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How to analyse workplace pension default funds

April 2020

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Introduction

Welcome to the Defaqto annual guide to reviewing workplace pension default funds.

Taking our standard impartial position, we explain the key factors to consider when reviewing default funds and then take a deep-dive into the most commonly used schemes.

Last year, 2019, was interesting. The higher 8% contribution rate came into force and a new tough authorisation standard was introduced by The Pensions Regulator (TPR) for master trusts.

The higher contribution rate didn't create the mass increase in opt-outs that some pundits had predicted and so, positively, record numbers of employees continue to save for their retirement.

The new authorisation process had a much bigger impact, with over half of master trusts closing in 2019. In addition, those that remain now need to maintain standards in order to retain their authorisations.

The 2020/21 year will also be an interesting one after the FCA introduced minimum standards for publishing and disclosing costs and charges to workplace pension members.

When it comes to choice, we still have a healthy and diverse array of scheme types and investment strategies to choose from. However, we can see a void growing between the well-managed and performing default funds and those where improvements are needed.

Ultimately, this guide will give you a working process to follow and the data to help make evidence-based assessments on default fund suitability.

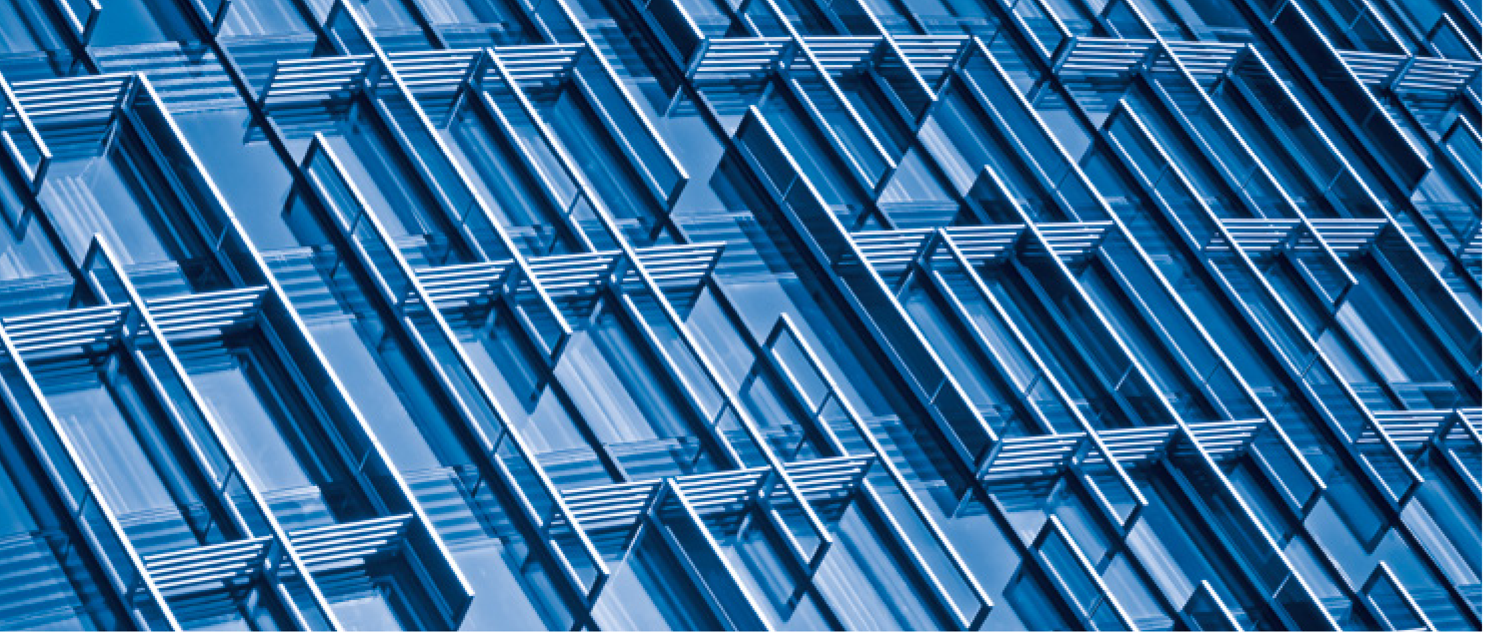
Part 1	**Key factors to consider when reviewing default funds** We explain scheme structures and variations, then the seven key factors to consider when undertaking due diligence and scheme selection
Part 2	**Comparison of default funds** Using hard facts we analyse and compare the default fund options available across several different criteria, with the ultimate objective of empowering advisers to help evidence 'value for money'

We hope you find this guide both informative and interesting.

Danny Luggah
Investment Consultant
(Funds and DFM)
dluggah@defaqto.com

Richard Hulbert
Insight Consultant
(Wealth products)
rhulbert@defaqto.com

Patrick Norwood
Investment Consultant
(Funds)
pnorwood@defaqto.com



Who should read this guide?

This guide is written for professionals providing advice and guidance on scheme selection. However, employers and employees with an interest in their workplace pension may also find the guide useful.

Learning objectives

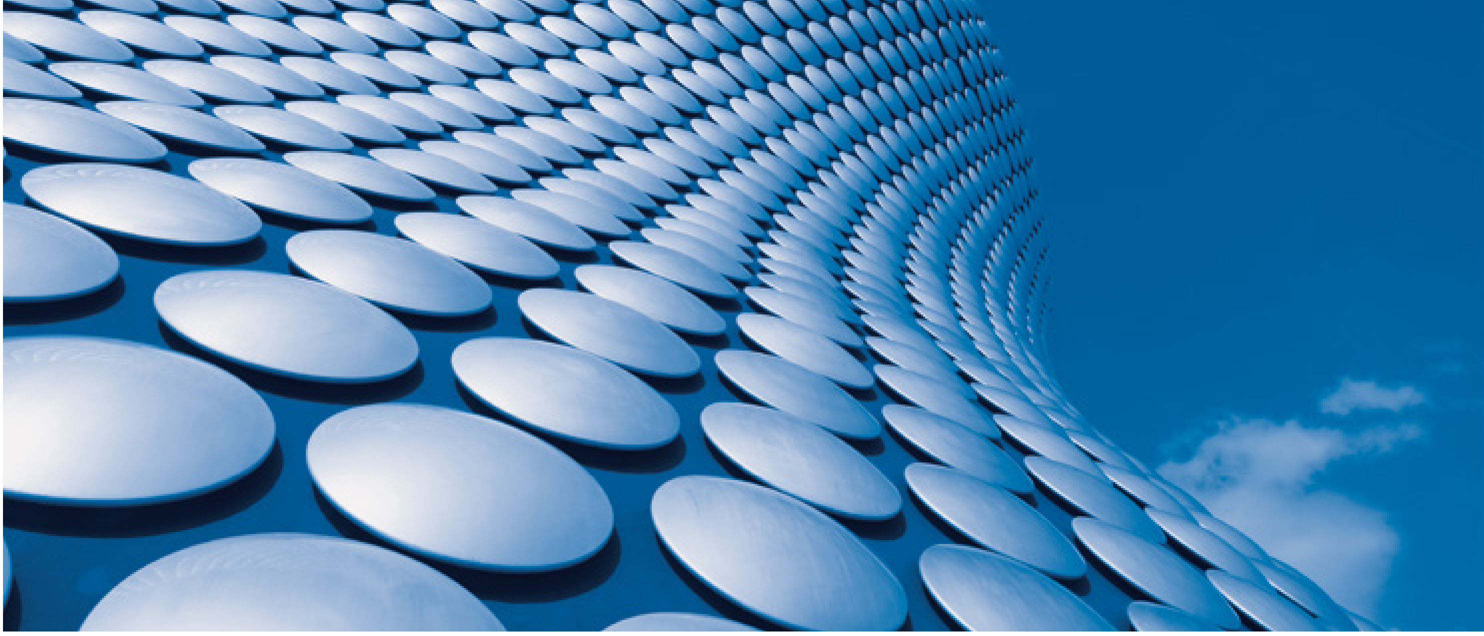
For those undertaking continuous professional development (CPD), reading this document will enable you to:

1	Opportunity	Be able to identify where improvements in employee benefit packages are available
2	Market place	Be able to identify a provider's default investment strategy, focusing on the accumulation phase, and how they compare to others
3	Reviewing	Be able to identify the main differentiating factors between default funds, including: • Governance and regulation • Provider financial strength and/or capability • IGCs, trustees and investment committee oversight • Investment management key factors • Cost • Investment and performance • Benchmarking and evidencing 'value for money'

Acronyms

The main acronyms used in this document are:

AMC	Annual management charge
DC	Defined contribution
ESG	Environmental, Social and Governance
FCA	Financial Conduct Authority
IGC	Independent Governance Committee
TPR	The Pensions Regulator



Part 1 – Key factors to consider when reviewing default funds

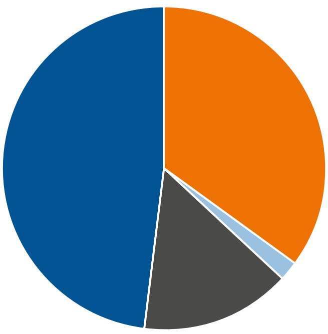
The market place

The workplace pension arena provides a great opportunity for advisers.

There are over 1.4 million employers with schemes, and this is growing by around 175,000 each year as every new business must have one in place. Underneath, there are 11 million workers, all saving at least 8% of their banded earnings (5% employee and 3% employer) and each has their own financial planning needs.

Defaqto currently holds comprehensive data for 62 workplace pension schemes open to new business, from 33 different providers, using 3 different sets of governance rules, all of which are overseen by 2 different regulators (see Chart 1).

Chart 1: Governance styles



Scheme type	Regulator	Number of schemes	% of market
Contract	FCA	22	35%
Hybrid	FCA & TPR	1	2%
Own trust	TPR	9	15%
Master trust	TPR	30	48%

The 22 contract-based schemes are regulated by the Financial Conduct Authority (FCA) and the 39 trust-based schemes by The Pensions Regulator (TPR). The hybrid scheme, as it uses both contract and master trust governance, is regulated by both the FCA and TPR.

