What to expect in a good default fund

Nico Aspinall from The People's Pension defines what trustees should look for within a master trust default fund

There's a fistful of factors that help advisers determine the masters trusts they'll recommend to clients – and the master trusts they won't.

The list will typically include governance, charges, customer service, the provider's financial stability and their default fund.

At The People's Pension, 98.7 per cent of our members have placed their money into the default fund – and I'd expect that proportion to be reflective of the broader master trust industry – so it's crucial to get it right.

Our thinking about a high quality default typically starts with what it's actually there for.

In the accumulation phase it should deliver a reasonable rate of return that sits above the long-run rate of inflation. This means that every element of a member's contribution (their own, their employer's and tax relief) could be worth more in their retirement than when they were paid in.

As members reach their stated retirement date a default fund should change to deliver what they need. In an age of freedom and choice, and with the average amount paid into pensions by workers in the private sector reducing in the past year, the clear majority of our members take their pots in one go.

That means reducing investment risk, but not too much – we still need to recognise members won't take their benefits from us exactly when we expect them to. We don't want inflation to reduce the value of their savings while we're waiting for them to take their money.

To meet its objectives, a default fund should be appropriately resourced. For example, at The People's Pension, we have a good balance of in-house and outsourced investment professionals. The latter include our investment manager, State Street, and custodian, Northern Trust – two established providers who we nonetheless monitor rigorously.

"Strong governance extends far beyond a default fund's investment partners"

Strong governance extends far beyond a default fund's investment partners – and we would say the quality and extent of governance is now a clear differentiator between default funds.

One of the best ways to assess the effectiveness of governance is to look at how a fund evolves to ensure its fit for the future. This is most evident in the composition of the fund itself.

Over the last year or so we've looked closely at the mix of growth assets in our default fund. We added a wider range of assets such as emerging market shares, infrastructure and real estate to diversify our default portfolios.

Diversification is more efficient and more cost-effective to do if you have a substantial weight of assets – and at The People's Pension we're demonstrating that our scale of more than £6 billion enables us to evolve the investments at sensible cost to directly benefit members.

We've also added to the diversification of our shares portfolio with factor investing. This complements diversification by using different weightings to traditional passive approaches, seeking out investments with the potential to offer better long-term performance.

Scale also helps a default fund achieve more in the field of responsible investment. This isn't about ethics, it's now widely accepted that businesses which treat their employees, society and the environment well tend to deliver better returns to their shareholders. We published our responsible investment policy last year and have demonstrated it by ensuring that our factor investments also address carbon exposure.

We were delighted to note the Department for Work and Pensions is thinking along the same lines as us here, because they're requiring major defined contribution schemes, including master trust providers, to incorporate this theme in the content of their statements of investment principles and to publish these documents later this year. That's going to give advisers more information with which to compare providers.

Better governance and larger scale not only support cost-effective responsible investment – it also enables us to think longer term.

We see responsible investment as a part of this long-term view of how a default fund can meet its objectives, because it gives us insights into what may be valued by society in future. It offers more routes to diversification than just looking at asset classes alone – part of the broad mix of measures that should be looked at when selecting a master trust and reviewing its default.

Written by The People's Pension chief investment officer Nico Aspinall

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