



### Summary

- Like lifestyle strategies, target-date funds (TDFs) aim for asset allocations that are adapted to a member's life stage, beginning with growth and moving towards security as the retirement date nears.
- Unlike lifestyle, TDFs offer one single fund that provides a start-to-end evolution for the member, taking them through their working life and into retirement.
- TGFs have long been the default model in the US; the UK pensions universe, and in particular the historic requirement for annuities, meant that TDFs were unsuitable.
- Freedom of choice and auto-enrolment and a shift towards larger-scale schemes have meant that TDFs can find a useful place in the industry, and a growing number of providers offer them.
- TDFs provide a different means to an endgame they share with lifestyle strategies, and the choice between them comes down to operational preference. However, the number of TDFs could expand as the industry's needs evolve.

follows a glidepath – a gradual shift in asset allocation as members move from the growth phase to retirement.”

They ultimately have the same goals as lifestyle strategies, then, but operationally TDFs are very different. Lifestyle strategies, says Moles, rely on switching members through different funds as the years progress, which can: “Create cliff-edge moves and heavier governance”. TDFs, on the other hand, package the whole investment journey into a single fund “based on a member's expected retirement age, and automatically adjusts risk as the member ages, giving schemes a flexible glidepath and reducing operational complexity,” says Moles.

“Another crucial difference is that TDFs can have different lifecycles and different allocations for members with different retirement ages,” he adds. “Lifestyle approaches cannot do this; a member retiring today will have the same asset allocation that a member retiring in 20 years will have when they retire.”

Given the similar outcomes, one could wonder why the US has seen such a big take up for TDF, while the UK has held back. One key reason, says WTW senior director, Robin Fillion, is that: “The UK had a very different starting

## On target?

### ✦ Sandra Haurant considers the growing role of target-date funds within the UK pensions landscape

**T**arget-date funds (TDFs) have been the dominant choice for US pensions since the 1990s, but so far have had a significantly lower profile in the UK. Over the past decade, with the advent of freedom of choice and auto-enrolment, the appeal of these funds has grown. But

what exactly are TDFs, and how are they used in the UK pensions industry?

Put simply, TDFs are funds that work towards a designated future retirement date. Legal and General (L&G) head of defined contribution (DC) and retail solutions strategy, Graham Moles, says: “Similar to lifestyle strategies, a TDF

position. Because if we think back to before freedom of choice, the vast majority of DC investment strategies worked towards an annuity outcome.” Today, though, things have changed, and, as AllianceBernstein portfolio manager responsible for multi-asset solutions in EMEA, David Hutchins, says: “In most cases, the choice of TDF and lifestyle is simply a preference, and the same asset allocation design can be implemented through either approach.”

### Typical lifecycle

So, what makes some providers choose TDFs? “The key advantage of TDFs is their simplicity,” says Hargreaves Lansdown head of retirement analysis, Helen Morrissey. “Members are invested in a single fund – known as a ‘vintage’ – which rebalances to the target asset allocation throughout their working life. The fund is selected to align as closely as possible to the member retirement age, and from then on, it’s set for the long term.”

A typical TDF will progress through a lifecycle that transitions from seeking growth in the beginning to de-risking as retirement approaches. “Early on, the fund prioritises equities and other growth assets to maximise potential returns. For our funds, at 10 years before the target retirement date, it begins to de-risk, increasing exposure to bonds and other lower-volatility assets. Other providers will start de-risking at different periods prior to retirement,” says Moles. “TDFs are a to-and-through solution and so even after the target date, the fund continues to adjust to support retirement behaviours (for example, drawdown needs). The to-and-through approach means members stay in the same fund throughout their journey.”

And a key different between TDF and lifestyle is that the former can have different lifecycles and allocations, depending on the different retirement ages of members. “Lifestyle approaches cannot do this,” says Moles.

### Long-term goals

Pensions savings are, by their nature, a long-term concern, and with that ‘to-and-through’ approach mentioned by Moles comes a level of tractability within TDFs. Nest chief investment officer, Liz Fernando, explains. “Our retirement date funds are designed for long-term investing; they give us the flexibility to hold assets that may be less liquid but offer strong diversification and return potential over time. This approach has enabled us to build significant allocations to private markets within our default strategy. This not only broadens the investment universe available to our members, but also supports our aim of delivering resilient, long-term outcomes.”

## “Although lifestyle strategies are still widely used, TDFs are gaining popularity, particularly among master trusts”

Of course, private markets bring their own challenges, and illiquidity risks must be managed carefully. But Fernando argues: “With thoughtful oversight they become a powerful diversifier.”

In fact, the simplicity of the TDF makes this more straightforward, says TPT Retirement Solutions DC director, Philip Smith: “As the asset allocation gradually changes over time, the investment manager knows when they will need to reduce illiquid exposure as members approach retirement. This predictability makes it easier to schedule liquidity events and rebalance.”

What’s more, Smith says, the frequently significant scale of TDFs means managers can blend illiquid assets with liquid ones to maintain overall liquidity. “In contrast, the individual structure of lifestyle funds makes inclusion of private market assets very

difficult,” he says. “TDFs offer centralised control, predictable allocation shifts, and scale, making liquidity management for private markets far more practical than in lifestyle strategies.”

### Same but different

However, not everyone sees a great difference between the capacity for TDFs and lifestyle strategies to manage private market illiquidity. Fillion, for example, argues: “I don’t think there is a material difference in terms of one structure being better suited to be able to deliver private markets, going forward. I think they can both have the capability to do that, in subtly different ways.”

According to Morrissey, claims that TDFs are more ‘modern’ because they target flexible retirement outcomes versus lifestyling strategies, which target an annuity purchase, are not necessarily accurate. “Lifestyling strategies were the original tool used to de-risk portfolios before the days of retirement flexibility and many of these will have targeted annuity purchase,” she says. “On the other hand, TDFs are newer and tend to have been designed with current retirement behaviours in mind. But in many modern schemes – including the HL Ready Made Pension Plan and our workplace Group SIPP offering, the lifestyling strategy targets a flexible approach.”

### Looking ahead

The US adopted the TDF model decades ago, but, according to Smith, the UK may be waking up to its benefits. “Although lifestyle strategies are still widely used, TDFs are gaining popularity, particularly among master trusts,” he says. “This expansion is likely to increase demand for scalable investment solutions that can meet the government’s expectations for greater diversification and sophistication, as outlined in the Pensions Investment Review.”

 Written by Sandra Haurant, a freelance journalist