

DC master trust expert series

Issue 2: Growing well - the member experience during 2020

January 2021



DC master trust expert series

Our master trust expert series for DC scheme sponsors and trustees review in detail key aspects of master trusts. This issue reflects on the member experience during 2020; a helpful case study for a particularly challenging year.

Growing well – the member experience during 2020

2020 was a difficult year for many. Without wanting to downplay the significance of the pandemic turmoil that has impacted on schemes and in particular their members over the course of the year, it has been a thought-provoking year also. The first quarter's major market crisis has offered the first real investment market test since auto-enrolment began in 2012, and also since Freedom and Choice was introduced in 2015.

As we noted in the first issue of our [master trust expert series](#), the Department of Work and Pensions (DWP) is now actively encouraging single employer DC schemes it deems as 'small' to consider their position and benchmark themselves against master trusts. Further consolidation is expected, particularly in the sub £100m DC scheme sector, but also in master trusts themselves, and ultimately, we expect there may be a relatively small number of mega master trust schemes in the future.

We see 2020 as an extreme market environment which helps to shine light on the member journey and how well members were supported during this period – setting a really helpful benchmark. We focus on the support offered to members but start with how investment strategies fared during the period.



Stephen Budge
Principal

In issue 2 of our master trust expert series, we look at the member journey during 2020. If you're an employer or trustee board looking at master trusts, at the end of the document, we provide our four top tips for considering how master trusts have fared.



The investment journey – quite the bumpy ride

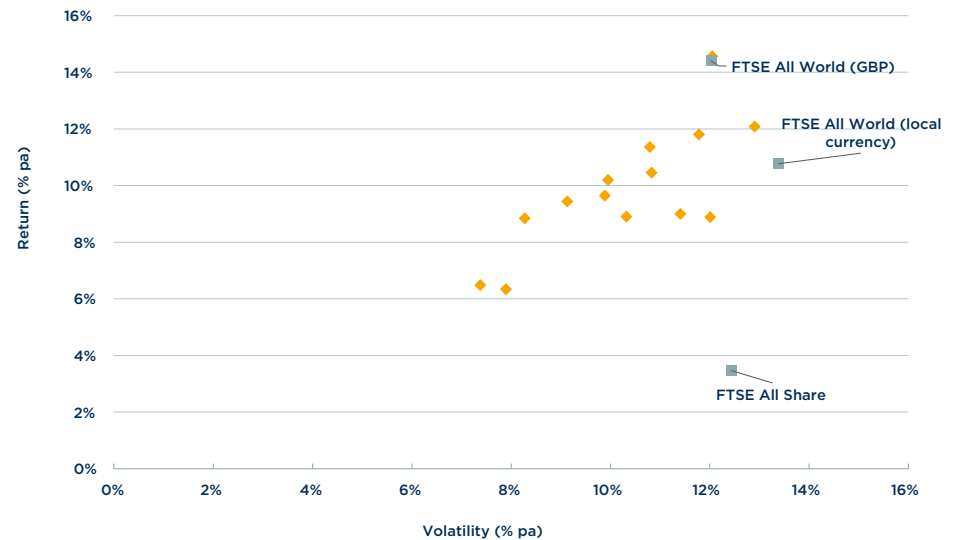
The investment journey for members during the course of the turbulent year very much depended on where members were invested. For most, as is widely commented, this is highly likely to have been in one of the default strategies for the master trust arrangements given the low level of members making their own investment choices. However, even within the default strategy, performance would have varied depending on how close the member was to retirement as de-risking glidepaths affected member allocations.

Performance for growth allocations (for members approximately aged 30) suffered significantly during the first quarter, with reductions to member savings reaching at worst a third lower and at best, a fifth lower. However, these returns from markets were not uncommon and the market rebound has since propelled these strategies to recoup much of their losses with two master trusts already in positive territory for the year to date to end of September 2020, and further improvements more recently, which is good news for members.

Five-year returns for these strategies are now back into strong growth territory, with only two arrangements showing returns close to typical long-term return targets of between 3% to 5% above inflation, while the rest are well above, as shown in the chart below (for those strategies in our peer group with long enough track records). The variation in return is, however, fairly stark over what is a long performance period and highlights the varying level of risk in the growth phases of these strategies.

