occupational pension schemes since its introduction in 2012, and, as a consequence, there are now 7.1 million DC members of occupational schemes, according to figures from the Pensions Regulator[1]. The initiative is now in its final stage of rollout to new businesses, with those firms that started up after October 2012 now having to meet the new requirements, which will further bolster DC scheme member numbers. From April 6 2018, staff contributions under auto-enrolment will rise from 1% to 3%. This report analyses the asset class mix of the default funds of FTSE companies' pension schemes, examining different strategies, and identifying short-term and long-term trends since March 2013. The DC default funds of 33 FTSE 100 and 28 FTSE 250 companies have been researched for this project.

1 http://www.fca.org.uk/news/fca-publishes-final-rules-for-charges-in-workplace-pension-schemes

Schroders' 2017 FTSE DC report finds investment diversification at a four-year high, as allocation to UK equities falls

For the last few years pensions have rarely been far from the Government and regulator's gaze. The roll-out of auto-enrolment, the introduction of the pension freedoms and a greater regulatory scrutiny of master trusts are just a handful of the changes and issues that have defined the UK landscape of late.

But with another General Election just a few weeks away and the UK embarking on what is sure to be a highly complex and delicate set of negotiations regarding its future relationship with the European Union there could well be scope for pensions to slip down the list of priorities. This may not be a bad thing, giving much-needed time for the recent changes to bed in.

What will remain challenging will be the investment environment as markets continue to operate in a period of heightened political uncertainty. This time a year ago a vote for Brexit and the election of Donald Trump both seemed far-fetched possibilities and proved that investors should avoid complacency, no matter what the bookmakers or polls may be saying!

These events have underscored just how important it is for pension savers to ensure they are well diversified, providing themselves with the best possible opportunity to weather market shocks. Fortunately Schroders' latest FTSE DC report demonstrates that diversification continues to be a focus for the UK's top 350 listed companies' default DC pension funds.

Since 2013 the average allocation to developed equities has fallen seventeen percentage points from 79% to 62%, a fall which has been countered by an increased weighting to both fixed income and alternatives. Specifically, investors' appetite for UK equities continues to decline – with the average allocation having fallen from 33% to 22% over the last four years.

Our investment principles continue to support the benefits that diversification and risk management can bring to pension savers. And although equity markets on both sides of the Atlantic have recorded strong gains over the last 12 months, we would urge pension funds to remain focused on the advantages that diversified portfolios do bring and not fall into any rear-view mirror investment traps.

Stephen Bowles
Head of UK Institutional Defined Contribution,
May 2017

Trends and key findings

- Asset class diversification in the average FTSE 350 DC scheme is at its highest level since Schroders started analysing the default fund asset allocation of DC schemes four years ago, indicating a shift in investment strategies to a broader range of asset classes and a reduced focus on developed equities (comprising UK and global equities combined).
- Asset diversification has been championed by Schroders since our inaugural analysis in March 2013. Since then, the average allocation to developed equities has fallen seventeen percentage points from 79% to 62% and been countered by increased weighting to both fixed income and alternatives, representing a sustained shift towards asset diversification. This shift has continued over the last twelve months.
- The average allocation to fixed income (including government bonds, credit and index-linked bonds) has risen from 9% in March 2013 to 21% in March 2017. In the same period, the allocation to UK equities has fallen from 33% to 22%, putting the two asset classes almost on a par.
- In the last year alone, the allocation to developed equities has fallen five percentage points, while there was an increase in the allocation to fixed income from 16% to 21%.
- The average allocation to alternatives (including commodities, property, hedge funds, absolute-return funds and cash) has increased from 7% to 13% over the same period. Both FTSE 100 and FTSE 250 allocate an average of 13% to the alternatives asset class.

Year-on year asset allocation splits and typical portfolios

The average default DC fund of a FTSE 350 firm invests 62% of its total assets in developed equities, as of March 2017.

This proportion breaks down to an average of 22% of assets allocated to UK equities and 40% to global equities.

Fixed income is the asset class with the third highest average allocation at 21%, followed by alternatives at 13%.

