HYMANS ROBERTSON

The DC provider report

From performance to outcomes - what it means for members

Table of contents

Focusing on member outcomes

Welcome to the latest edition of our DC Provider Report, where we assess the impact of default investment strategies of master trusts and group personal pensions (GPPs) on member outcomes.

The defined contribution (DC) market continues to grow, with over £400 billion of pension savings being invested into master trusts and GPP default funds. With this growing scale comes a greater need to closely monitor and compare master trust and GPP providers.

Our report looks at recent investment performance and uniquely presents a forward-looking assessment to model the impact on member outcomes for different members. In simple terms, we answer the question:

"What does this mean for me?"

While recent fund performance is an important factor in the assessment, we believe it must be considered in the context of longer-term member outcomes.

Tracking member outcomes

Our Member Outcomes Tracker model shows how expected retirement fund values have changed over the last five years. We've modelled this for three sample members at different stages of the savings journey.

In each chart, the solid line is based on the average master trust and GPPs default investment strategy.

We've estimated this based on the strategies of the providers sampled.

The shaded regions show the potential range of expected fund value for members invested in different provider default strategies and how these change over time.

We have used various assumptions to estimate the change in expected fund values for each sample member, so the changes shown are not guaranteed. The use of different assumptions is also likely to lead to different results.

Jasmine

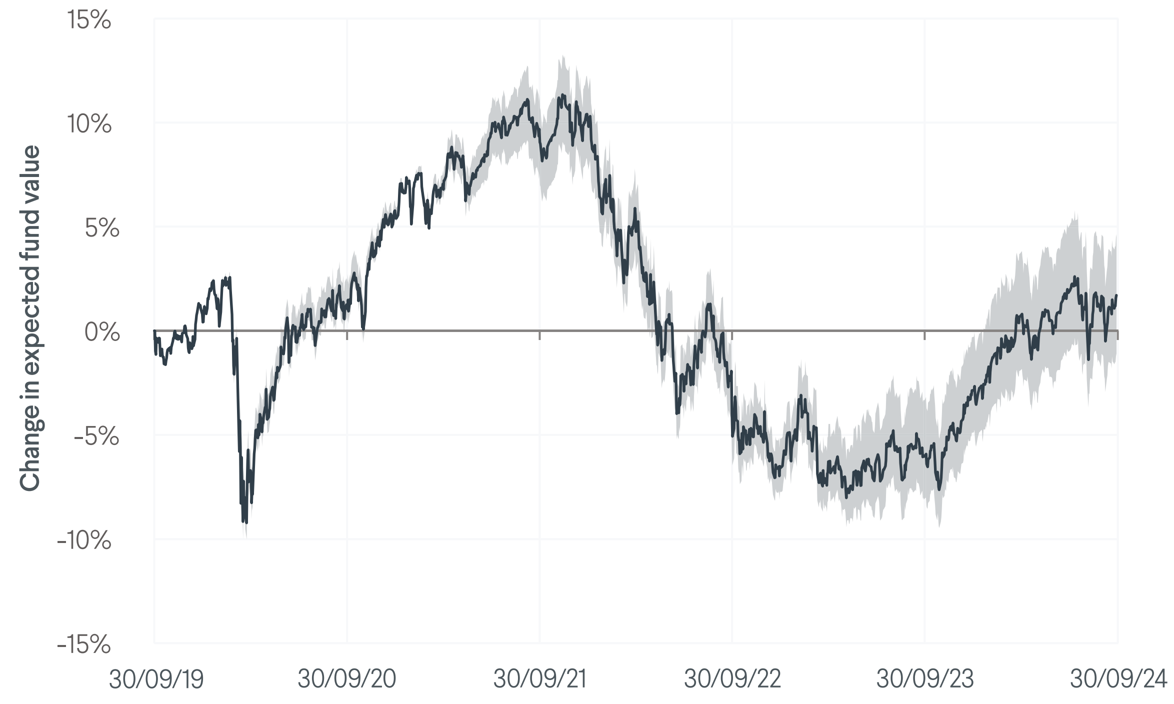
30 years from retirement

Jasmine is currently 30 years from retirement, in the early part of her savings journey and has a modest level of savings. At this point, she is most concerned about making ends meet and doesn't view her pension as a significant priority.

