Master trust governance in a consolidating world

Gregg McClymont considers how the master trust authorisation process is improving governance

The overall level of master trust governance is improving – but we think advisers should still expect to see big differences in standards between schemes.

The regulatory environment has become much more stringent. It started with the 2013 report by the Office of Fair Trading into the quality of UK workplace pension schemes – and as it continues it is prompting change in the single employer scheme sector, with the number of pension schemes with 12 to 5,000 members contracting sharply since 2010.

We expect tighter regulation to continue. Lesley Titcomb, former chief executive of The Pensions Regulator (TPR), recently argued that the organisation should become a rule maker, like the Financial Conduct Authority (FCA). And the new authorisation regime for master trusts has set a new bar for regulation in occupational pensions.

This is prompting pension providers and advisers to think further about the relationship between scale, governance and consolidation. The evidence suggests members benefit from scale and governance: work on the latter by Keith Ambachtsheer, a leading expert in this field, suggests a "governance premium" of 100-300 basis points. Additionally, larger schemes tend to achieve better investment returns and they also seem to do so at lower cost with no observable scale diseconomies.

We've long focused on strong governance at The People's Pension. And that, coupled with our scale, enables us to return profits to members. Our current annual management charge of 0.5 per cent is already competitive and makes it simple for members to see the costs involved. But that's not enough for us. So, from summer 2019, we'll be switching to a banded pricing structure which sees member charges fall as pots grow, with any savings over £50,000 attracting just a 0.2 per cent annual management charge.

More broadly, DC governance remains a mixed bag. Some very large master trusts and single employer schemes are well governed but there are many schemes with less effective governance – and this seems partly related to scale.

Evidence gathered for TPR's 21st Century Trustee programme shows that key governance requirements are more likely to be present in large schemes than in small schemes and are particularly likely to be present in master trusts. Whereas 100 per cent of master trust trustees met requirements for knowledge and understanding in 2018, just 31 per cent of small single employer scheme trustees did so. The pattern repeats across the other governance requirements: default fund design, value for members assessment and processing of core financial transactions.

The sector needs to consider whether there are enough trustees out there to adequately govern the 2,180 remaining schemes with over 12 members. And whether it's possible to adequately resource the governance of smaller schemes, especially where most schemes are subject to the 75 basis point charge cap.

While scale enables good governance, being big doesn't mean a scheme will automatically be well run. We suggest that schemes and policymakers consider both issues simultaneously.

But that's where master trust authorisation comes in. It's making master trusts think about and document the way they're run. It's also establishing a model for how occupational schemes could be regulated. We don't think TPR will just cut and paste its approach on master trust regulation into other sectors but the experience of master trust authorisation is likely to shape TPR's thinking in these areas.

Master trust authorisation is intended to mark schemes out as fit to carry on business. It will establish a standard that will be increasingly seen as 'entry level' and, once they've caught their breath, trustees will start demonstrating that their scheme governance exceeds this level. That will create useful points of differentiation that advisers can assess.

It's likely that DWP and TPR will continue encouraging consolidation into larger schemes. The challenge for policy makers though, is ensuring that those choosing to consolidate can identify well run schemes in which to consolidate. Master trust authorisation will make this easier but it's not the be all and end all in the governance debate.

If you would like to discuss master trust governance or any other aspect of The People's Pension, please contact us on 01293 586666 option 1.

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