Emerging markets remains the asset class with the smallest average allocation, with the typical FTSE 350 DC fund investing just 3% of assets in this category.

Other or unspecified investments account for 1% of the total fund allocation

Overall average asset allocation ALL FTSE	March 2016	March 2017
UK Equities	25.3%	22.1%
Global Equities	41.4%	39.8%
Developed Equities[2]	66.7%	61.9%
Emerging Markets	4.2%	3.3%
Fixed Income (including government bonds, credit and index–linked bonds)	15.5%	20.8%
Alternatives (including commodities, property, hedge funds, absolute–return funds and cash)	12.5%	13.1%
Other	1.1%	0.8%

2 Global and UK Equities combined

All FTSE portfolio composition: Long and short-term trends

The average portfolio composition of FTSE 350 DC funds is now more diverse than at any time in the last four years, reflecting a consistent move to more diversified investment strategies over this period.

Four years on from our first analysis in March 2013, the average allocation to developed equities has fallen seventeen percentage points from 79% to 62%.

In particular, the average allocation to UK equities has reduced significantly from 33% to 22%, while the allocation to global equities has also shrunk, albeit less markedly, from 46% to 40%.

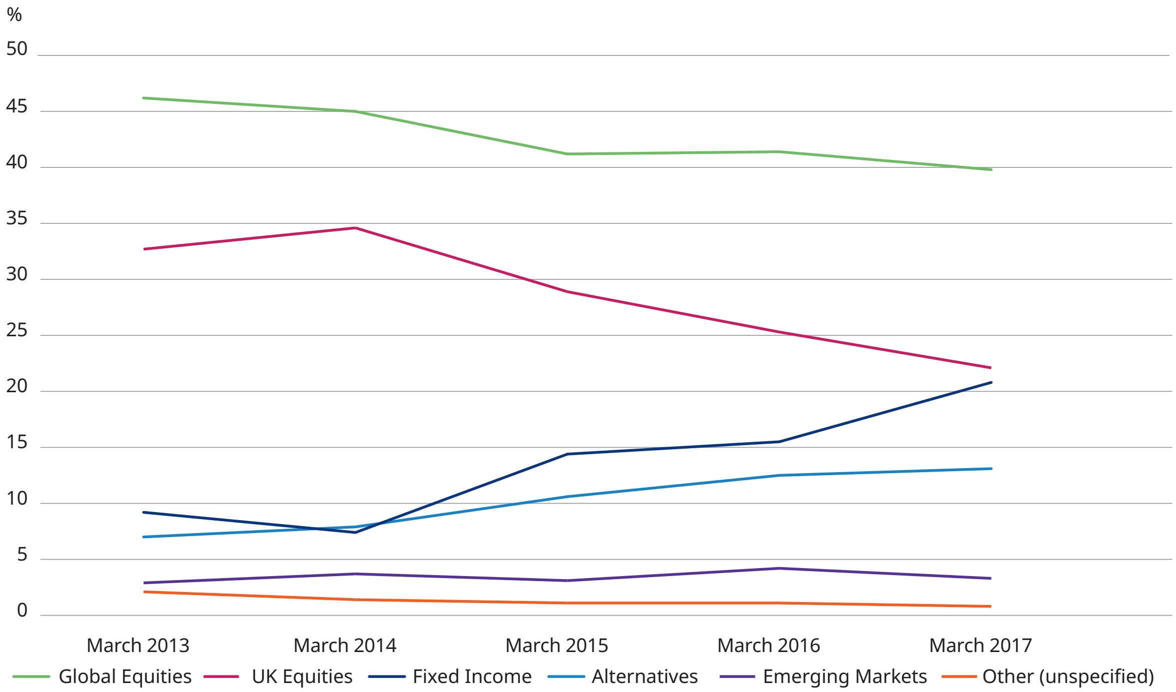
This redistribution of asset allocation away from developed equities has allowed more significant weighting to both fixed income and alternatives. Compared to March 2013, the average allocation to fixed income has more than doubled, rising from 9% to 21%. Over the same period, the average allocation to alternatives has also increased substantially, from 7% to 13%.