All of the 62 schemes are listed in Appendix A.

Common reasons why employers need advice

What employees expect from their employer

The top five benefits employees look for from their employer are:

1	Life cover
2	Dental cover
3	Medical cover
4	Paid time off
5	Retirement planning

Source: LIMRA report, 12 June 2018

Employers can often provide additional benefits 'tax efficiently' and 'cost effectively'

By discussing these 'extra benefits' with employers, advisers create the potential to be able to recommend improvements to their employee benefits packages.

How to promote reviews

The regulations help to promote reviews as they indirectly encourage employers to evaluate the scheme they use. The two common triggers work on a triennial basis and are:

- Trustees to undertake a review of their Statement of Investment Principles (SIP), the outcome of which may impact on suitability assessments
- Employers have to automatically re-enrol eligible employees who have previously opted-out

Both of these events trigger many employers to evaluate their proposition and ascertain if the pension scheme they are using could be improved on and/or if costs and liabilities can be reduced. Ultimately, employers have a 'duty of care' obligation to their employees, and the pension scheme they fund falls within that remit. Accountants and advisers are now providing due diligence reports to help employers through this process, and we encourage you to use these reports.

Questions to ask employers about their existing pension schemes

- Are they confident employees are saving enough to be able to afford to retire and how are they evidencing this?
- Are they running a number of schemes?
- Are they having to rekey data, ie into payroll, middleware and/or pension schemes?
- Did auto-enrolment also inadvertently introduce discrimination in areas such as age, religion and/or salary?
- What has been their experience of their existing adviser/pension provider service?
- What charges are the business and its employees paying and are they competitive?
- What is the default fund invested in, and are they comfortable with this?
- Do they wish to improve their employee benefits package, ie to retain staff?
- What current (and potential) support and activity are available to promote member engagement?

Providers

We invited all workplace pension providers known to Defaqto that are open to retail business to participate. This equates to 62 schemes from 33 providers.

Below we list the 22 providers who have kindly taken part in this review:

Providers	
Aegon	Nest
Aon	NOW: Pensions
Atlas	Royal London
Aviva	Salvus
B&CE (The People's Pension)	Scottish Widows
Ensign	Smart Pension
Evolve Pensions	Standard Life
Hargreaves Lansdown	True Potential
Intelligent Money	Willis Towers Watson
Legal & General	Workers Pension Trust
Lewis & Co	XPS Pensions Group

A complete list of the retail workplace pension providers can be found in Appendix A.

Key factors to consider when reviewing a default fund

Below are the seven key factors we believe you should identify and consider in any workplace pension due diligence process:

1	Governance and regulation
2	Provider financial strength and/or capability
3	IGCs, trustees and investment committees
4	Investment management key factors
5	Cost
6	Investment and performance
7	Benchmarking and evidencing 'value for money'

The ever popular 'Default fund due diligence checklist' can be found at the end of Part 1. It is designed to be completed and placed on your compliance file to help evidence the steps you have taken.

We will now consider each of the seven key factors.

1. Governance and regulation

There are two types of workplace pension, and it is therefore important you understand which type of pension scheme you are recommending. While there is insufficient room in this guide to compare the two types, they can be summarised as:

Trust based	Contract based
Uses a collective approach to investing whereby savers are beneficiaries of a trust	Each saver has their own 'contract' with the pension provider
Regulated by The Pension Regulator (TPR)	Regulated by Financial Conduct Authority (FCA)

There are two types of trust-based scheme, own trust and master trust. We will concentrate on master trusts within this guide, as collectively they have the largest number of employers and employee members.

2. Provider financial strength and/or capability

There is little point putting in place a scheme with a provider who is not going to be in business in the foreseeable future.

Being able to ascertain the financial strength and capability of a provider is not straight forward as there is no single independent barometer. The most commonly used measures we are aware of are:

Contract	Own trust	Master trust
AKG Financial Strength rating	None	Authorised by TPR in 2019

We suggest any measure you use should use data that is no more than 12 months old. Also, remember it is financial strength and capability you are interested in, not credit ratings. By the end of March 2019 all master trusts had to apply to TPR to be authorised in order to continue to operate. This resulted in over half of all master trusts closing. Master trust authorisation regulation has strengthened the underpinning financial covenants and increased the focus on governance by trustees, the scheme sponsor and the regulator alike.

Master trusts now have to maintain high standards going forward and report to TPR on their ongoing compliance. Failures in a master trust can result in TPR authorisation being removed and the subsequent closure of the scheme. Most notable is the introduction of legal obligations on master trust trustees, which those who oversee contract-based schemes do not face. The master trust authorisation process and ongoing supervision is designed to provide strength and stability to these schemes. This in turn should give advisers more confidence to recommend them.

Another factor to consider is ownership. Contract-based schemes tend to be run by large companies with shareholders. Trusts by design hold little capital value themselves, but their administrators are companies. A small number of providers are run on a 'not-for-profit' basis. It is fair to say that the type or nature of ownership should not necessarily influence selection; however, advisers should be aware of the models and the variations between them and make comment on this in their selection and review processes.

3. Independent governance committees (IGCs), trustees and investment committees

All of these groups are in place to provide oversight to mitigate risk, reduce cost and ultimately provide consumers with peace of mind that their scheme is well run and provides 'value for money'. ('Value for money' is explained in section 7 on page 19.)

Independence of the oversight is considered important by both regulators (FCA and TPR) as a way to mitigate any conflicts of interest. We will concentrate on the three key ways oversight is provided, namely:

1	IGCs	Responsible for contract-based schemes
2	Trustees	Responsible for trust-based schemes
3	Investment committee	These committees are found in both contract- and trust-based schemes and have responsibility for the investment strategy and underlying assets used

Independent governance committee

The FCA has regulated that contract-based schemes must have an IGC in place.

All IGCs must have a minimum of five members, the majority of whom must be independent, including an independent chair. IGCs have limited influence though, this is because they have no legal power over the provider. IGCs have a duty to scrutinise the 'value for money' provided and must publicly report to members on how this is being achieved.

They must specifically report on:

- Assessing the ongoing 'value for money' of the workplace pension scheme
- Assessing the ongoing 'value for money' of the investment pathways solutions **(new in 2020)**
- That they have acted solely in the interests of the relevant scheme members (savers)
- Raising any concerns with the provider's board
- Escalating their concerns to the regulator, if necessary
- Reporting annually on what they have done

Trustees

Trustees are legally responsible to ensure trust-based schemes work in the best interest of members.

The Pensions Act (s.36) obliges trustees to seek advice on how best to administer the scheme and invest to achieve the stated objectives. Trustees tend to obtain that advice from professional trustees, professional administrators and/or investment consultants. Advisers should seek to understand underlying relationships, as each has its strengths and weaknesses.

TPR has expressed concern about these relationships and has issued guidance focused on trustees employing strong governance and protecting members' interests.

Trusts must produce an annual Chair Statement which contains much of the information included within IGC reports. They also include details on additional subjects including:

- Default fund
- ESG risks (this is explained on page 13)
- How 'value for money' is being achieved

As with the IGC reports, there is no standardisation, and so comparing information and data is not straight forward.

Full details on trustees' obligations and rules can be found in the defined contribution (DC) code. Advisers should familiarise themselves with this before recommending a trust-based scheme. It can be found at thepensionsregulator.gov.uk

Investment committees

Researchers should look at the remit provided to those running and managing the default fund and ascertain what, if any, conflicts of interest exist and how 'value for money' is being evidenced.

Governance styles to consider:

In-house	Independent	In-house oversight of independent solutions	Independent oversight of in-house solutions

Researchers should be attracted towards schemes that have independent and impartial oversight, with the ability to influence decisions. This can be found at the fund level, the asset allocation level and/or at the trustee/provider level.

Many schemes are run on a basis whereby either in-house staff oversee outsourced solutions or independent advisers oversee in-house solutions. It is not unusual to find some form of independent scrutiny and reporting being undertaken on the in-house decisions, and these reports can aid the due diligence process.

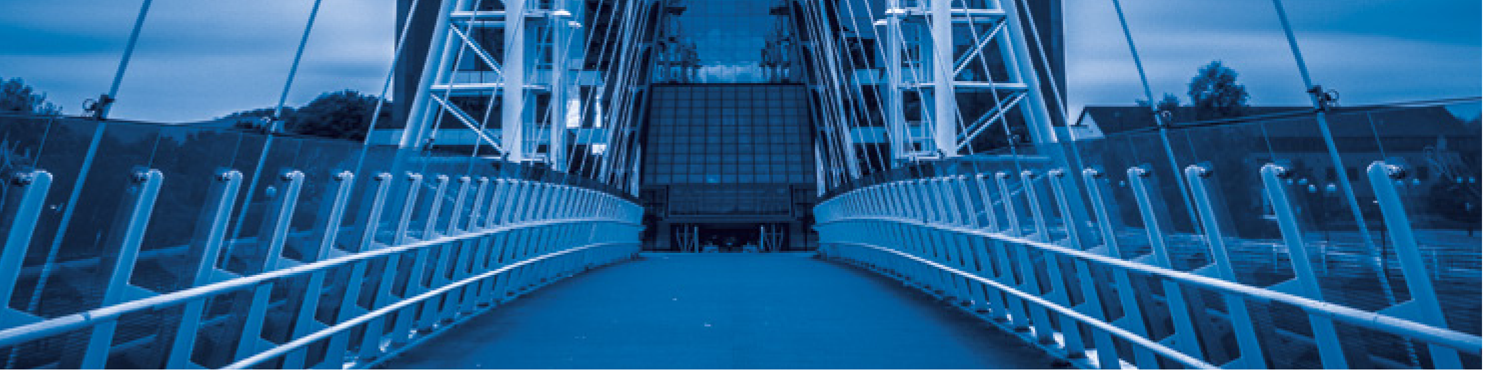
Impartial oversight and/or outsourcing to independent third parties does not necessarily increase costs – indeed, the opposite can be true.