Over the last year, Jasmine has seen a material improvement in her expected fund value at retirement, because of strong returns in equity markets. This will make up most of Jasmine's asset allocation at this stage of her investment journey.

Given Jasmine is a long way away from retirement, she has time on her side and is in a good position to recover from future market downturns. However, it's important she maintains or aims to maximise her pension contributions to grow her pension savings over the long term.

Our view is that during the growth phase, a strategy should maximise the return potential given how long members are invested until retirement.

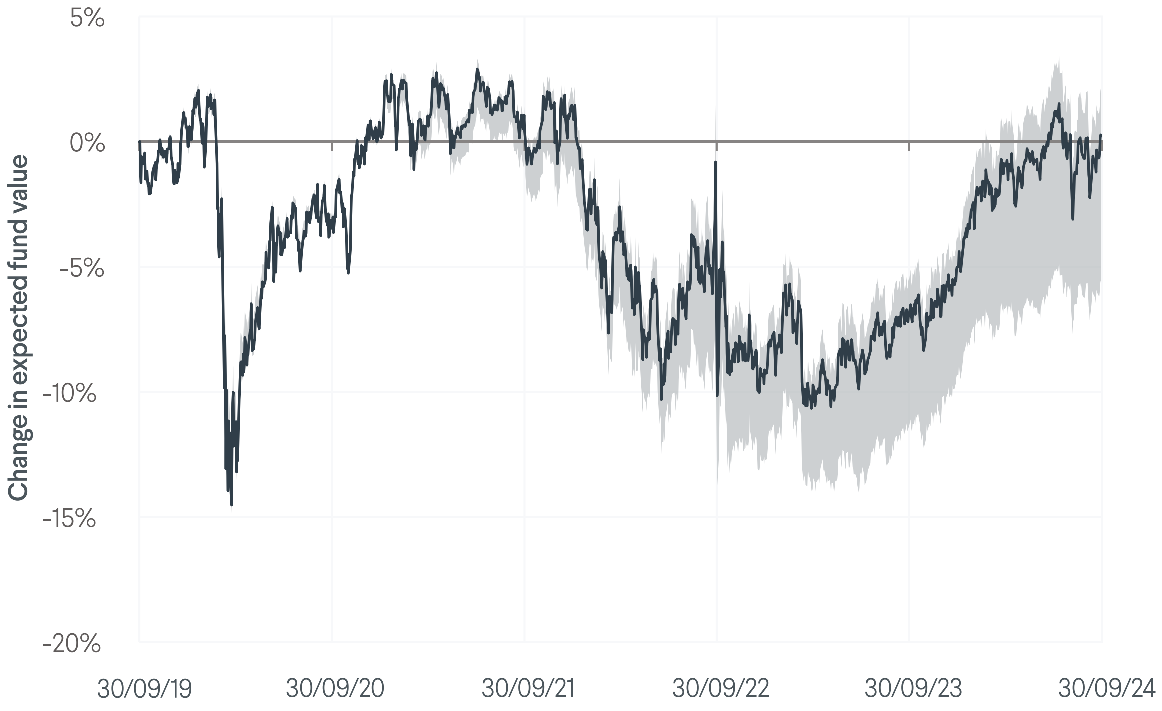


Louise
10 years from retirement

Louise is 10 years from retirement. She has a reasonably sized fund and is thinking about her retirement choices.

Members like Louise who were negatively impacted by volatility within bond markets throughout 2022 have since experienced a recovery in their expected retirement outcomes, benefitting from strong returns in both equity markets and falling yields, which support positive returns for bonds.

It's important Louise understands the risks associated with her current investment strategy; any subsequent market falls associated with a prolonged recession could have a significant impact on her pension and the amount of income she is likely to retire with. Over the next 10 years, Louise's investment strategy will shift in focus towards assets focused on downside protection, to de-risk towards retirement.



