Steve Charlton is defined contribution and solutions managing director at SEI

RETHINKING GLIDE PATHS TO MEET THE NEEDS OF AN AGEING POPULATION

Investing for retirement needs a rethink. People are living longer than they anticipate, and while this is not a new trend, the extent to which retirement durations have extended over the past few decades is considerable. This shift means that how we think and plan around retirement durations needs to also shift.

As an industry, we understand risk to mean market volatility, but for people whose retirement may last 30 years or more, we should be thinking about retirement goals and the risk of running out of money. Longer-term planning is needed, and it is now impossible to argue with the fact that equities, which often play little to no role in the run-up to and into retirement within DC default investment options, must now be considered a critical part of the asset mix for goals-based retirement planning.

Yet, the prevailing industry thinking is to secure income throughout retirement, which sees the majority of these default options de-risk in the decade before retirement, resulting in the omission of equities when retirement comes around. With retirement horizons extending, an approach that leverages the benefits of equities for longer is needed. Presuming the vast majority of people are in default options – 95% of people in the SEI Master Trust are – a serious discussion is needed about whether they have the right ingredients to see them through retirement.

In this vein, it should be noted that individuals' expectations of their length of retirement have always exceeded expectations, so conservative thinking here is a significant risk. My grandfather died aged 78, exceeding his life expectancy by more than 10%. It is more likely than not that I will live to 91 years of age, while a seven-year-old now has a higher than 50% chance of reaching 99 years old. In four generations, the increase in life expectancy is staggering, and the problem it poses for retirement income is too.

To bring this to life, consider three different age groups: an 88-year-old has low discretionary spending, has some fixed costs, such as food, housing and clothing, and will perhaps live another eight years, or maybe more. A portfolio focused on secure income is appropriate but needs some oversight to react in case of extraordinary circumstances. Fixed-income, low-risk assets are suitable. For an 81-year-old, the traditional logic suggests the same – except industry logic is out of step. In 2022, an 81-year-old is expected to live for another 15 years, which may mean more than one economic regime and market cycle. Assets that prioritise income play a part but ensuring the best quality of life during a timeframe of more than a decade and weathering potential issues, such as inflation, require different thinking and a different asset mix. This glide path is far longer, and the industry needs to tailor how default portfolios are constructed to accommodate this shift.

Perhaps the starkest example is to look at a 65-year-old embarking upon retirement. In 2022, they are expected to live for another 30 years or more. For a 20-year-old with a 30-year time horizon, the default approach would be a large portion of higher risk assets to ensure 30-year goals were being addressed. Yet, default investment options too readily de-risk our 65-year-old's portfolio in the 10 years to retirement and focus on income assets when the individual could have 30 or more years left to fund. Is that responsible retirement planning?

Retirement and life goals have changed dramatically in just a few decades as the age of our population and the length of retirement has increased. When we look at the default options in pension schemes, in which most members are, it is clear that approaches in the industry need to continue to evolve, too. It is now common sense that de-risking default portfolios completely in the run-up to retirement makes no sense. Yet, most schemes and their members are doing just this.

Traditional glide paths are simply too prudent for an ageing population. Re-thinking what 'risk' means when thinking about retirement is central to this. The risk of running out of money in a retirement spanning decades is where we should focus. If anything, we need to be more prudent when predicting how much life we have left, and in turn, be more ambitious with how we fund it.

Nigel Aston
Director, SEI's Master Trust
14–18 Finsbury Square, London EC2A 1BR
T: +44 (0)20 3810 7921
E: naston@seic.com
W: www.seic.com/mastertrust