Advisers should look for schemes where the remit and incentives used to remunerate third parties match the needs and objectives of the investors. Importantly, look for impartial managers and trustees with the ability to appoint professionals to meet specific needs. They can then target them accordingly and therefore identify failure promptly, potentially resulting in their swift replacement.

Summary

The IGC and Chair reports provide useful information. However, the lack of consistency in the way data is collated and presented means the results are largely not comparable. In addition, conclusions are often based on internal data and are therefore arguably subjective. All of this means the relevance of the reports is low, which decreases the trustees' strengths.

This is certainly an area where further collaboration between the FCA and TPR would improve matters for advisers, employers and, most importantly, members.



4. Investment management key factors

Investment management procedures and responsibilities

There are three elements to consider:

Investment strategy	Working practices	Individuals involved
Arguably the most important element. The key is to match the strategy and asset diversification to the risk profile of the employer and their employees. For example, if the workforce is primarily within 10 years of retirement, a high-risk strategy is unlikely to be appropriate for the members.	How robust, repeatable and independent are the working practices used to govern the investment strategy? How can this be evidenced, and what breaches and changes have there been in recent years? You should also understand the controls and checks in place to make sure the working practices are being followed fully.	This could potentially be more of an issue with smaller trust-based schemes. You should look at the control and influence individuals have and whether their knowledge, experience and expertise are sufficient to make such decisions.

As a final check, you should consider whether the combined process works in the best interests of members and how it produces 'value for money'.

The clarity, robustness and repeatability of decision making

Advisers should be checking that there is a freely available, fully documented, clear and structured decision-making process in place. Ask questions about how the processes are managed and compliance checked. In particular, when exceptions have occurred, and what impact these have had on savers.

Humans are not perfect and so the reality is that exceptions will have probably occurred at most providers. If a provider tells you they have not experienced exceptions or issues, you should question why. The nature of workplace pensions means that the value of the funds under administration is growing quickly and significantly.

Who has the most to gain and lose from the decision-making process?

While economies of scale can improve outcomes, it is asset allocation decisions that drive the biggest differences in returns. It is prudent to ensure that the scheme has sufficient diversification through how it accesses markets. For example, how is risk mitigated when exposure to equities is required, ie through more than one asset class, fund and/or manager?

Advisers should consider the ability of the scheme to invest while maintaining its investment strategy and ideal asset allocation weightings. Arguably, those schemes that can facilitate investment through diversification of asset classes and investment managers are best placed to meet this need.

Investing responsibly – ESG

Investing responsibly is often confused with socially responsible investing. These are two very different approaches; therefore, we have explained each of them below to aid understanding.

Socially responsible investing

This is where an investment manager targets a specific investment philosophy or strategy based on investors' values. Commonly, investors will access socially responsible investing strategies via a collective fund that has a specific values-led objective. Ethical funds or social impact funds, for example, might exclude companies based on the harm they could potentially do to society, such as tobacco firms or weapons manufacturers, or seek to invest primarily in companies that are engaged in efforts to improve society, such as community investment funds or social housing projects.

Investing responsibly

Investment managers often buy and hold shares with little, if any, proactive involvement with the businesses in which they are invested. By comparison, investment managers with a responsible investing remit have an emphasis on being proactive in the performance of the capital under their management.

The thinking is that well-run businesses with sound environmental and social practices have a better chance of long-term success and profitability, while those businesses exposed to environmental, social and governance (ESG) issues should be engaged with or avoided. This is because the profitability of these businesses can be damaged or limited by fines, reputational damage and/or markets evolving in a way that is at odds with their business models.

Below are some examples of ESG factors:

- **Environmental** – climate change/carbon emissions and toxic emissions/waste
- **Social** – health and safety of employees, data protection/privacy and community relations
- **Governance** – independence of the directors, compensation and business ethics

Activities undertaken with responsible investing in mind include:

- Proactive discussions with key personnel at the companies whose shares are held by the fund manager to influence their ESG policies and plans where appropriate
- Indirect pressure such as not increasing their shareholding and/or voicing concerns about activities being undertaken
- Direct pressure such as voting at AGMs and selling shares

Based on the above, many managers and investors will use responsible investing as a process for risk management and as a source of potentially superior returns. In the case of socially responsible investing, however, returns will always be secondary to the investor's values.

Responsible investing is about effective fund management beyond just buying and holding shares

5. Cost

Defaqto considers there are two rules to remember when undertaking cost analysis and we consider these in this section. The rules are:

1	Costs reduce returns
2	Cheap does not equal 'value for money'

Making a like-for-like comparison is not always easy. Some providers set a standard annual management charge (AMC), while others charge a combination of fees. This is an issue because for advice to be accurate and for 'value for money' to be evidenced, advisers need to include all costs in their research.

Commonly, the charge levied on the employee and/or employer depends upon many factors, including the size and profile of the employer and the adviser's relationship with the provider. Interestingly, none of these factors is in the payer's (employee's) control.

There are three stages of fees to consider: initial, ongoing and exit. Below we illustrate some of the more common ones to consider:

Governance	Initial	Ongoing	Exit
• Contract • Trust	• Establishment • Contribution	• Fund AMC Administration • Service • Platform • Product • Payroll	• Closure • Transfer

Not all of these fees are charged by all providers. In addition, some schemes only charge either the employer or employee, while others weight the fee towards one party. In addition, these fees may be tiered and therefore reduce the more that is saved at either the employee or employer level.

Where a provider charges a combination of fees, these need to be added together to ascertain the net ongoing charges paid by the employees and employer. Advisers will find that some schemes do not publicly state their fees, requiring an application to be made before 'bespoke' rates are offered.

Some of these opaque practices will shortly vanish. This is because in February 2020 the FCA published policy statement 20/2, which sets out standards for publishing and disclosing costs and charges to workplace pension scheme members. Together these standards should improve transparency and comparability.

As a rule of thumb, if the AMC is comparatively low, it may be worth checking to see if any additional fees apply.

There are three different common fee structures in use, increasing in complexity from left to right:

A	B	C
Single AMC	Single fund AMC, plus initial and/or ongoing charge(s)	Variable fund AMC, plus initial and/or variable ongoing charge(s)

Workplace pension default fund AMCs are capped at 0.75%

This is a great message to give employees – the maximum they will pay is 0.75% per annum.

Technically, we are talking about an equivalent default fund AMC of 0.75%. The reason for this is that the method used to calculate it can exclude certain activities. This analysis is outside the scope of this document, but both the FCA and TPR have produced guidance on this. We encourage researchers to keep up to date with the regulators' guidance so they can understand what is and is not included in each provider's quoted AMC.

Common additional fees to be aware of above the 0.75% include:

- Administration fees (payable by employees or employers)
- Investment charges over and above the annual charge (paid by employees)
- Establishment fees (paid by employers)

Some of the more common fees to look out for that can be applied to the employer and/or the employees are:

1	Allocation rates	11	Implications of suspending contributions
2	Annual investment/fund	12	Installation
3	Annual management	13	Retirement illustrations
4	Annual product/scheme	14	Reviews
5	Change of contribution	15	Statutory communications
6	Difference between bid and offer prices	16	Time out of investment between changes
7	Exit fees for employer	17	Transaction per type/on time cost basis
8	Exit fees for individuals on death	18	Transfer costs (in and out)
9	Exit fees for individuals on transfer	19	Transfer illustrations
10	Implications for member leaving employer	20	Valuations

Costs reduce returns

On this page we evidence exactly what this means. We have calculated the impact of different charging structures on identical pension savings over 10, 20, 30, 40 and 50 years. These calculations assume net figures of:

Salary at start of process	£30,000
Salary growth rate pa	2.5%
Investment growth rate pa	5.0%
Total contribution pa	8.0%

The fees levied by schemes vary significantly, and so, to keep things simple, we have illustrated the implications of a sample of charging levels in Tables 1 and 2.

Table 1: Implications of total annual charges (capital value)

Annual charge	10 years	20 years	30 years	40 years	50 years
0.00%	£34,586	£101,237	£223,411	£440,507	£818,386
0.20%	£34,227	£99,073	£216,040	£420,596	£770,964
0.30%	£34,049	£98,013	£212,469	£411,057	£748,508
0.40%	£33,872	£96,968	£208,972	£401,785	£726,846
0.50%	£33,696	£95,936	£205,547	£392,771	£705,946
0.60%	£33,522	£94,919	£202,193	£384,008	£685,781
0.70%	£33,349	£93,916	£198,907	£375,488	£666,322
0.75%	£33,263	£93,419	£197,290	£371,317	£656,849

Source: Defaqto, January 2020

Table 2: Implications of total annual charges (cost)

Annual charge	10 years	20 years	30 years	40 years	50 years
0.00%	£0	£0	£0	£0	£0
	0.00%	0.00%	0.00%	0.00%	0.00%
0.20%	£359	£2,164	£7,371	£19,911	£47,422
	1.04%	2.14%	3.30%	4.52%	5.79%
0.30%	£537	£3,224	£10,942	£29,450	£69,878
	1.55%	3.18%	4.90%	6.69%	8.54%
0.40%	£714	£4,269	£14,439	£38,722	£91,540
	2.06%	4.22%	6.46%	8.79%	11.19%
0.50%	£890	£5,301	£17,864	£47,736	£112,440
	2.57%	5.24%	8.00%	10.84%	13.74%
0.60%	£1,064	£6,318	£21,218	£56,499	£132,605
	3.08%	6.24%	9.50%	12.83%	16.20%
0.70%	£1,237	£7,321	£24,504	£65,019	£152,064
	3.58%	7.23%	10.97%	14.76%	18.58%
0.75%	£1,323	£7,818	£26,121	£69,190	£161,537
	3.83%	7.72%	11.69%	15.71%	19.74%

Source: Defaqto, January 2020

While we show the implications of the flat annual charging structures, it is not always clear what the net cost is at application. Some schemes charge additional fees such as contribution charges, and there are tiered and bespoke pricing structures to consider.