In the last year alone, allocation to developed equities has fallen five percentage points, countered by an increase in allocation to fixed income from 16% to 21%. Such is the increase in allocation to fixed income that it is not far behind UK equities.

The average allocation to emerging markets declined slightly to 3%, the same level as four years ago, while the allocation to alternatives has edged up slightly over the year.

Overall average asset allocation ALL FTSE	March 2013	March 2014	March 2015	March 2016	March 2017
UK Equities	32.7%	34.6%	28.9%	25.3%	22.1%
Global Equities	46.2%	45.0%	41.8%	41.4%	39.8%
Developed Equities	78.8%	79.6%	70.7%	66.7%	61.9%
Emerging Markets	2.9%	3.7%	3.1%	4.2%	3.3%
Fixed Income	9.2%	7.4%	14.4%	15.5%	20.8%
Alternatives	7.0%	7.9%	10.6%	12.5%	13.1%
Other	2.1%	1.4%	1.1%	1.1%	0.8%

Average Asset Allocation – FTSE Default DC Schemes



Year-on-year FTSE 100 and FTSE 250 comparison

The average FTSE 100 default DC pension fund allocates almost ten percentage points more towards developed equities than the average for the FTSE 250.

While there was only a narrow gap between allocations towards UK equities (23% for the FTSE 100 compared to 21% for the FTSE 250), there was a substantial nine percentage point gap in allocation to global equities, with FTSE 100 schemes allocating an average of 44% compared to 35% for FTSE 250 schemes.

The average FTSE 250 scheme had a greater allocation to fixed income investments, with a 29% average allocation to this asset class – double that of the 14% average for the FTSE 100.

There was no difference in allocation between the FTSE 100 and FTSE 250 schemes when it came to alternatives, with both standing at 13%.

Both the average FTSE 100 default DC pension fund and the average FTSE 250 default DC pension fund have a relatively small exposure to emerging market equities. However, the allocation to emerging markets was more substantial for FTSE 100 schemes (5%) than FTSE 250 schemes (1%).

Overall average asset allocation (March 2017)	FTSE 100	FTSE 250
UK Equities	22.6%	21.4%
Global Equities	43.7%	35.3%
Developed Equities	66.3%	56.7%
Emerging Markets	5.3%	0.9%
Fixed Income	14.0%	28.9%
Alternatives	13.0%	13.2%
Other	1.2%	0.3%

FTSE 100 and FTSE 250 breakdown: Long and short-term trends

Over the last four years, FTSE 100 and FTSE 250 default DC funds have significantly reduced their exposure to developed equities, but the shift has been more pronounced in the FTSE 250. The average FTSE 100 fund has reduced investment in this category by nine percentage points, from 75% in March 2013 to 66% in March 2017. Meanwhile, the average FTSE 250 fund has reduced allocation to developed equities by twenty-eight percentage points, from 85% to 57%.

In the FTSE 100, allocation towards alternatives has declined, falling from 14% last year to 13% this year.

However, the same is not true for alternatives in the FTSE 250, which are up two percentage points from 11% to 13%.