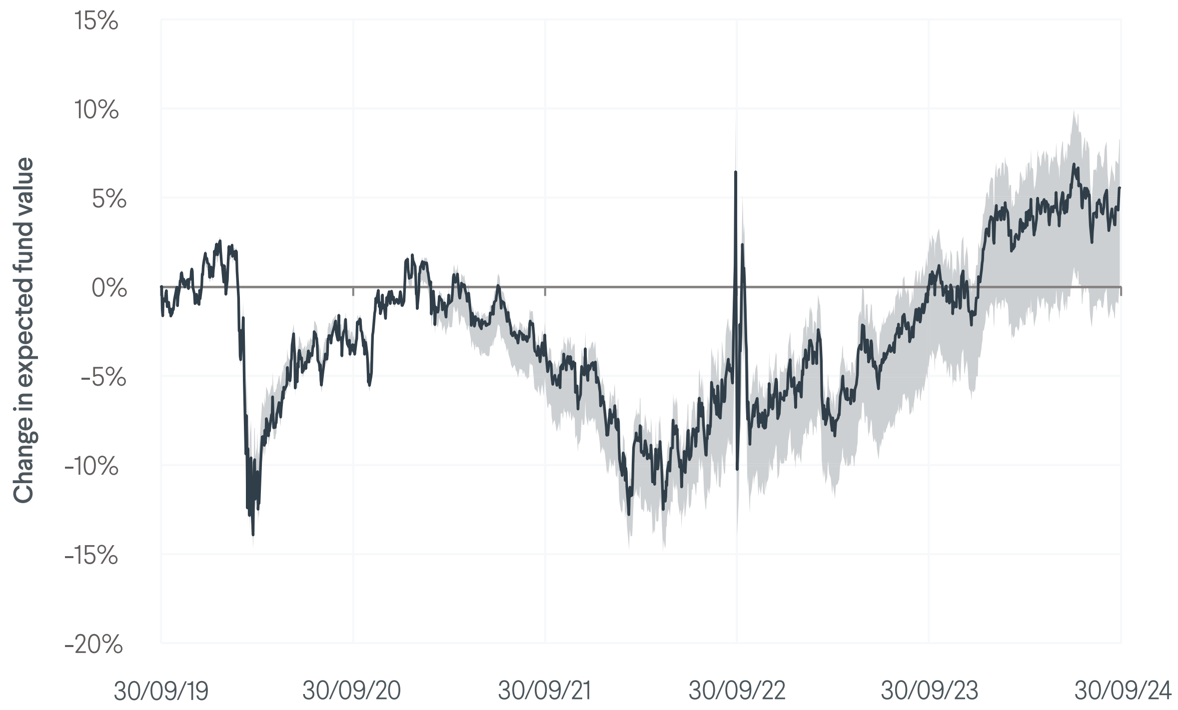
David
5 years from retirement

David plans to retire in 5 years and certainty of his pension value is important.

As with Louise, David's expected fund value at retirement has risen in recent months on the back of strong returns within both equity and bond markets, having largely recovered from the bond market volatility throughout 2022.

David's investment strategy will have a more defensive asset allocation and a greater focus on downside protection than Louise's, given he is 5 years closer to his retirement.

David must be invested in a manner that protects his pension while helping him meet his retirement goals.



What is appropriate at different stages of DC investing

Growth
Take on more investment risk for the prospect of higher returns.

Consolidation
Balance risk reduction and aligning strategy with retirement goals.

Pre-retirement
There is a need to move away from 'one size fits all' and understand what members plan to do with their savings.