Cost findings

- While costs reduce returns, low cost does not necessarily equal 'value for money'
- Over 50 years, an annual fee of 0.75% pa equates to a 20% reduction in return
- **Initial fees** are diluted over time; the longer an asset is held the less influence the fee has on the total return
- **Ongoing fees** have the opposite effect; the longer an asset is held the greater influence the fee has on the total return

Cost factors to consider

- In view of the many variations of scheme and charging models in the market, it is always going to be prudent to review costs alongside all other aspects on a periodic basis
- Can the provider explain their costs succinctly and then confirm them in writing in a manner you can understand and use with your client?
- How does the fee structure fit with the regulators' desire for 'clarity of cost', 'treating customers fairly (TCF)' and evidencing 'value for money'?
- Does the fee charged reflect the costs being incurred? For example, a passive solution may be paying less than 0.1% to the fund manager, while charging members 0.75%
- Is the fee structure comparable to other schemes?
- How does the fee structure support evidencing 'value for money'?

6. Investment and performance

Using quantifiable facts to analyse funds creates evidence-based decisions.

We have designed these guidelines to be impartial and repeatable. In addition, researchers shouldn't need to go hunting for data as schemes should provide this information freely on their public website. If a scheme does not, you should consider why.

Subject areas to analyse:

- Management style (weightings to active and passive)
- Asset allocation and diversification
- How providers invest responsibly
- Annualised returns and risk-adjusted returns against peers
  - Absolute
  - Sharpe ratio
  - Sortino ratio
- Annualised returns against the relevant benchmark/objective and term

On the last point of using a relevant benchmark/objective and term, whether the fund has outperformed some investment industry benchmark has little, if any, meaning to members. Inflation and cash returns resonate better with members as they have working experience of them. For this reason Defaqto encourages their use as objectives to discuss with members.

The term is also important as some default fund managers talk about 20+ year investment horizons, but this very rarely matches the employee's expectations of working with that employer. At Defaqto, we consider anything less than three years' performance to be insufficient to draw any meaningful conclusion. Ideally, one should be looking at five or more years and most default funds are now in a position to demonstrate such longevity in performance.

Fund providers' preferred benchmarks/objectives vary greatly across the industry and common examples include:

- An investment industry benchmark such as one, or a composite, from the IA, FTSE or MSCI
- Cash + x% pa
- Inflation + x% pa (consumer price index (CPI) or retail price index (RPI))
- Volatility
- A mixture or composite of these

We do see providers using composite benchmarks, ie different benchmarks, for different elements of the assets held. While this may work well for providers and fund managers, they are usually difficult for consumers to understand and are probably best avoided.

7. Benchmarking and evidencing 'value for money'

So, what is 'value for money' and how can you evidence it?

When we look at how other industries assess value for money, we find some interesting guidance.

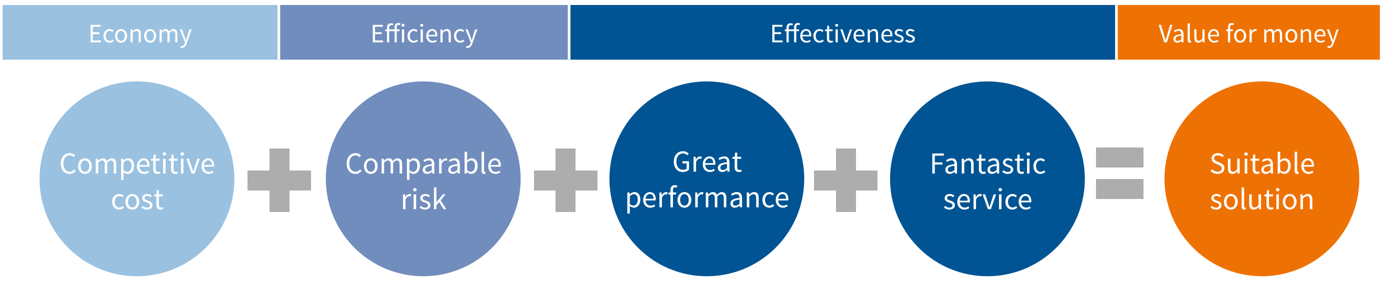
The UK government National Audit Office uses three criteria to assess 'value for money' in government spending, ie the optimal use of resources to achieve the intended outcomes:

> 'Value for money' is the regulators' preferred benchmark

Economy	**Spending less** – Minimising the cost of resources used or required (inputs)
Efficiency	**Spending well** – The relationship between the output from goods or services and the resources to produce them
Effectiveness	**Spending wisely** – The relationship between the intended and actual results of public spending (outcomes)

However, should the test actually be 'meeting expectations and value for money'?

Only by setting the expectation (benchmark(s)) is it possible to evidence value for money. When we apply this to the workplace pension's arena, an assessment along the following lines seems like an appropriate headline strategy to follow:



Source: Defaqto

Advisers put themselves at risk if they fail to define 'expectations' and what the 'value for money' assessment is at inception.

They can do this by ascertaining exactly what the client's needs and objectives are and then agreeing and documenting SMART benchmarks for each one. Collectively, these benchmarks can help define and evidence expectations and 'value for money'.

Shop around to improve 'value for money'

We acknowledge that paying less for the same service can enhance value for money, and with bespoke pricing commonly available, shopping around can create additional benefits.

When reviewing an existing scheme or any potential new scheme the following factors may be valuable considerations:

- Each provider's stated target market
- The business profile, which includes facts such as employee salaries, contribution rates, accumulated pension savings and definition of pensionable earnings
- The average employee's profile, which can help identify suitable fee structures and investment profiles
- Performance. True net risk adjusted performance is critically important and we suggest you look for consistent good performance over 3 and 5 years

Default fund due diligence checklist

The most important factor when making recommendations is to meet the client's needs and objectives, whether they be individual or corporate. We suggest considering and documenting decisions made on the following points in your research:

		✓
A	**Ascertain, agree and document advice needs** • Client's needs, objectives, aspirations and time frames • Profile of employees and turnover • Risk framework	
B	**Provider's financial strength and capability** • Would a contract, master trust or own trust be most appropriate? • What evidence have you used to justify the solution scheme?	
C	**Scheme strengths and weaknesses** • Does the scheme guarantee acceptance of the employer and all of its employees? • What groups of employees does it exclude or discriminate against? • Can the scheme facilitate tax relief for all employees? • Does the scheme provide access to alternative fund options, ie ethical and Sharia? • Check FCA and/or TPR websites for authenticity of scheme (is it a scam?)	
D	**Investment management procedures and responsibilities** • Level of independence • Are the investments sourced in-house and/or from third parties and the implications of the strategy • Does the investment strategy match the client, their needs and that of their employees? • Are there robust and repeatable working practices in place? • Are the individuals involved suitably experienced and qualified to manage the scheme?	
E	**Clarity, robustness and repeatability of default fund decision making** • Is there a documented and clear structure and decision-making process in place? • Is it being adhered to, and how is it compliance managed? • Is the fund of a sufficient size to be able to facilitate diversification and pricing to operate in the client's/savers' best interests?	
F	**Benchmarking** • Agree independent, relevant and easily understood benchmarks against which performance should be measured • Agree suitable timescales for these measures • Put in place an action plan to make sure measures are taken • Put in place an action plan for when underperformance is identified • Consider additional benefits, such as retirement options (investment pathways) and IT functionality	
G	**Assess value for money and suitability** • Consider what, if any, additional benefits and services are provided • Is a lower cost option available for the employer or employees (AMC + other charges)? • Detail how the selected default fund compares to its peers • Provide an overall assessment and summary of the decision-making process and rationale for ultimate selection	
H	**Set periodic review dates for** • Updating The Pensions Regulator (TPR) • Ongoing scheme and contribution suitability assessments • Triennial reviews • Trustee meetings • Implementing additional employee benefits and pension/financial reviews • Implementing additional business financial planning (key man insurance etc.)	

Source: Defaqto

Part 2 – Comparison of default funds

The reviewed population

Default strategies are the funds in which contributions to workplace pensions will automatically be invested without the employee making a decision. In February 2020 TPR reported that over 95% of workers are invested in the default fund, highlighting their importance in the retirement of millions of people. When comparing the default strategies across the different organisations in this study, we look at the main growth phase and have used the funds shown in Table 3.

Defaqto sent a questionnaire to all known workplace pension providers and the tables in the following sections use the answers provided, along with additional information where necessary from provider websites and fund factsheets. Table 3 summarises the default funds from each of the providers.

Table 3: Main default funds

Provider	Default fund
Aegon	Aegon Workplace Default (ARC)
Aon	Aon Managed Retirement Pathway 2043-2045
Atlas	Higher Equity Lifestyle (Multi Asset Portfolio 1)
Aviva	My Future Focus Growth S6
B&CE (The People's Pension)	B&CE Global Investments (up to 85% shares) Fund
Ensign	Aegon BlackRock LifePath Flexi
Evolve Pensions	Crystal Trust Target Date 2044-2046 Retirement Fund
Hargreaves Lansdown	BlackRock Consensus 85 Fund
Intelligent Money	QWPS Default
Legal & General	LGIM PMC Multi-Asset 3
Lewis & Co	Default 1
Nest	Nest 2040 Retirement Date Fund
NOW: Pensions	Diversified Growth Fund
Royal London	Royal London Governed Portfolio 4
Salvus	Cautious Lifestyle Growth Stage
Scottish Widows	Scottish Widows Pension Portfolio Two
Smart Pension	Smart Growth Fund - Moderate Risk
Standard Life	Standard Life Active Plus III
True Potential	SVS True Potential Balanced 5
Willis Towers Watson	Medium Risk Drawdown (LifeSight Equity Fund)
Workers Pension Trust	WPT Growth Fund
XPS Pensions Group	National Pension Trust Global Equity Fund

Source: Provider websites and factsheets

Note: At the time of writing, Smart Pension was looking to change its default fund; the following sections refer to the existing fund.

Investment process

Table 4 shows the investment process in terms of investment approach (active versus passive fund management) and fund manager structure for each of the main default funds.