The good news for members is that the Q1 2020 poor performance now looks more like a large blip for long-term investors.

Risk vs Return of Master Trust defaults over five years to 30 September 2020

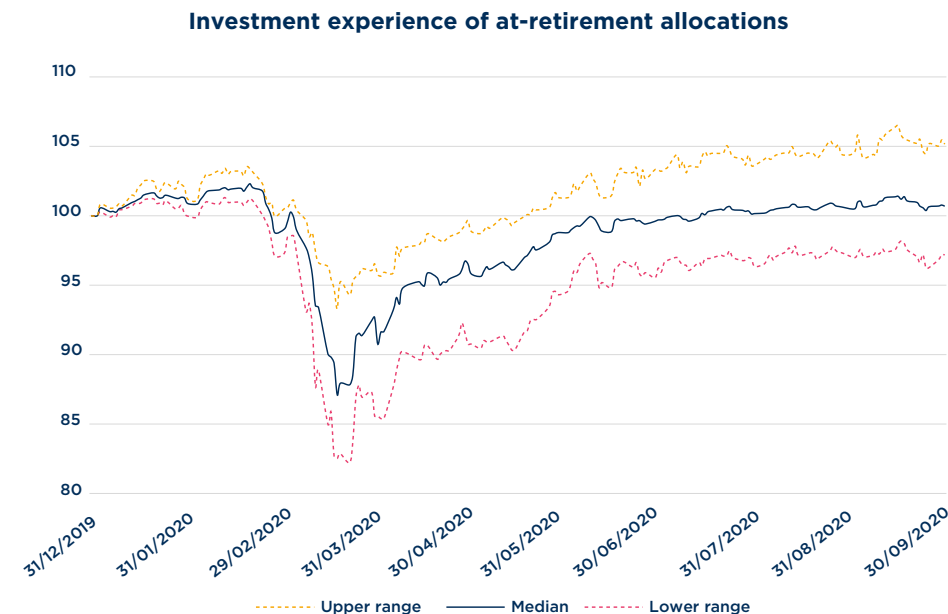


Source: LCP research of 11 major master trusts - September 2020



For members at the other end of the retirement age-scale, we see a similar story although the vast majority of strategies saw lower drawdowns due to the lower risk taken at this point in the glidepath. However, given that most schemes are positioning member investments to still grow above inflation, members suffered during this period more than alternative strategies still used in other types of arrangements – such as funding for cash or an annuity.

The chart below highlights the range of investment journeys for members at their target retirement age across all of the default strategies from the beginning of the year. Although it is never easy to truly predict when a member will access their savings, this is potentially a critical time for members as they approach retirement; yet the impact on member savings were significant, with members losing at worst -19.7%, and at best only -9.0% (not taking account of fees). However, half of these strategies are now in positive territory year to date as at the end of September 2020. The approach to de-risking and supporting members as they approach retirement is one area we expect to see further developments during 2021 given the launch of the Investment Pathways initiative from the FCA and this flowing through to master trusts.



Members react - a flight to safety

In our research, a number of master trusts commented on the increase in the number of members making investment elections with one scheme noting an increase of over 100% during the period. Interestingly, the scheme also commented that most of these changes were to lower risk or cash investment choices highlighting the unsurprising flight to safe haven assets and fund choices. One scheme even commented that just over half (52%) of the total value of assets switched were directed into cash funds.

In one example, 52% of assets switched during the period went into cash funds.

A key issue that arose during the period was the closure of property funds across the platforms. This was not due to liquidity issues which has troubled the asset class previously, but due to the new ‘material uncertainty clause’ imposed on funds as the coronavirus pandemic sent stock markets tumbling and impacted on the ability for valuers to accurately value the properties with the same degree of certainty as would otherwise be the case. These funds have now mostly reopened with only one master trust scheme continuing to keep their property fund closed—and likely to remain so for the foreseeable future—although now also due to liquidity concerns.

One property fund remains closed, nine months after member trading was suspected in the fund.