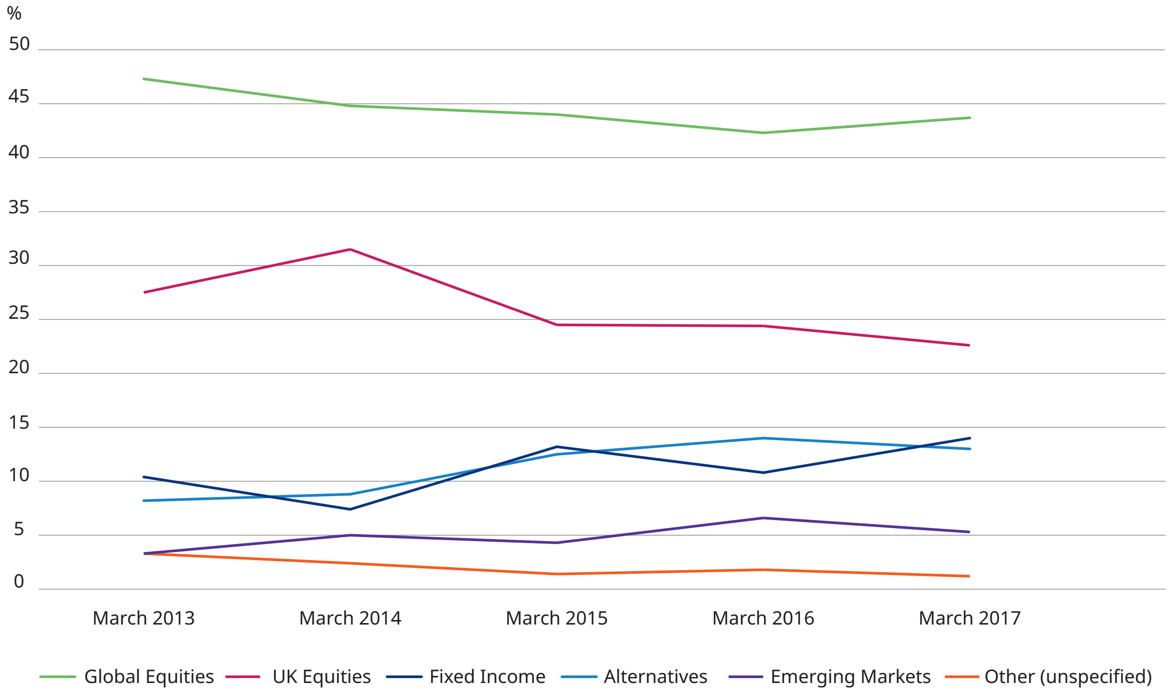
Fund allocation towards fixed income has risen for both the FTSE 100 and 250, but particularly sharply in FTSE 250 schemes where it is up nine percentage points from 20% last year to 29% this year.

FTSE 100 and FTSE 250 firms have both reduced their exposure to emerging markets. Average allocation to emerging markets is down from 7% to 5% in FTSE 100 schemes in the last year, and down from 2% to 1% in FTSE 250 schemes over the same period.

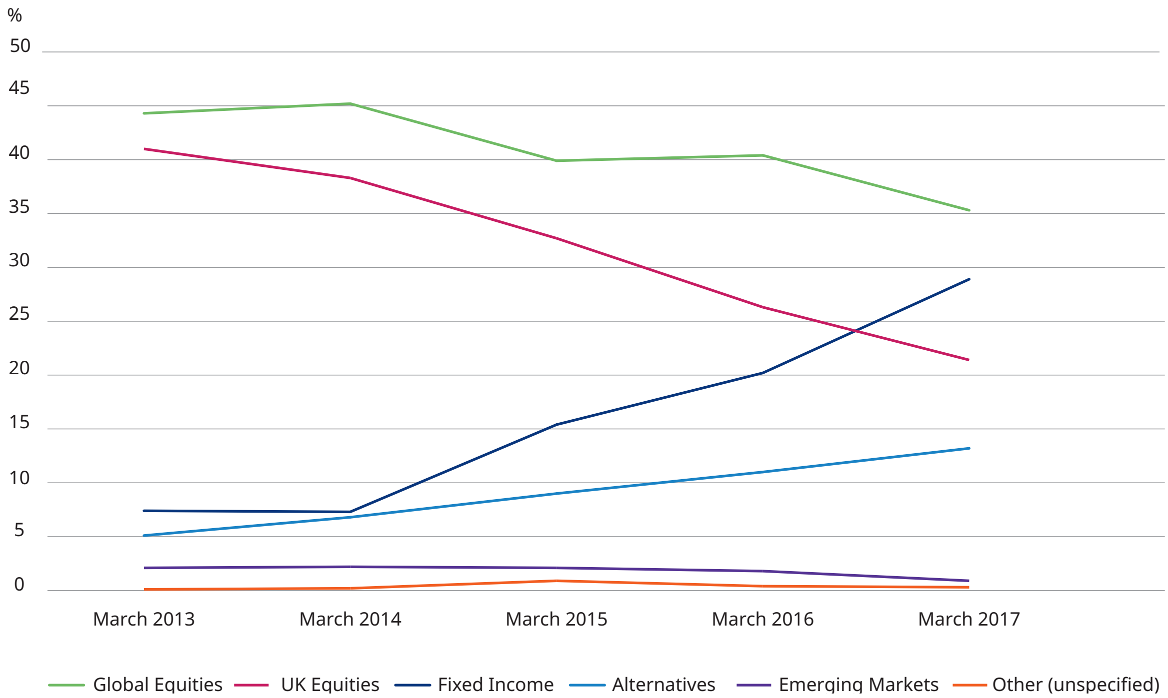
Average asset allocation	FTSE 100				
	March 2013	March 2014	March 2015	March 2016	March 2017
UK Equities	2017	31.5%	24.5%	24.4%	22.6%
Global Equities	47.3%	44.8%	44.0%	42.3%	43.7%
Developed Equities	74.8%	76.3%	68.6%	66.7%	66.3%
Emerging Markets	3.3%	5.0%	4.3%	6.6%	5.3%
Fixed Income	10.4%	7.4%	13.2%	10.8%	14.0%
Alternatives	8.2%	8.8%	12.5%	14.0%	13.0%
Other	3.3%	2.4%	1.4%	1.8%	1.2%