Table 4: Main default funds – investment approach and fund manager structure

Provider	Active	Passive	Solution
Aegon		yes	Aegon/BlackRock
Aon	yes	yes	Various managers
Atlas	yes		Schroders
Aviva	yes	yes	In-house
B&CE (The People's Pension)		yes	State Street Global Advisors (SSGA)
Ensign		yes	BlackRock
Evolve Pensions		yes	Alliance Bernstein
Hargreaves Lansdown		yes	BlackRock
Intelligent Money		yes	Quilter Cheviot
Legal & General	yes	yes	In-house funds
Lewis & Co		yes	Legal & General Investment Management (LGIM)
Nest	yes	yes	Various managers
NOW: Pensions	yes	yes	In-house
Royal London	yes	yes	In-house and BlackRock
Salvus		yes	Aegon/BlackRock
Scottish Widows		yes	Scottish Widows, SSGA and Aberdeen Standard
Smart Pension		yes	LGIM
Standard Life	yes		In-house
True Potential	yes	yes	Various managers
Willis Towers Watson		yes	LGIM and Robeco
Workers Pension Trust		yes	LGIM
XPS Pensions Group		yes	LGIM

Source: Provider questionnaires, websites and factsheets

As can be seen, there is a mix of manager structures across the main default funds reviewed. Some keep fund management in-house, either using fund managers from elsewhere within their organisation or investing directly in securities. Some default funds completely outsource to external managers; while others use both in-house and third-party managers.

One of the reasons for outsourcing to third-party managers is that no one manager can be the best across every single asset class. Instead, the pension fund should source a specialist manager for each different area. Other reasons for outsourcing include scale, resources/expertise within the provider and their investment philosophy. The disadvantage of this method is that third-party managers are generally more expensive than managing the funds in-house; however, this may well be dependent on the available economies of scale and negotiating position. Also, in the case of workplace pension schemes, fund charges are capped.

In terms of investment approach, almost all of the default funds have at least some passive management within them, and just under a half use actively managed funds.

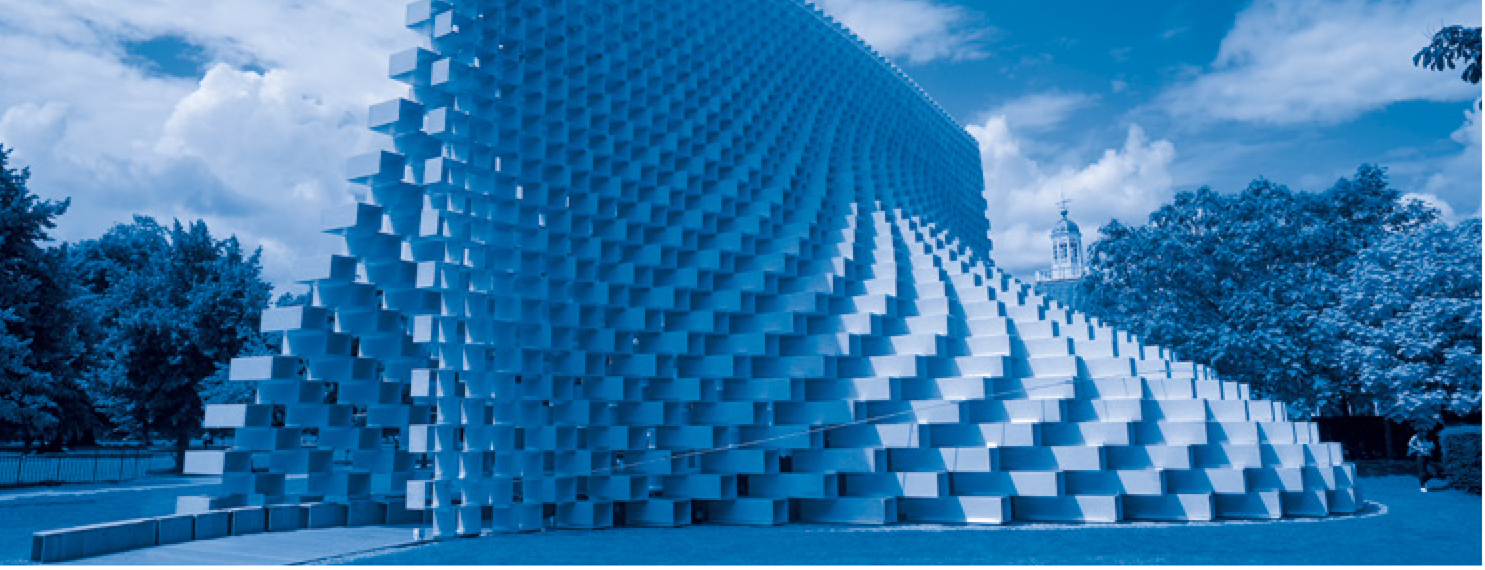
Active managers have the chance to outperform their respective index but also run the risk of underperforming it. Passive managers, meanwhile, simply track an index and generally cost less. Looking at it from a 'value for money' perspective, the passive strategy has the ability to control risk, diversification and costs and is therefore worth considering as an element within a default fund.

Many people believe that the use of active or passive managers depends on the asset class. For example, if the asset class is believed to be 'efficient' – that the market is already highly researched and covered, leaving little scope left to outperform – then a passive manager may be used. If, however, a market is less researched and less efficient then an active manager is more likely to be able to outperform. This is one of the reasons why some funds use a mix of the two approaches rather than one or the other.

Finally, performance benchmarks/objectives vary greatly across the default funds reviewed, although most are one of:

1. A benchmark from the IA
2. A composite benchmark using indices from FTSE or MSCI
3. An objective of cash or inflation plus a certain percentage (usually 2 to 4%) per annum

A handful of funds do not have any performance benchmarks/objectives but instead use volatility targets; another small number have both performance benchmarks/objectives and volatility targets.



Asset classes

Table 5 shows the high-level asset classes in which each of the main default funds invests.

Table 5: Main default funds – high-level asset classes used

Provider	Cash	Fixed income	Property	Equity	Commodities	Other alternative
Aegon		yes		yes		
Aon			yes	yes		yes
Atlas		yes		yes		
Aviva	yes	yes	yes	yes		
B&CE (The People's Pension)		yes	yes	yes		yes
Ensign		yes	yes	yes	yes	
Evolve Pensions		yes	yes	yes	yes	
Hargreaves Lansdown	yes	yes	yes	yes		
Intelligent Money	yes	yes	yes	yes		
Legal & General		yes	yes	yes		yes
Lewis & Co				yes		
Nest	yes	yes	yes	yes	yes	yes
NOW: Pensions		yes		yes	yes	yes
Royal London	yes	yes	yes	yes	yes	
Salvus		yes		yes		
Scottish Widows		yes		yes		
Smart Pension		yes		yes		
Standard Life	yes	yes	yes	yes		yes
True Potential	yes	yes		yes	yes	
Willis Towers Watson				yes		
Workers Pension Trust				yes		
XPS Pensions Group				yes		

Source: Provider questionnaires, websites and factsheets

Note: 'Other alternative' consists of absolute return, infrastructure and private equity

As might be expected, given that this study is comparing the default funds in their main growth phase, all of them hold equities as part of their asset allocation. The majority also hold some fixed income.

Some funds also hold 'alternative' asset classes (property, commodities, absolute return, infrastructure and private equity) to varying degrees. The advantages of such asset classes are the greater potential for higher returns and diversification. However, they can also be more expensive, less liquid and less transparent.

Investing responsibly

Table 6 shows the attention given to investing responsibly by the provider, trustees and fund manager generally, as well as the main default fund specifically (it is recognised that providers may also have standalone funds in this area that employees can select from). Examples of initiatives recently taken or planned in the near future are also included.

Table 6: Main default funds – investing responsibly considerations

Provider	Consideration given to responsible investment
Aegon	The fund does not currently apply any specific ESG screens. Aegon is investigating how ESG might be more formally included in default strategies.
Aon	Within the default strategy, ESG is currently incorporated through Aon's manager selection process (all their managers are required to achieve a minimum ESG rating from Aon's research team, which looks at how managers integrate ESG considerations into their process). Aon will also be making changes this year to introduce ESG screening on individual stocks (including tobacco, thermal coal and controversial weapons) and a low carbon tilt to approximately 50% of the growth default fund. Also this year they are creating a new Impact Equity Fund, which will invest in actively managed global equities, through managers who not only seek to outperform the index but also aim to make a positive impact. There will be an allocation to this fund within the default funds.
Atlas	The trustee has a strong conviction that ESG issues can and do affect the performance of investment portfolios over the long term. Consequently, ESG factors must be considered alongside more traditional financial factors. During 2019 the trustee instructed Schroders to redirect the equity component of Atlas's assets managed by them into the Schroders Sustainable Multi Factor Equity Fund, a systematic global equity strategy that incorporates ESG risk factors at the stock level and applies various exclusions.
Aviva	Responsible investment is embedded throughout the whole strategy. The funds also employ an ESG tilt on the regional equity components. This tilt removes the lowest scoring 10% of stocks. The funds also exclude any companies that have failed Aviva's engagement and those companies involved in the manufacture of cluster munitions and landmines.
B&CE (The People's Pension)	B&CE has a policy on responsible investment which includes consideration of ESG issues. The default fund includes a strategy with an index that targets an improved ESG profile (ESG score improvement of 20%) and a reduction in carbon emission intensity (of at least 50%) compared to the broad MSCI World index. SSGA Multi-Factor Global ESG Index Equity Fund is a passive equity-only index tracker that combines portfolio exclusions with tilts towards improvement in ESG score and reduction in carbon intensity.
Ensign	Since July 2019, a proportion of the portfolio's assets has been invested in the BlackRock ACS World ESG Equity Tracker fund, an ESG focused fund, with the allocation expected to grow over the next few years.
Evolve Pensions	Alliance Bernstein (AB) has been a signatory to the UN Principles for Responsible Investment (PRI) since November 2011. However, as the underlying funds are predominantly passively managed and/or systematic approaches, the incorporation of active ESG consideration when making an investment and taking ownership is limited. When selecting and appointing third-party investment managers, AB reviews shortlisted third-party managers' UNPRI signatory status, ESG and ownership/stewardship policies, and proxy voting history to ensure that any appointed manager is as closely aligned to the polices of AB as possible.