Helping members weather the storm

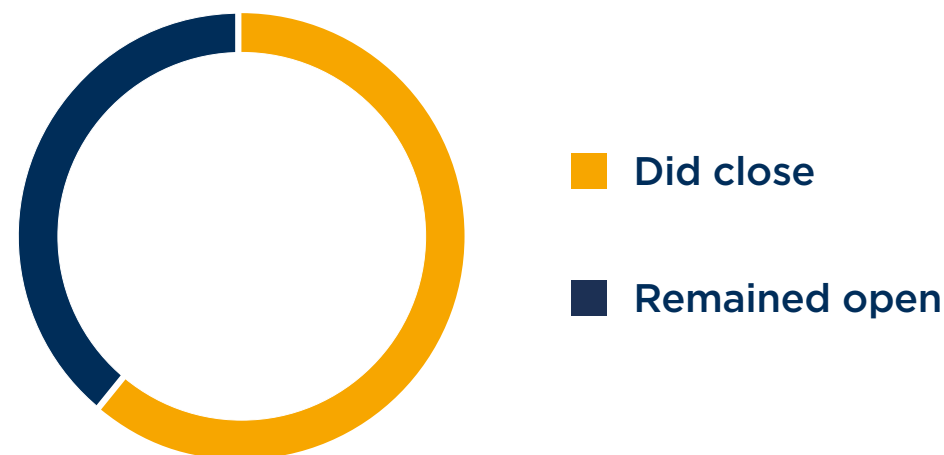
When it comes to looking after their members, during the pandemic, master trusts offered a wide range of support, with most offering a Covid-19 digital 'hub' approach to information alongside targeted email communications. One master trust referred to creating over 100 outputs including, articles, videos and guides covering a range of topics such as a video to explain investment volatility. However, the increase in digital content to engage members, was offset at least in part by just under half of our survey of schemes having to close down their telephone helpdesk. For some this was for as little as a week while others had a much longer period extending to over a month. This is quite remarkable given the need to move a large number of staff quickly to home-working. It is worth also noting that service levels fell during the period and are still lagging behind their pre-crisis levels in many cases. In response to the pandemic, or on the back of this increase in engagement, the master trust market saw a significant increase in engagement over the period, noted through members opening new communications or accessing the online tools, rather than necessarily through the telephone helpdesks. As an example, one scheme is reporting a seven-fold increase in views of online material.

When it comes to members accessing their savings, surprisingly, many schemes actually saw notably fewer members accessing benefits in the first half of the year. Further, the shape of benefit withdrawals remained consistent during the period highlighting no sudden knee-jerk reaction to the market volatility, although there continued to be members withdrawing savings across all of the available options during the period. For example, one scheme reported a fairly typical month of members fully cashing out their benefits which included several members with savings in excess of £100k. Depending on when the member actually took their savings and where they were invested, the final value could have been quite different.

At the time of writing, a number of schemes have since reported an increase to benefit withdrawal requests – a sign of increasing pressure from financial hardship and use of retirement income to offset lost earnings. This will be an important trend to follow.

As a general view, calls to helplines and email queries declined during the market turbulence, however, overall engagement levels increased

Master trust helplines during Q2 2020

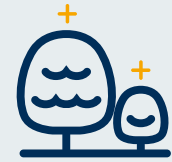


Benefit withdrawals reduced during the market turbulence as members held off making important decisions. However, it has now increased significantly due to financial hardship/income provision.

Conclusion

Member journeys during 2020 have been a rollercoaster of a ride for all member generations, but that's not unexpected given the markets and, more importantly, the broader impact of the pandemic. The Government wants the master trust market to become benchmarks for the industry from October this year. If you're an employer or trustee board looking at master trusts, here's our four top tips for considering how master trusts have fared.

1. **Performance** - how did performance compare for different age cohorts for defaults offered in the master trust arrangements and more importantly, what does this mean for longer-term performance?



2. **Strategy** - how much risk is your default strategy taking compared to the range of master trust strategies at each key phase such as, growth, approaching retirement and importantly, at retirement? Are you comfortable with the level of risk being taken, for example, an objective of better long-term returns for higher risk strategies?



3. **Engagement** - what was your strategy during 2020; how were members supported and what was their experience - how quickly was support made available, or communications issued?



4. **Administration** - did standards slip during the period and how have they recovered? How flexible were the administration teams to supporting the changing demands over the period?



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