Hard to measure

Marek Handzel explores the difficulties of ensuring DC schemes' value for money assessments will truly generate the best results for members

Summary
- More than two-fifths of DC pension schemes are looking to consolidate over the next five years in the UK, according to some estimates.
- New regulations requiring schemes to annually benchmark themselves against alternatives encourages a focus on value.
- Scheme assessment and comparison are not without their problems, however. Some of the biggest issues lie in a lack of available data and a danger of confirmation bias.
- 'Value for money' is a highly subjective term and may lead to outcomes that do not necessarily benefit all DC members.

Released at the end of January, The Pensions Regulator's 12th *DC Trust* report showed that the UK's occupational defined contribution (DC) pension market has consolidated by almost 40 per cent in the space of a decade. From having 45,150 DC schemes in 2011, the number in existence by December 2021 stood at 27,700.

At the same time, DC membership has continued to increase, while assets in master trusts have reached £78.8 billion. Speaking at the time the report was released, TPR executive director of policy, analysis and advice, David Fairs, said that this continuing trend of consolidation in the DC market was good news for savers. "The vast majority of DC members continue to be saving into larger, more stable master trusts, which have demonstrated that they meet the high standards of governance savers deserve," he said, adding however, that there remains a large segment of small DC schemes that are poorly run. "We expect this trend of DC consolidation to continue as small schemes are now required to demonstrate that they provide value for members," he added.

The regulations Fairs was referring to are, of course, those that came into force from 31 December last year. They require DC schemes with assets under £100 million to conduct thorough 'value for money' assessments and report back on whether consolidation into another DC pension plan would improve outcomes for their members. The directive is expected by many to result in a further wave of consolidation over the next few months and years.

WTW senior director of DC retirement, James Colegrave, explains that the assessments are very much needed. "Many smaller trust-based pensions arrangements have been delivering poor value to their members for too long," he says. "They have often continued for the wrong reasons, including a lack of understanding of the alternatives and the self-interest of those operating and managing them. Requiring schemes to annually benchmark themselves against alternatives encourages a focus on value and ensures that when they continue, the trustees are able to demonstrate that value is being provided."

Robust enough?

The legislation may be necessary, but is it fit-for-purpose? According to many commentators, the answer is a firm no, with some of the biggest problems lying in a lack of available data and a danger of confirmation bias.

"The regulator hasn't been clear on its end game for scheme consolidation, so until it provides some clear direction, we can't be completely confident that these assessments will be sufficiently robust," says LGIM co-head of DC, Rita Butler-Jones. "For example, we're still unclear about how, or if, any future assessment requirements might affect contract-based schemes."

LGIM hopes that trustees will take a holistic approach to their assessments and look for value in areas other than simply costs alone, such as the quality of communications, robust governance and ESG integration across a scheme's default options. "Since ESG isn't yet included in the regulator's value for money assessment guidelines, we're concerned that some assessments might not consider it, even though we believe investments that don't take account of ESG can be a material risk, while those that do can provide opportunities," says Butler-Jones. "Trustees should ask providers if their net-zero journey is on track and assess their short-term strategies."

For Premier head of DC consulting,

Sue Pemberton, the regulations are also impractical. Pemberton and her colleagues are coming across many issues in relation to the measuring of scheme data when aiding their clients through the process. This is perhaps best illustrated when attempting to weigh up the cost benefits of with-profits funds, which form a part of many older DC investment strategies. To start with, a with-profits fund does not have an explicit charge. But more concerningly, trustees are unable to measure the performance of a with-profits fund as there are complications created by the application of terminal bonuses and scheme maturity dates. "You simply can't assess it against it against larger DC schemes and so you've got nothing to assess against," says Pemberton.

A more general problem with the assessments is that they are not independently produced, so they can be subject to bias being applied by advisers and trustees who wish to protect the status quo. Colegrave says that WTW wants them to be reviewed after a period of time. "The assessments are designed to ensure that members receive good value through either the existing trust-based scheme or by consolidating with another scheme. A future review should consider whether an independent approach would be more robust," he argues.

The faulty default?

According to the legislation, default funds should be compared with the default of the plans they are using as comparators, even if that comparator employs a different investment strategy. Butler-Jones says that this is the best comparison to make in the circumstances, but trustees must remember that they are not comparing like-for-like.

A default fund may be more expensive, but it may have performed better than its cheaper comparator, for example. And aside from charges, a comparator fund could provide stronger ESG integration and access to illiquid assets. "Trustees should consider the strategy's flexibility," adds Butler-Jones. "Can it evolve over time to meet the changing needs of future generations? Does it offer a to-and-through solution? And how has the strategy performed over the shorter and longer term?"

Finding the right investment vehicle to compare against is not, however, as straightforward for all schemes. As Pemberton points out, many older DC schemes without active contributions may not have a default. This effectively means that somebody has to spend a considerable amount of time pouring over comparator schemes to find some funds that are similar.

Matters are not necessarily simplified with the use of a straight default-to-default observation either. The most accurate default data will only be found in the UK's 36 master trusts, because the UK does not currently have a large library of default DC investment data in place, despite it becoming a requirement to publish performance figures as of last October.

Selective assessment could also become an issue, warns Pemberton. "Eventually when we've got lots of data available, if you've got the time and energy — and deep enough pockets to look at all these funds — then you can manipulate which schemes you compare yourself against. And it's a bit cynical of me, I guess, but there is the ability for schemes who really want to stay in their current state to find other schemes that haven't necessarily performed well or have got very high costs."

Value for money?

Manipulation of data can also be partnered with very subjective views on what constitutes 'value for money'.

A recent survey conducted by XPS Pensions Group found that more than two-fifths of DC pension schemes it questioned are looking to consolidate over the next five years. Fifty-five per cent, however, are not planning on consolidating within the next five years, with the most common factor cited by respondents being that their current scheme offers appropriate "value-for-money".

But what constitutes good value in a DC scheme?

The key, says Colegrave, is knowing the membership and understanding the DC market; specifically, how other schemes may be delivering better value than your own. There are many constituents of value for money, he says, it is "absolutely not just about charges".

"Whenever we buy something, we typically weigh up many factors other than just price. The same applies for pensions. Administration services; digital functionality and support; communications and other support services; investment options and quality and relevance of governance oversight, are all important factors. But we all prioritise things differently."

For its part, Legal & General's WorkSave Mastertrust has a 'Value for Members Framework' that sets out in details how its independent trustees assess value, and the processes they undertake to ensure it.

It has also created a designated scheme consolidation microsite that provides information on conducting assessments and it accepts transitions straight into the master trust, which means value for money assessments aren't required. "The feedback received from clients who have already consolidated is that they felt well supported by us and their advisers," says Butler-Jones.

As always, then, it is teamwork and collaboration that will deliver the best results for DC schemes on their path to consolidation, rather than entrenched perspectives and pure corporate avarice.

Written by Marek Handzel, a freelance journalist

In association with