Table 6 (cont): Main default funds – investing responsibly considerations

Provider	Consideration given to responsible investment
Hargreaves Lansdown	No exclusionary filters. However, the underlying assets are subject to BlackRock's full corporate governance and engagement strategy. HL expects to integrate ESG within the default in the future.
Intelligent Money	Uses trackers; no consideration given to ESG.
Legal & General	ESG issues are reflected in the fund's investment strategy, plus LGIM produces an ESG Impact Report on a quarterly basis.
Lewis & Co	ESG factors are taken into account as per their Statement of Investment Principles. An ESG fund is being introduced into the Default 1 portfolio.
Nest	Responsible investment (ESG) is at the heart of their investment strategy. They believe that companies with good ESG practices will deliver better long-term investment results for members as well as help global efforts to tackle climate change. They also work closely with current and prospective fund managers to ensure they fulfil their responsibilities in addressing material ESG factors in the investment process and stewardship on their behalf. Nest announced their decision to go tobacco-free across their investment portfolios last year. They also announced last year that they would start using the live databases of RepRisk and Sustainalytics to increase their ability to invest responsibly and further integrate ESG factors into their investment strategy, allowing them to spot ESG risks and screen out certain assets. The 2040 Retirement Date portfolio holds a climate-aware global developed equities fund, which over-weights companies making a positive contribution towards limiting climate change and reducing carbon, while under-weighting those which are least aligned to meeting industry carbon reduction targets, as well as concentrating voting and engagement activities on improving companies that most need to adapt their business models in order to meet climate change goals. It also holds an ESG-screened emerging markets equities fund and an ESG-screened commodity fund (alongside other funds).
NOW: Pensions	Has a 'Policy of Social Responsibility in Investments'.
Royal London	Within their default funds, Royal London Asset Management (RLAM) drives change mainly through voting and working alongside companies they invest in to improve standards, although they can make investment decisions based on ESG factors too. There are situations where RLAM invests in a company and chooses to engage with the company to improve standards either as a shareholder or owner of its debt. Examples of how RLAM engages with companies they invest in were provided: (1) conflict of interest and governance issues at Metro Bank led to RLAM voicing concerns publicly, voting against various resolutions and meeting Metro Bank's directors; (2) RLAM voted against and voiced concerns over several years about Persimmon Homes' long-term bonus plan for senior executives; and (3) RLAM did not invest in Ferroglobe due to an 'opaque' ownership structure as well as concerns around accounting and reporting transparency.
Salvus	They will shortly be updating their website to include information on the trustees' approach to ESG.
Scottish Widows	Scottish Widows (SW) has a Responsible Investment Strategy Team. SW is currently actively reviewing the components of their default investment in relation to ESG strategies.

Table 6 (cont): Main default funds – investing responsibly considerations

Provider	Consideration given to responsible investment
Smart Pension	They have applied to the UNPRI and state that they are committed to the UK Stewardship Code. From a fund point of view, a new default fund is being introduced, the Smart Growth Fund, which will have an ESG overlay.
Standard Life	Their fund strategy for responsible investment is based on the UNPRI and the UK Stewardship Code. As part of Aberdeen Standard's investment process they have engagement with their holdings on all of their key risks and opportunities (both financial and ESG related) as an integral part of their investment process. They conduct this type of engagement with their current holdings and potential investments. An example of how they engage with companies they invest in was provided. They had concerns with a major online retailer that specialises in fashion for younger people around labour management, working conditions and the environmental impact from fast fashion, together with poor disclosures on these issues. Aberdeen Standard carried out continued engagement and due diligence and made repeated requests of the company until they had enough comfort that the above risks were being managed appropriately and initiatives put in place to address them.
True Potential	ESG is not a consideration for this fund.
Willis Towers Watson	The LifeSight Trustees explicitly believe that sustainable investment practices (which include ESG factors) are part of good financial risk management and that they should produce better outcomes for members over the long term. The trustees have a policy regarding 'responsible investing, stewardship and sustainability' from their Statement of Investment Principles. Over half the LifeSight Equity Fund is currently invested in strategies that explicitly assess the ESG scores of global companies and weight the investment in them accordingly, while strong stewardship focusing on ESG factors is applied across the whole portfolio. One of the explicit ESG funds held is LGIM's MSCI ACWI Adaptive Capped ESG Index Fund, which applies tilts and exclusions based on ratings provided by MSCI ESG Ratings. The other explicit ESG fund is Robeco's Global Sustainable Multi-Factor Equity Index Fund, a factor-based smart beta strategy which combines high conviction equity premiums with an ESG constraint and exclusions. LGIM provides active corporate engagement and stewardship on 100% of the LifeSight Equity Fund.
Workers Pension Trust	The trustee recognises that ESG factors can have a financially material impact on the investment risk and return outcomes of the portfolio and therefore it is in members' best interests that these factors be taken into account within the investment process. The trustee is satisfied that the manager, LGIM, takes an active approach to voting and engaging with the companies in which it invests, to encourage long-term, responsible corporate behaviour. The trustee is in the process of reviewing the investment strategy and, as part of this review, is considering how to incorporate ESG principles further.
XPS Pensions Group	Their Trust Statement of Investment Principles has been updated to reflect 'the importance of factoring ESG into their investment decisions' and ESG will be factored into the trustees' upcoming Investment Strategy Review.

Source: Provider questionnaires, websites and factsheets

As can be seen, most of the providers/trustees have some policy in terms of responsible investment.

Some of the default funds explicitly include responsible investment in their strategy, for example through holding ESG-focused funds in their portfolios, while a few other providers appear to be planning to add in some form of responsible investment to their default funds or are at least considering it.

Performance

We now compare performance numbers across the default funds, in their main growth phase.

It is generally agreed that longer-term numbers are more significant from a statistical point of view, and therefore we caution against decisions being made on a performance history of less than three years, especially so in the case of risk-adjusted performance. That said, auto-enrolment only started in 2012, so at the moment the majority of funds will only have a seven-year history at most.

Table 7 shows the annualised returns for the default funds reviewed.

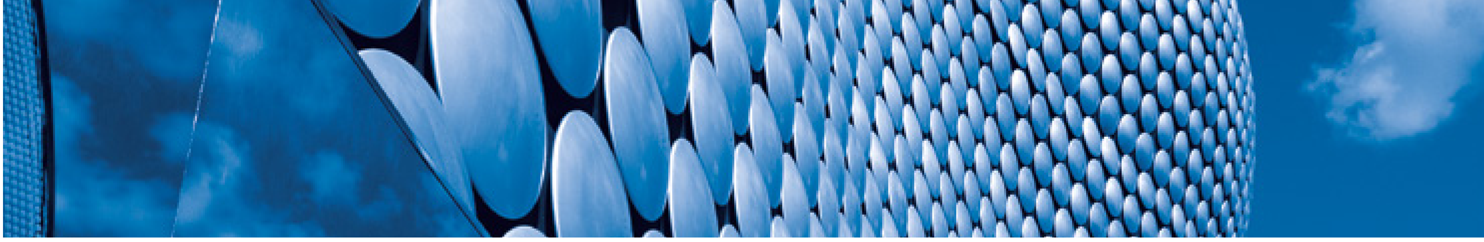
Table 7: Annualised returns

Provider	1 year	3 years	5 years
Average	17.9%	7.5%	8.6%
Aegon	18.1%	7.5%	8.9%
Aon	19.1%	8.7%	11.4%
Atlas	17.0%	6.6%	–
Aviva	18.3%	8.0%	8.6%
B&CE (The People's Pension)	18.3%	7.8%	9.1%
Ensign	22.3%	9.2%	–
Evolve Pensions	18.8%	7.9%	9.2%
Hargreaves Lansdown	16.2%	6.5%	8.2%
Intelligent Money	18.2%	6.5%	–
Legal & General	15.3%	6.9%	8.1%
Lewis & Co	19.3%	7.9%	10.0%
Nest	17.0%	7.0%	8.9%
NOW: Pensions	13.7%	7.0%	4.2%
Royal London	15.5%	6.4%	7.5%
Salvus	18.1%	7.3%	8.9%
Scottish Widows	17.6%	7.0%	8.7%
Standard Life	12.8%	4.7%	5.0%
True Potential	14.1%	–	–
Willis Towers Watson	23.0%	9.4%	–
Workers Pension Trust	19.9%	8.2%	9.8%
XPS Pensions Group	23.6%	10.0%	10.9%

Source: Data from Morningstar and providers to end December 2019; calculations by Defaqto using monthly data, net of fees

Note: Smart Pension reports on a quarterly basis, so we were unable to collect the performance figures to December 2019 within our timescale. Therefore they have not been included in the performance tables

These figures, however, are returns only and take no account of the fund's volatility, ie the risk taken in achieving these returns.



Sharpe ratio

The Sharpe ratio, which is fund return minus the risk-free rate divided by the volatility of these 'excess' returns, does take risk into account.

(Fund return − Risk-free rate) ÷ Volatility of returns = Sharpe ratio

This ratio has no units, but a higher number indicates better risk-adjusted performance. Table 8 shows the Sharpe ratios for the default funds reviewed.

