

Taking a deeper look at “value” in DC pensions

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It's hard to believe it was a year ago since I was about to set off on my travels around Japan to follow Scotland in the Rugby World Cup. It was clear early on that the trip wasn't going to be cheap - but it was the trip of a lifetime. In order to embark on this month-long adventure, I needed to take a lot – and I mean a lot! – of days holiday. Unfortunately, it also meant I was straight back to work the next day after arriving back in the UK at 10pm the night before.

Like many people, I often struggle to fall asleep on planes. So, when comparing the prices of economy vs. business class flights, one of my prime goals was to arrive back at work as refreshed as possible – ready to greet the inevitable influx of emails! Business class was obviously more expensive, but by offering me a bed, it promised me a greater chance of some sleep! Therefore, it represented good value for me in spite of the higher cost. My point being that “value” represents more than just cost, and priorities can change depending on your goals.

As part of its wide-ranging pension transparency report, the Work and Pensions Committee called for an “agreed definition” of value for money in defined contribution (DC) pensions. Whilst there is clearly some merit in providing a like-for-like comparison of DC plans, there are also two fundamental issues which could arise. Firstly, placing too much concentration on cost and secondly, diverting focus away from member outcomes.

To illustrate my point, I'd like to draw on a scenario that is becoming all too common. For example, say a board of single occupational-trust trustees is told by their employer that they intend to switch to a Master Trust arrangement for future pension provision and that they plan to move the scheme's existing assets.

The trustees may be concerned because they currently have a well-designed investment strategy that was carefully constructed to consider the risk and returns targets deemed necessary for members at each stage of their investment journey (including a high weighting to return seeking assets in the growth phase). However, members are currently paying a 0.32% per year charge on average across the strategy and the company reassures the trustees that they've negotiated a great deal and that members will only pay 0.24% per year. And even more, members will benefit from better communications and a better supported to- and through-retirement proposition.

Sounds appealing, doesn't it?

Well, ultimately, members are paying less and the improved communications and retirement support are undoubtedly positive, but is it really the great result it looks like on paper?

What many trustees, and companies, fail to do when considering this change is to compare the expected investment return and likely outcomes members will receive at retirement in both the existing and proposed new arrangements. We've carried out some modelling on this for a range of our clients, and in some cases, projected member outcomes at retirement can be up to 20% lower after a move. In many cases, this is because some Master Trusts take less risk in the early stages of a member's journey, losing out on the impact of the compounding of returns over a long period of time. That projection is based on stochastic modelling of outcomes under 5,000 possible different economic scenarios. And whilst we all know that past performance isn't a guide to the future, even a 10% difference in pot size at the point of retirement can have a major impact on the quality of a person's life in their later years.

So, if we do move down the route of properly assessing the “value” of one vehicle’s offering against another, there absolutely has to be a focus not only on cost but also on what will ultimately be delivered for the member. Managing trustees’ and companies’ expectations of their members’ outcomes will be critical when long-term “value” is assessed.

In the end, I did sleep on the plane on my way back from Japan and came back to work refreshed and ready to start the week. So, the extra cost was well worth the added value to me. Even more so now with the prospect of any future trips feeling like a distant dream!

Want to find out more?

Contact Rona to discuss how we can help you assess value for money in your DC pension arrangement.



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