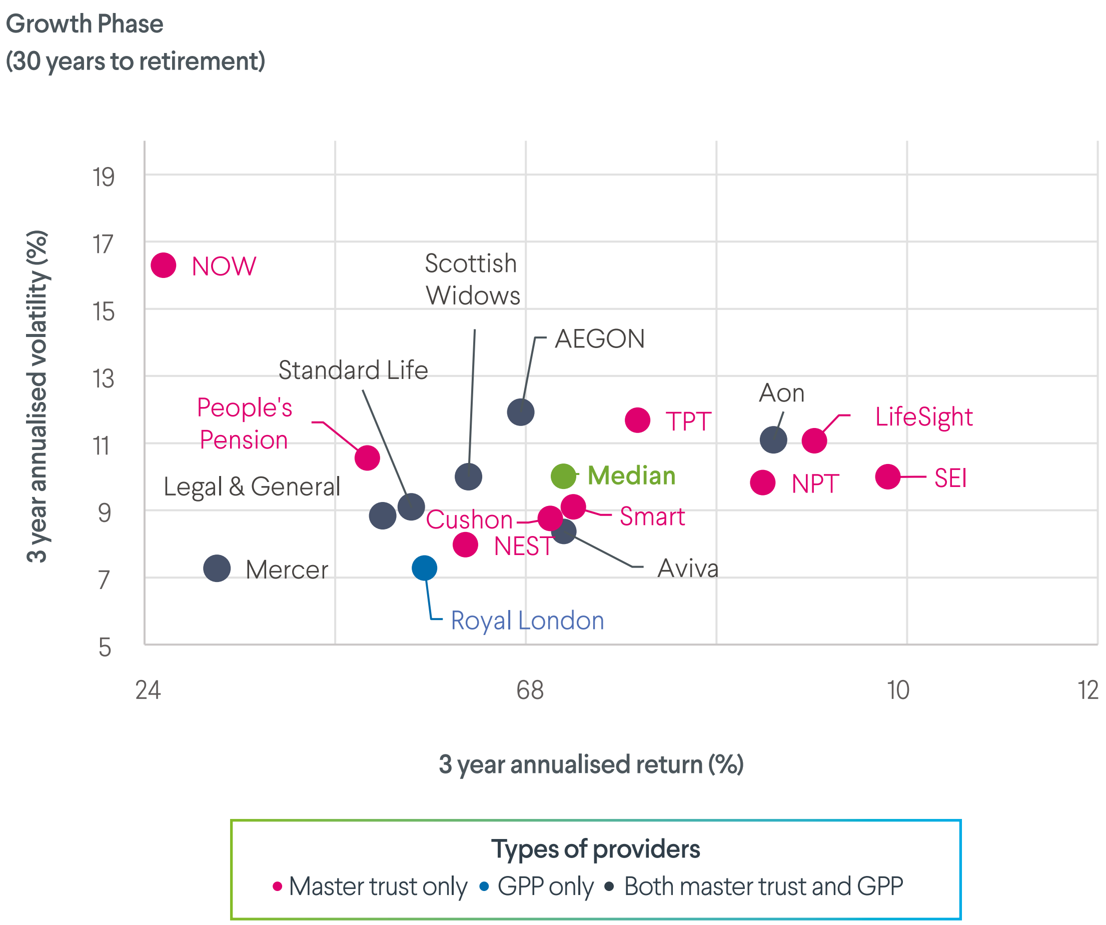
In the next section, we compare the investment performance in the three years to 30 September 2024 for different providers and its impact on member outcomes in each phase. Providers who offer both a master trust and a GPP have the same default investment strategies for both. We differentiate between the providers who offer a master trust, those who offer a GPP and those who offer both.

Growth phase

Over the last three years, members in the growth phase have experienced positive, but varying, levels of performance. Depending on their provider, otherwise similar members could have faced differences in return of up to 8% pa. In general, members in strategies which have a higher allocation to equities during this stage have fared better, as a result of stronger returns in equity markets over the period.

3yr performance and volatility

based on net performance and volatility

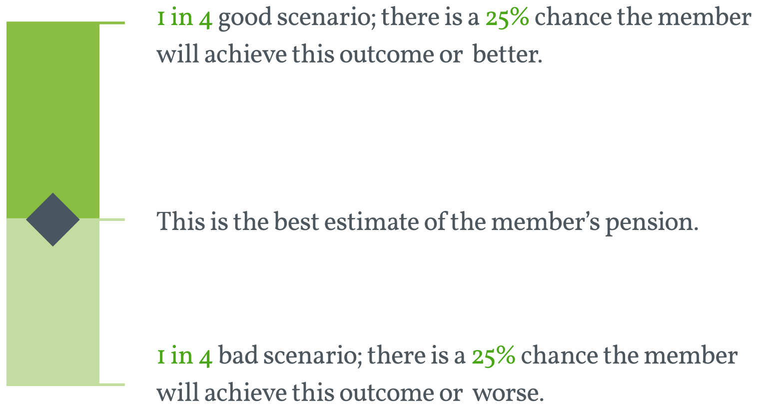


In the growth phase, members are a long way from retirement. We believe short-term risk mitigation through diversification of asset classes or active asset allocation is of questionable value. Cautious investment strategies may show relative outperformance during periods of market stress. However, it's unlikely such outperformance will persist and lead to better member outcomes (versus higher volatility approaches) over the longer term.