Table 8: Sharpe ratios using 0.75% risk-free rate

Provider	3 years	5 years
Average	0.88	0.93
Aegon	0.92	0.98
Aon	0.91	1.09
Atlas	0.69	–
Aviva	1.11	1.01
B&CE (The People's Pension)	1.03	1.04
Ensign	0.97	–
Evolve Pensions	0.82	0.93
Hargreaves Lansdown	0.84	0.97
Intelligent Money	0.63	–
Legal & General	1.14	1.10
Lewis & Co	0.78	0.93
Nest	0.87	1.07
NOW: Pensions	1.20	0.49
Royal London	0.78	0.90
Salvus	0.84	0.93
Scottish Widows	0.72	0.80
Standard Life	0.72	0.77
True Potential	–	–
Willis Towers Watson	0.88	–
Workers Pension Trust	0.83	0.96
XPS Pensions Group	0.88	0.89

Source: Data from Morningstar and providers to end December 2019; calculations by Defaqto using monthly data, net of fees

On a five-year basis, Legal & General, Aon, Nest, B&CE (The People's Pension) and Aviva all have a Sharpe ratio above 1, indicating that the fund is generating a positive return for each unit of risk. Over three years, four funds have a Sharpe ratio above 1: NOW: Pensions, Legal & General, Aviva and B&CE (The People's Pension), the latter three featuring in both lists, showing consistency over time.

Sharpe ratios penalise upside and downside volatility equally. Most people would consider volatility caused by high returns to be acceptable and volatility due to low returns to be 'bad'; therefore, we next consider Sortino ratios.

Sortino ratios

Sortino ratios differentiate 'bad' volatility of returns from total volatility by penalising only downside deviations and are an expression of the fund's return minus the risk-free rate divided by the downside volatility.

(Fund return − Risk-free rate) ÷ Downside volatility of returns = Sortino ratio

The Sortino ratios for the default funds are shown in Table 9 (again, these ratios have no units, but a higher number indicates better downside risk-adjusted performance).

Table 9: Sortino ratios using 0.75% risk-free rate

Provider	3 years	5 years
Average	1.43	1.55
Aegon	1.60	1.68
Aon	1.43	1.92
Atlas	1.02	–
Aviva	1.86	1.69
B&CE (The People's Pension)	1.92	1.85
Ensign	1.42	–
Evolve Pensions	1.22	1.44
Hargreaves Lansdown	1.43	1.63
Intelligent Money	1.03	–
Legal & General	2.14	2.11
Lewis & Co	1.23	1.50
Nest	1.36	1.86
NOW: Pensions	2.13	0.68
Royal London	1.24	1.43
Salvus	1.39	1.56
Scottish Widows	1.08	1.27
Standard Life	1.14	1.22
True Potential	–	–
Willis Towers Watson	1.28	–
Workers Pension Trust	1.34	1.55
XPS Pensions Group	1.35	1.39

Source: Data from Morningstar and providers to end December 2019; calculations by Defaqto using monthly data, net of fees

Over a five-year period, Legal & General, Aon, B&CE (The People's Pension), Nest and Aviva are again the top five performers (based on downside risk-adjusted performance). Over three years, Legal & General, NOW: Pensions, B&CE (The People's Pension) and Aviva are the standout performers.

Summary

This case study lays out the key factors we believe you should consider when reviewing or selecting a default fund.

Considering the seven key factors to be considered, we draw the following conclusions:

Governance and regulation

Contract-based schemes are regulated by the FCA and trust-based schemes by TPR.

Both the FCA and TPR have introduced tougher standards and announced plans to tighten up further over the coming years.

Advisers should therefore have confidence in recommending off the shelf contract-based and master trust-based schemes.

Provider financial strength and/or capability

This assessment has become a lot easier.

Most contract-based schemes hold independent financial strength ratings that can be considered.

All master trusts have to pass an ongoing ‘authorised’ assessment, which includes their financial capability and that of its sponsors.

IGCs, trustees and investment committees

These controls can be seen across the market place. However, identifying the strengths and weaknesses of each is not straight forward.

What is clear is that reliance on IGC reports and Chair statements is unlikely to provide sufficient due diligence evidence, especially if impartiality is required.

Investment management key factors

Consideration should be given to the investment, strategy, working practices, responsible investment strategy and the individuals involved.

While the decision-making process should provide clarity, robustness and repeatability, it should also create consistent good performance.

Cost

We know that costs reduce returns, and we can see that reflected in many default fund performances.

While the headline fee cap of 0.75% pa is attractive, the use of bespoke pricing means it is good practice to periodically shop around for a better deal.

Investment and performance

While annual returns over three and five years should be the minimum consideration, Sharpe and Sortino ratios provide a more comprehensive assessment.

It is important to understand the benchmarks/objectives each fund manager is working towards and make sure these align with members’ needs and expectations.

Ultimately, will the scheme deliver the workers the returns they promised/ indicated?

Benchmarking and evidencing 'value for money'

Without defining 'expectations' and setting SMART 'benchmarks' it is impossible to evidence whether 'value for money' is being achieved, or indeed if the advice provided is suitable.

Once benchmarks are agreed, Defaqto suggests a 'value for money' assessment along the following lines be documented at inception and the scheme assessed against it at future reviews to evidence how and where 'value for money' is being achieved and even improved.

Economy	Efficiency	Effectiveness		Value for money
Competitive cost +	Comparable risk +	Great performance +	Fantastic service =	Suitable solution

Overall...

It is notable that some default funds consistently compare well to their peers when compared to most measures.

Arguably, these represent the best value for money for savers and should be considered in any due diligence process.

Conclusion

The number of employees in workplace pensions now stands at well over 11 million, which compares to approximately 1 million in 2013, all of which is delivered through over 1.4 million employers. Defaqto's database currently reports on over 60 different workplace pension schemes from more than 30 providers.

This guide identifies the key factors we believe should be considered when reviewing or selecting a default fund from these or any other scheme.

The study identifies a great variety in terms of manager structure (in-house manager, third-party managers or a mix), investment approach (active, passive or both), level of diversification, attention paid to responsible investing, performance and charging across the funds.

With some of these attributes, such as manager structure, investment approach and attitude to responsible investing, the choice of provider and fund might come down to the investment beliefs of the employer or their adviser. In terms of the other more objective features, ie risk-adjusted performance and charges, some providers and funds are clearly more competitive than others.

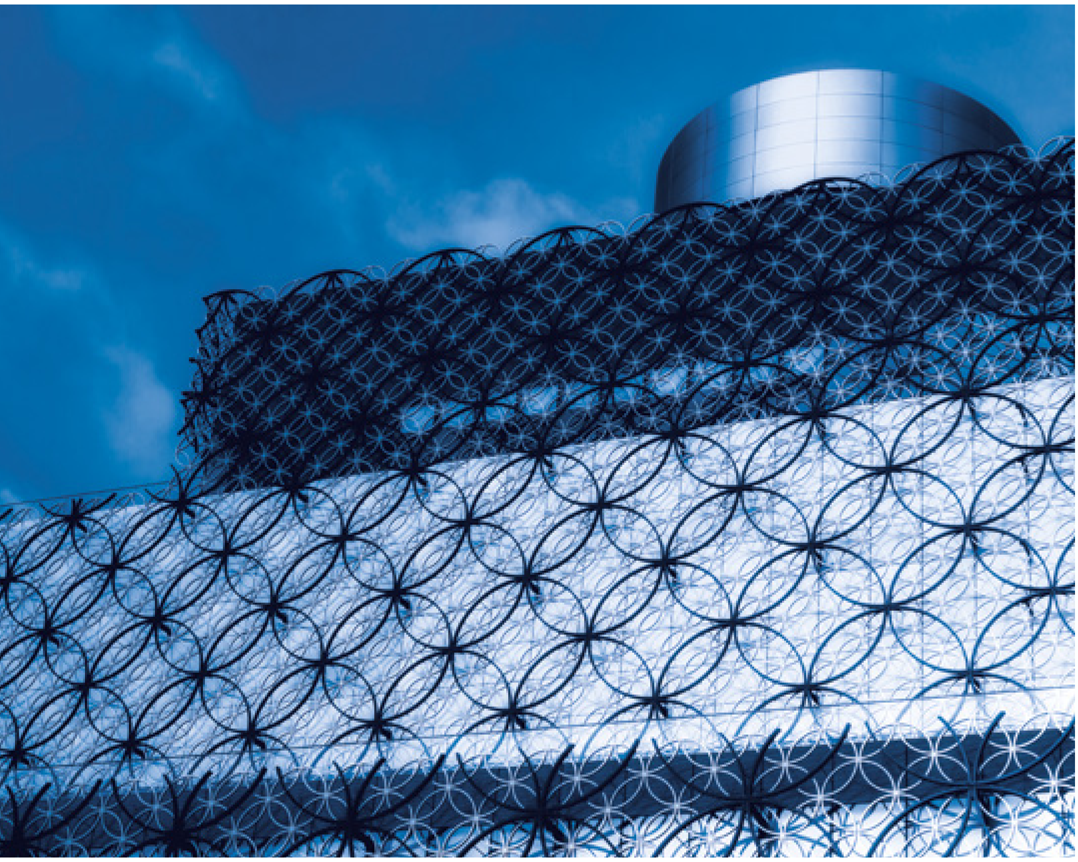
Bearing in mind the diversification in providers and clients, and their respective needs and objectives, it is not surprising that no individual default fund outperforms its peers in every subject area considered. That said, it is notable that some default funds consistently compare well to their peers across most subject areas, and arguably these represent the greatest opportunity for advisers to evidence 'value for money'.

Defaqto would like to thank those schemes that provided information as without their kind co-operation and the support of our two sponsors, this guide could not be written

Learning objectives

Having read this publication you will now:

1	Opportunity	Be able to identify where improvements in employee benefit packages are available
2	Market place	Be able to identify a provider's default investment strategies, focusing on the accumulation phase, and how they compare to others
3	Reviewing	Be able to identify the main differentiating factors between default funds, including: • Governance and regulation • Provider financial strength and/or capability • IGCs, trustees and investment committee oversight • Investment management key factors • Cost • Investment and performance • Benchmarking and evidencing 'value for money'



Test yourself for CPD purposes

To assess your knowledge having read this publication, why not work your way through the following questions?

All the answers can be found within the text.

1	Which regulator is responsible for master trusts?
2	Which regulator is responsible for contract-based schemes?
3	Name the three elements to consider when assessing investment management procedures and responsibilities 1. 2. 3.
4	Name four common default fund performance benchmarks 1. 2. 3. 4.
5	What is the maximum equivalent default fund AMC that providers can charge savers?
6	Do independent governance committees work in the interests of the scheme members (savers) or the provider?