Average asset allocation	FTSE 250				
	March 2013	March 2014	March 2015	March 2016	March 2017
UK Equities	41.0%	38.3%	32.7%	26.3%	21.4%
Global Equities	44.3%	45.2%	39.9%	40.4%	35.3%
Developed Equities	85.2%	83.6%	72.6%	66.7%	56.7%
Emerging Markets	2.1%	2.2%	2.1%	1.8%	0.9%
Fixed Income	7.4%	7.3%	15.4%	20.2%	28.9%
Alternatives	5.1%	6.8%	9.0%	11.0%	13.2%
Other	0.1%	0.2%	0.9%	0.4%	0.3%

Average Asset Allocation – FTSE 100 Default DC Schemes



Average Asset Allocation – FTSE 250 Default DC Schemes



The current DC marketplace at glance

a) The regulatory landscape

Over the last few years the pensions sector has faced a raft of regulatory changes, with Government policies re-defining how retirement savers accumulate investment and turn it into retirement funds ('decumulation'). Pension tax relief has been reduced, auto enrolment has been introduced and the 2015 pension freedoms give consumers much greater choice in how they access their pension savings.

In addition, April 2015 saw the implementation of a new 'charge cap' limiting the fees which can be charged to manage default DC pension schemes[4]. Firms providing workplace pension schemes used by employers for auto-enrolment must now cap the charges within default funds to 0.75% per year of funds under management.

b) Auto-enrolment and scheme membership numbers[5]

Membership in DC schemes increased by 42% in the last twelve months, and by over 300% since 2009 thanks to auto-enrolment. 92% of members are invested in the schemes' default strategy.

In total, the UK currently has just 7.1 million members of DC trusts, of whom 4.4 million are active members.

From April 6 2018, staff contributions under auto-enrolment will rise from 1% to 3%.

Methodology

In order to gather a snapshot of the UK DC default funds during the accumulation phase the FTSE 100 and FTSE 250 firms were asked to supply data. This was supplemented by publically available information for their employees, taken from corporate websites. The DC default funds of 33 FTSE 100 and 28 FTSE 250 companies were analysed.

The subsequent data was then broken down into broad asset classes for analysis purposes. All figures are rounded to 1dp in tables and graphs. Figures labelled as 'May' refer to the most up-to-date asset allocations available at time of analysis, i.e. figures for Q4 2016.

Information is correct as at 31st March 2017. The research has been undertaken by Instinctif Partners on behalf of Schroders.

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4 http://www.fca.org.uk/news/fca-publishes-final-rules-for-charges-in-workplace-pension-schemes
5 All figures from this section from http://www.thepensionsregulator.gov.uk/doc-library/dc-trust-presentation-of-scheme-return-data-2017.aspx

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