Lower volatility strategies are unlikely to achieve significantly better downside protection over longer time horizons. To illustrate this point, we've projected the range of potential pension outcomes for growth phase members of the master trusts in our sample.

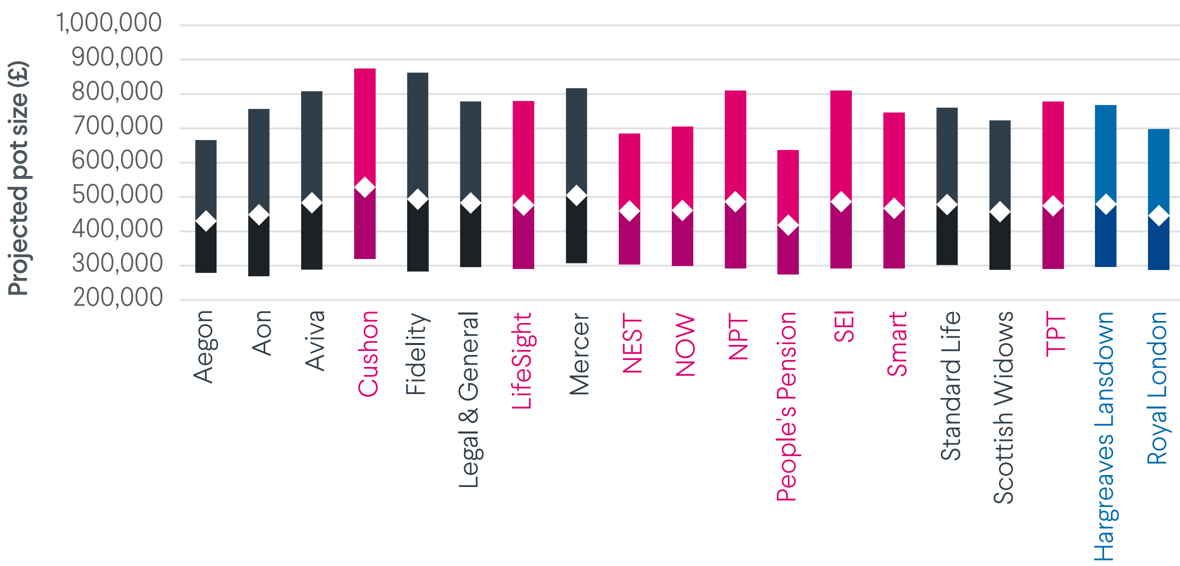
1. Chart is based on net performance and volatility to 30 September 2024, supplied by the providers and relates to their default lifestyle option. Please note that the performance figures are actual performance, except for those from Cushon which are based on a static allocation. Fidelity and Hargreaves Lansdown is not included in the performance charts due to their default strategies being in place for less than three years.

Illustrating uncertainty in outcomes



Projected member outcomes

basd on a member 30 years from retirement



1. Projections are based on a member 30 years from retirement on 30 September 2024, with a starting fund value of £50k, earning £30k pa and with a total contribution rate of 10% pa.

The chart shows downside outcomes are similar across the providers, but there is greater upside potential for higher-risk strategies.