CII/PFS and CISI accredit this document for up to **60 minutes** of structured continuing professional development (CPD).

Name	
Signature	
Date	
CPD time recorded	

Send us your feedback

Your feedback is extremely important to us and we would be grateful if, after completing this publication, you would take a few minutes to complete a short survey. Your answers will be treated in the strictest confidence and the results of this will help the development of future publications.

The survey can be accessed at:

https://www.snapsurveys.com/wh/s.asp?k=144610976149

CPD answers

As a guide, your answer should include the following points:

1. TPR
2. FCA
3. Investment strategy, working practices, individuals
4. Cash, inflation, industry index, volatility
5. 0.75%
6. Scheme members

Appendix A

Retail workplace pension schemes followed by Defaqto.

Tax relief method acronyms:

RAS	Relief at source	Net	Net pay	Ns	Not stated

Provider	Scheme	Governance	Tax relief
Aegon	Targetplan CIMP	Own trust	Net
Aegon	Targetplan Group Personal Pension	Contract	RAS
Aegon	Targetplan Master Trust	Master trust	Net
Aegon	Workplace ARC SIPP	Contract	RAS
Aon	Aon Delegated DC Bundled	Own trust	Net
Aon	Aon Master Trust	Master trust	Net
Aon	Bigblue Touch	Contract	RAS
Atlas	Atlas Master Trust	Master trust	Net
Aviva Life & Pensions	Company Pension @ Aviva	Contract	RAS
Aviva Life & Pensions	Company Stakeholder Pension @ Aviva	Contract	RAS
Aviva Life & Pensions	My Money - Flexible Retirement A/C	Contract	RAS
Aviva Life & Pensions	My Money - Workplace Retirement A/C	Master trust	Net
Aviva Life & Pensions	My Money - Workplace Retirement A/C	Own trust	Net
B&CE	The People's Pension from B&CE	Master trust	RAS, Net
Baptist Pension Scheme	Baptist Pension Scheme	Master trust	Ns
BCF	BCF Pension Trust	Master trust	Ns
Cheviot Pension	Cheviot Pension Trust	Master trust	Ns
Creative Auto Enrolment	Creative Pension Trust	Master trust	Net
Creative Auto Enrolment	Creative Pension Trust - Flexible & Enhanced	Master trust	Net
Ensign	Ensign	Master trust	Net
Evolve Pensions	The Crystal Trust (Crystal)	Master trust	Net
Fidelity International	Fidelity Group Money Purchase Plan	Contract	RAS, Net
Fidelity International	Fidelity Group Personal Pension Scheme	Contract	RAS, Net
Fidelity International	Master Trust	Master trust	Net
Fidelity International	Own Trust	Own trust	Net
Fidelity International	Stakeholder Pension Plan	Contract	RAS, Net
Hargreaves Lansdown	HL Workplace Solutions	Contract	RAS, Net
Intelligent Money	IM Group SIPP/Nest hybrid	Hybrid	RAS, Net

Provider	Scheme	Governance	Tax relief
ITB	ITB Pension Funds	Master trust	Ns
Legal & General	Worksave Mastertrust	Master trust	RAS, Net
Legal & General	Worksave Pension	Contract	RAS
Legal & General	Worksave Pension Trust	Own trust	Net
Lewis & Co	The Lewis Workplace Pension Trust	Master trust	Ns
Mercer	Contract-Based Product	Contract	Net
Mercer	Mercer Master Trust	Master trust	Net
Mercer	Own Trust	Own trust	Net
Nest	Nest Scheme	Master trust	RAS
NOW: Pensions	NOW: Pensions Trust	Master trust	Net+
Options Corporate Pensions	Options Workplace Pension Trust	Master trust	Net
Punter Southall	Aspire	Master trust	Ns
Royal London	Retirement Solutions - Company Pension	Own trust	Net
Royal London	Retirement Solutions - Group Personal Pension	Contract	RAS
Royal London	Retirement Solutions - Group Stakeholder	Contract	RAS
Salvus	The Salvus Master Trust	Master trust	Net
Scottish Widows	Group Money Purchase Scheme	Own trust	Net
Scottish Widows	Group Personal Pension	Contract	RAS
Scottish Widows	Group SIPP - Retirement Saver	Contract	RAS
Scottish Widows	Group Stakeholder Plan	Contract	RAS
Scottish Widows	Master Trust	Master trust	Net
Scottish Widows	Occupational Money Purchase Pension Plan	Own trust	Net
SEI Investments (Europe)	SEI Master Trust	Master trust	Net
Smart Pension	Smart Pension Master Trust	Master trust	Net
Standard Life	Good to Go - GFRP	Contract	RAS
Standard Life	Group Flexible Retirement Plan	Contract	RAS
Standard Life	Group Self Invested Personal Pension	Contract	RAS
Standard Life	Group Stakeholder Pension	Contract	RAS
Standard Life	Standard Life Master Trust	Master trust	Net
TPT Retirement Solutions	Flexible Retirement Plan - Smarter Pensions	Master trust	Ns
True Potential	True Potential Investments SIPP	Contract	RAS
Willis Towers Watson	Lifesight	Master trust	Net
Workers Pension Trust	Workers Pension Trust	Master trust	Net
XPS Pensions Group	National Pension Trust	Master trust	Net

Source: Defaqto, December 2019

Net+ = NOW: Pensions provides a facility to help non-taxpayers top up their savings to offset net pay income tax relief shortfall

About Defaqto

Defaqto is an independent financial information business, helping financial institutions and consumers make better informed decisions.

Our experts research, collect and continuously assess over 43,000 financial products. Our process is extremely robust and is driven by over 60 specialist analysts who have unparalleled knowledge of financial products, services and funds in the market. Our independent fund and product information helps banks, insurers and fund managers with designing and promoting their propositions.

Defaqto Ratings

defaqto STAR RATINGS

Defaqto Star Ratings are the most trusted expert assessment of products in the market. Products can receive a Rating of 1 to 5, depending on the quality and comprehensiveness of the features it offers. A 1 Star Rating indicates a basic product, while a 5 Star Rating indicates one of the highest quality products in the market. Star Ratings provide consumers, advisers and brokers with an accurate benchmark so that they can see at a glance how products and policies in the market compare.

defaqto DIAMOND RATINGS

A Diamond Rating reflects the performance of a managed fund or fund family. Funds or fund families can receive a Rating of 1 to 5 based on a detailed and well-structured scoring process, allowing advisers and other intermediaries – and their clients – to see instantly where they sit in the market in terms of fund performance and competitiveness in areas such as fees, scale, access and manager longevity. A 5 Diamond Rating indicates it is one of the best quality funds available in the market.

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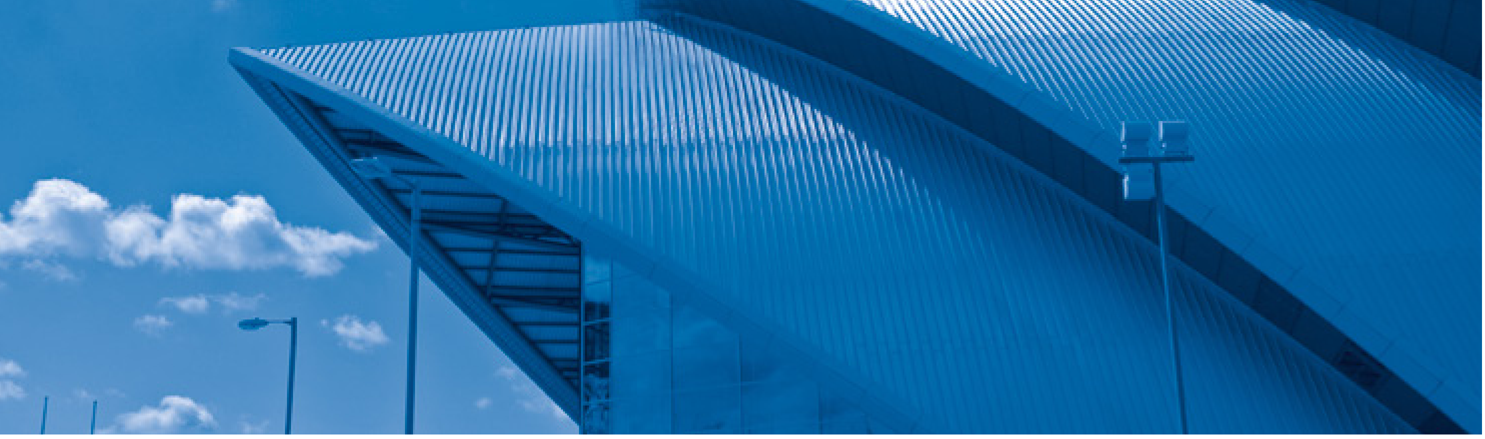
Service Ratings provide advisers with a simple and unbiased assessment of provider service. Based on advisers' perceptions of the service they receive, providers are rated Gold, Silver, Bronze.

defaqto RISK RATED FUND

Risk Ratings use the projected volatility of a fund using asset allocation and historic volatility, based on observed standard deviations, to map a fund to a Defaqto Risk Profile. Risk Profile 10 indicates highest risk and Risk Profile 1 represents lowest risk.

defaqto INCOME RISK RATED FUND

Income Risk Ratings are unique to the market, comparing fund objectives, asset allocations, income and capital volatilities, and maximum drawdown. The Ratings are mapped to four Income Risk Profiles based on the income required and the level of risk. They are: capital preservation, low income volatility, medium income volatility, high income volatility.



Workplace pension scheme review

With employers of all sizes having to undertake a triennial review of their workplace pension, Defaqto can do the hard work for you by carrying out a thorough review of your scheme.

Put our industry experts at the centre of your review process and we will provide you with a detailed, impartial report to help you ensure the on-going suitability of the entire pension proposition you provide to your employees, which will include:

The reports are based on the latest industry wide data and we will deliver this within 30 days. This service is available to financial professionals such as advisers, accountants and bookkeepers to commission for their clients.

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