Does size matter

Phil Taylor explores what small, trust-based schemes should consider when moving into a master trust arrangement

One of the hot topics right now is The Pensions Regulator's drive to ensure trust schemes are providing value for money. Its focus is on value for member assessments and whether smaller trust-based schemes with less than £100 million are able to achieve the outcomes members need in respect of cost and charges, investment returns, administration and governance. Part of the rationale is that larger schemes will have lower running costs per member and better buying power, leading to reduced investment costs.

Of course, it's a daunting task ensuring the correct governance is in place to meet the new requirements and carry out the assessment. Where do you start? How much will it cost? Which three DC schemes do you compare yourself with? How long will it take to put the steps in place to prove your scheme will deliver value for money? And of course, what happens if having undertaken all this work, you find your scheme doesn't meet the requirements?

These are all challenging questions, and there's a belief that many trustees of smaller trust-based schemes will take this opportunity to move their scheme to a master trust arrangement. So, if you're faced with this scenario what key things would it be useful to understand?

One of the main determinates could be the master trust's size and scale. We often use AUM to determine this but possibly more important – and often overlooked – should be the size of monthly cashflows. High ongoing cashflow is a really big deal as it helps to provide the scheme with stability and longevity and if the scheme/provider chooses, it can use profits to support future propositional development for the benefit of its membership. As such, it's important to consider the ownership structure of the master trust and understand its profitability model.

Investment capability should also be viewed with scale in mind. For instance, an important aspect to consider is the evolution of providers' ESG investment strategies. It's my belief that we all need to have an appreciation of what a provider's investment team actually means by ESG and, critically, how their strategies are being implemented. This of course is important for all the funds on offer, but even more so for the default arrangement where experience tells us the greatest majority of savers invest. Scale, in terms of large cashflows together with a clear investment roadmap, can allow for a more sophisticated execution of an ESG strategy, possibly through cashflow redirection, rather than a simple sale and buy strategy. This can ultimately reduce risk and, just as importantly, reduce the costs borne by the member.

It is also very important to understand what the provider's end game is. Is it to sell when the scheme is large enough and becomes attractive to competitors? Is it to repay its shareholders? Is the scheme making a loss and being subsidised by an old book of business, and if so, how long will that situation be allowed to continue?

The answers to these questions will help paint a picture of whether the selected scheme can be trusted to really provide value for members in the long run. If there is uncertainty in any of these areas, it may result in the need for future change leading to subsequent confusion for members and possible poorer outcomes. And ultimately, I guess the final question has to be… is that something any of us should knowingly be willing to accept?

Written by The People's Pension national business development team manager, Phil Taylor

In association with