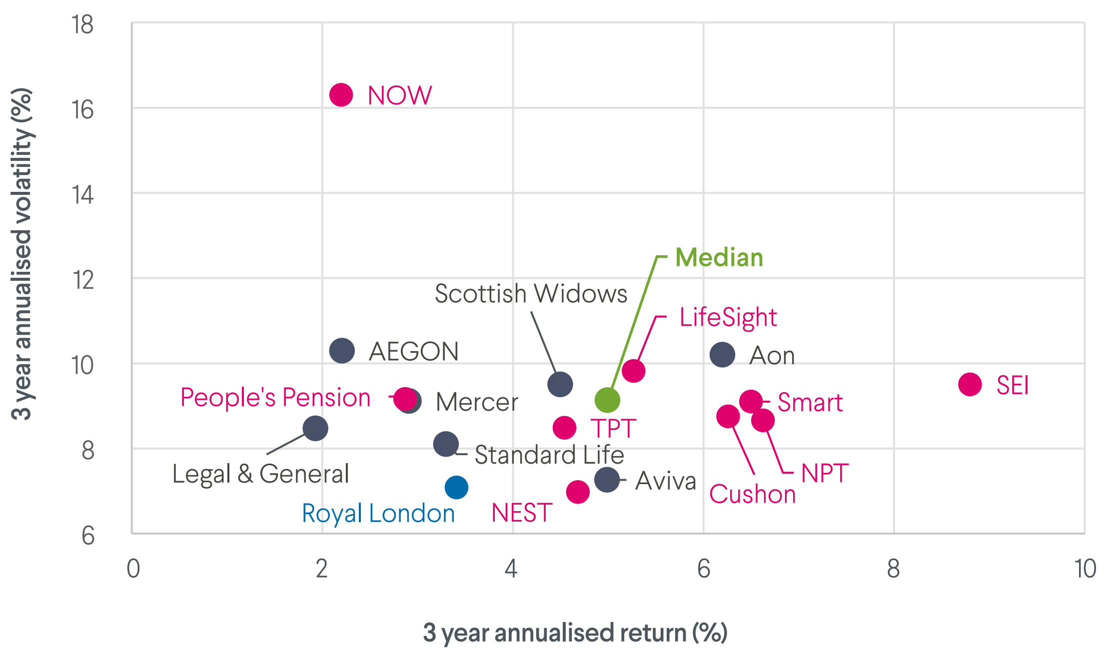
Consolidation phase

Most providers have returned in the region of 2-9% pa for consolidation phase members over the period shown. At this stage, providers invest in different levels of growth assets, as evidenced by the range of returns and volatilities in the chart.

3yr performance and volatility

based on net performance and volatility

Consolidation Phase
(10 years to retirement)



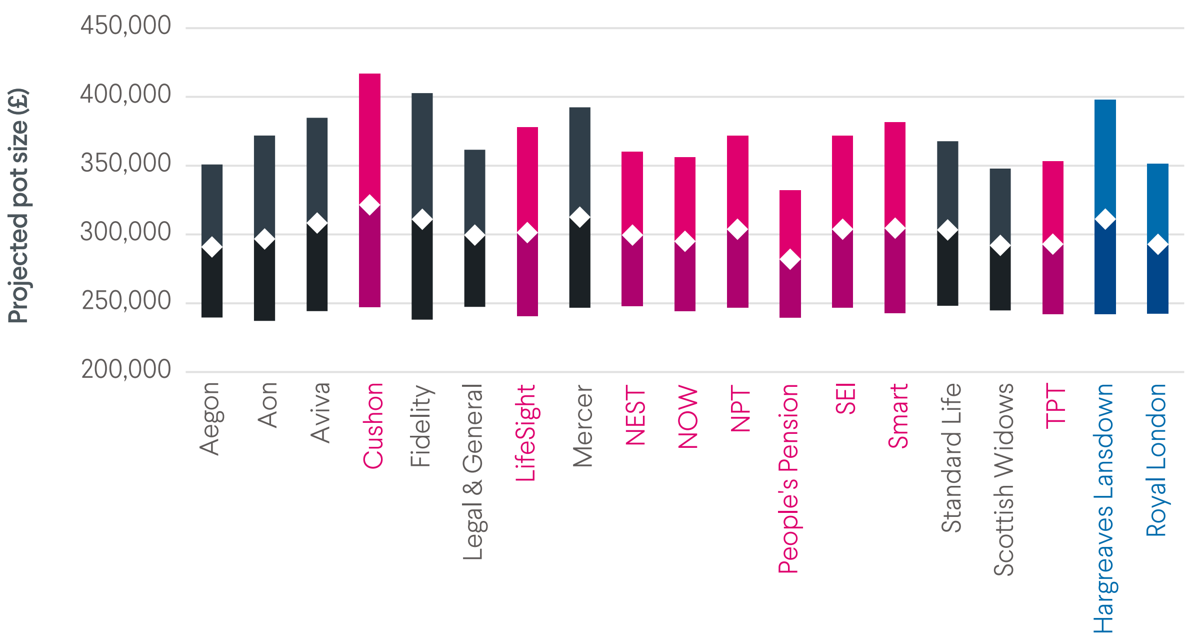
1. Chart is based on net performance and volatility to 30 September 2024, supplied by the providers and relates to their default lifestyle option. Please note that the performance figures are actual performance, except for those from Cushon which are based on a static allocation. Fidelity and Hargreaves Lansdown is not included in the performance charts due to their default strategies being in place for less than three years.

At 10 years to retirement, there's likely to have been or begin to be a shift in focus towards downside protection as assets begin to de-risk towards retirement. Although any change in strategy should be consistent with the member's plans for their DC savings. For members likely to take cash at retirement, risk reduction makes sense. However, those who can rely on other sources of income, such as a defined benefit (DB) pension, may wish to maintain a higher-risk strategy for longer.

Our projections show the level of uncertainty in member outcomes (indicated by the length of each bar) varies significantly across providers during the consolidation phase. At this stage, while riskier strategies may offer higher expected returns, they could leave members vulnerable to market shocks in their run-up to retirement.

Projected member outcomes

basd on a member 10 years from retirement



1. Projections are based on a member 10 years from retirement on 30 September 2024, with a starting fund value of £150k, earning £50k pa and with a total contribution rate of 10% pa.

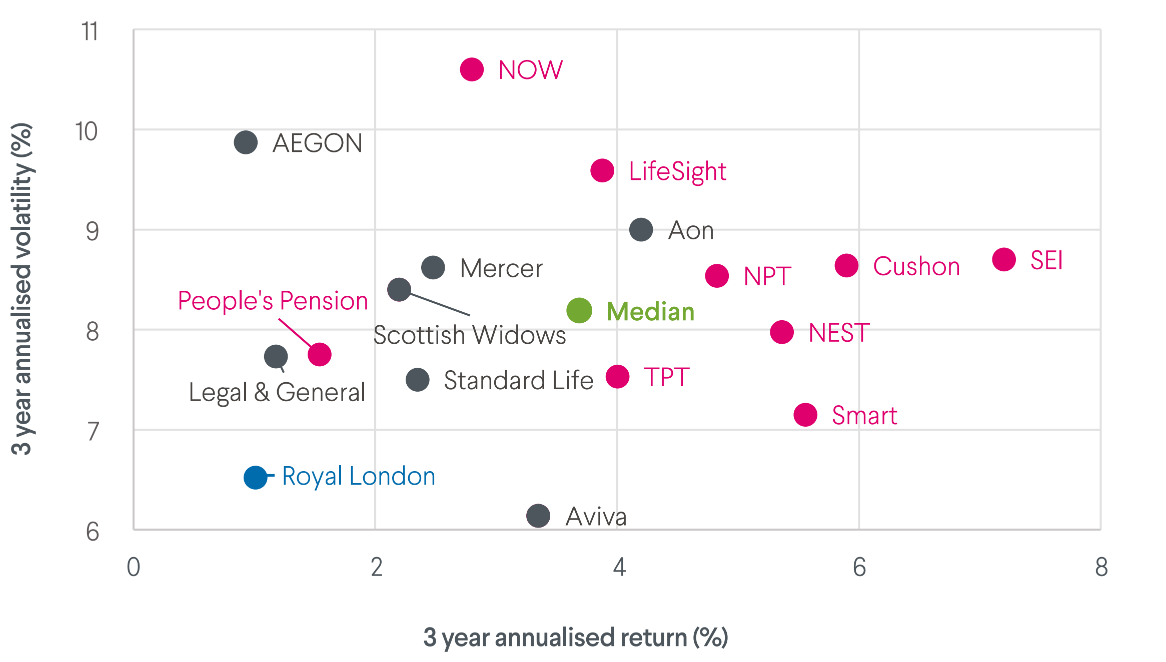
Pre-Retirement phase

As with the consolidation phase, differences in investment strategies during the pre-retirement phase are evident with a wide dispersion of default fund performance and risk across providers. Provider's return ranges from 1-7% pa, with different levels of investment in growth assets during this phase evidenced by the range of volatilities in the chart.

3yr performance and volatility

based on net performance and volatility

Pre-Retirement Phase
(5 years to retirement)



Types of providers
• Master trust only • GPP only • Both master trust and GPP

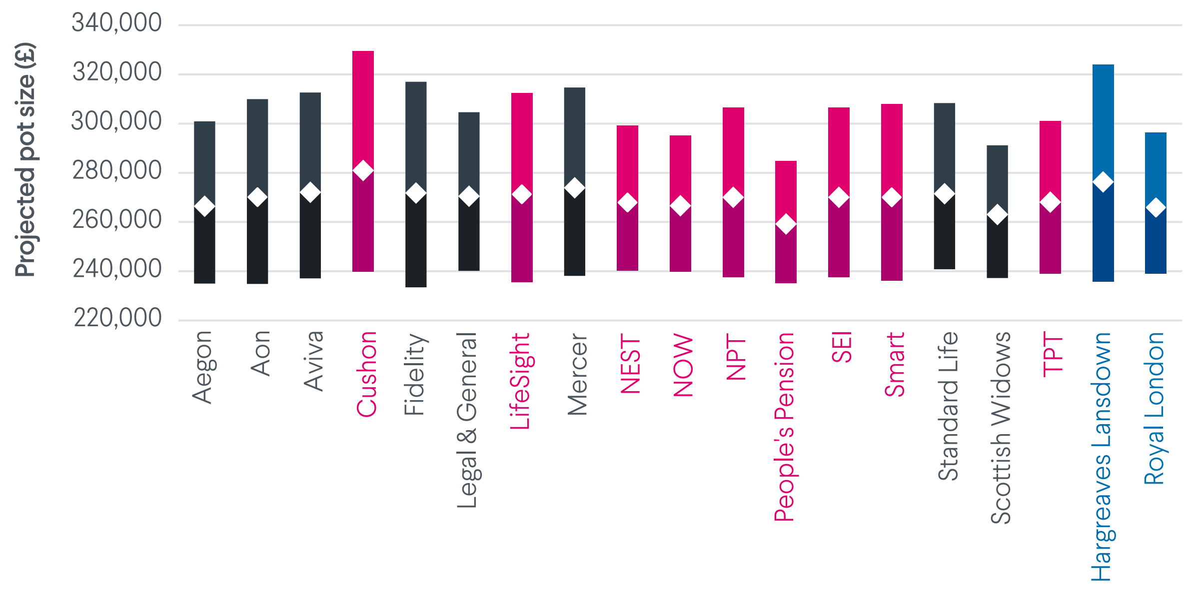
[1]Chart is based on net performance and volatility to 30 September 2024, supplied by the providers and relates to their default lifestyle option. Please note that the performance figures are actual performance, except for those from Cushon which are based on a static allocation. Fidelity and Hargreaves Lansdown are not included in the performance charts due to their default strategies being in place for less than three years.

Investment strategy in this phase should be aligned to members' likely decisions at retirement. In the short term, it will be normal to reduce risk, as most members withdraw nearly all their DC savings in cash. However, as DC pot sizes are expected to become larger over time, there will be a growing requirement for pre-retirement strategies with higher levels of risk as members opt for flexible drawdown at retirement. Strategies focused on drawdown must generate growth at retirement while also addressing income needs and providing certainty. This is crucial since members' ability to earn additional income during retirement diminishes.

Again, our projections illustrate a range of investment approaches being implemented by providers. While the shorter horizon and more conservative investment strategies mean the range of potential member outcomes is generally narrower (with shorter bars) than in other phases, there is evidence that members in this phase are assuming very different levels of risk.

Projected member outcomes

basd on a member 5 years from retirement



1. Projections are based on a member 5 years from retirement on 30 September 2024, with a starting fund value of £200k, earning £55k pa and with a total contribution rate of 10% pa.

Closing words

Overall, our analysis indicates that member outcomes have improved since 2022, particularly for older members affected by the gilt market volatility. Since the beginning of 2023, members across all stages of the glidepath have benefited from more favourable market conditions.

Returns have been particularly strong within equity markets. The technology sector continues to be the driving force in global markets. Stocks associated with AI maintained their outperformance, in particular, benefitting younger members over the period given their higher equity allocation.

Looking forward, we anticipate further developments in provider defaults with the introduction of private market assets in strategies. Whilst some providers are looking to incorporate a modest (<5%) allocation to private assets within their main default, the broader trend we expect from providers is the launch of additional 'premium' defaults at a higher cost point. This incorporates a more material allocation to private assets (around 10-15%).

In addition, greater focus is also being placed on consolidating smaller pension funds into "mega funds" with £25–50 billion of assets under management, as set out in the Government's consultation on Unlocking the UK pensions market for growth. This and several other themes discussed in this consultation, if implemented, are likely to have a significant impact on the master trust and GPP market.

Please get in touch if you would like to discuss this further.

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