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Master trusts focus:

An evolution

The People's Pension director of policy and market engagement Darren Philp

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Master trusts: Quality, transparency and value

Darren Philp considers how the master-trust market will develop and its key drivers for change

Cast your minds back to the start of this decade... Auto-enrolment was still in the planning stages, the naysayers were saying that it just wouldn't work and there were significant doubts about the supply of good quality pension schemes that would serve low to middle income individuals – those whom auto-enrolment was designed to help.

It seems a long time ago now, but in the space of a few years the provision of DC pensions has evolved massively, and, I think, for the better.

Auto-enrolment has had a successful start. Opt-out rates are low, and, most importantly, more than eight million people are newly enrolled into a workplace saving scheme and saving for their futures. Yes, contribution rates are still low. Yes, further reforms are needed to ensure the pensions system is really delivering for scheme members. But we have certainly come a long way in a relatively short space of time. That must be applauded.

And it is clear that master trusts have played a crucial role in implementing auto-enrolment. Done well, they offer real economies of scale and a professional level of governance and oversight that would be hard to find in the traditional pensions market for the many employers that had to offer pensions, and make mandatory contributions, for the first time.

Master trusts are a force for good: the best of them use their scale, experience and sound processing, systems and governance to produce effective pensions options for employers that might otherwise struggle with the options (or lack of options) in front of them.

But as with any new market, it has taken a while for the legislative and regulatory environment to catch up with innovation, and given that, by definition, we are dealing with disengaged employers and members, it is more important than ever to get the basics of regulation right. This ensures that the full potential of the master-trust model is realised for employers, but, most importantly, for the ultimate beneficiaries, individual members.

We believe that three key trends will shape the sector's development in the months and years ahead:

- The quality agenda;
- The drive towards greater transparency and value for money ; and
- Moving beyond the saving phase and providing good retirement options.

So, how do we think the master-trust market will develop, and what will be the key drivers for change?

Advancing the quality agenda

Not all master trusts are created equal. In fact, some no doubt fall considerably short of what the regulator would expect. Yet until recently, regulation of the sector had not kept pace with its growth.

Thankfully, this has been largely addressed in the Pension Schemes Act 2017, which requires master trusts to have regulatory authorisation; pass tests to confirm that the people running them are fit and proper; and fulfil requirements on capital adequacy.

Of course, no supervisory regime can operate effectively without proper sanctions for breaches of its standards, so the Act itself will do much to secure the health of the overall sector by providing a means for the orderly closure of those master trusts that fail to make the grade. The requirements on the communication of triggering events – developments, such as the insolvency or withdrawal of a scheme funder, with the potential to cause the winding-up of a scheme – will play an important role in maintaining transparency and protecting members' interests.

Separately, the Law Commission's recent recommendation that pension trustees should make a statement annually on whether their members are disadvantaged compared to members of other funds is a positive move. If adopted, this could also help drive standards in the market by forcing under-performers to exit. Not unlike the 'shape up or ship out' regime they have in Australia.

The way the quality agenda is being pursued will certainly drive consolidation. What remains to be seen is the level of consolidation and

how orderly the process is. So far, we have seen the well-executed absorption of a series of smaller auto-enrolment schemes by larger players. Will that continue? I hope so! We are certainly expecting a second wave to follow once the secondary legislation on capital adequacy is published, and again, when the process of authorisation under the new legislation begins.

Driving transparency and value for money

While transparency and value for money are two separate concepts, they are fundamentally inseparable. You cannot begin to assess value for money until you understand costs. This is why transparency is so important and why recent announcements by the government and regulators are so welcome.

While master trusts do not pretend to have all the answers – and some have more work to do in this area – one of the genuine benefits of the model is the fiduciary nature of the governance where trustees have a legal duty to act in the best interest of members. Done properly this is a fantastic model to help employers who have little knowledge of or interest in pensions, and it is a great model to protect members' interests. If it is done well, that is.

We should embrace the transparency agenda, particularly around transaction costs, but we need to go further in making sure that scheme governance (whether trustee or through an IGC) is scrutinising this information and, importantly, acting on it to ensure the scheme is being operated in the best interests of the members. To this end, I would argue that we should bring transaction costs in to the 0.75 per cent AMC charge cap, and, if the cap is breached due to a spike in transaction costs, then this should be a reportable event to employers, members and ultimately regulators.

Transparency on costs, enabling the industry to then focus on the net returns that grow contributors' savings, is a must. Experience tells us that while it would be fantasy land to expect most savers to scrutinise the underlying costs in their pension in depth, addressing this challenge is fundamental to restore public trust in our industry.

The People's Pension were one of the first master trusts to provide full disclosure on transaction costs across default funds and all other funds through our main asset manager, State Street Global Advisors.

We are also playing a leading role in the pensions dashboard initiative, as we are convinced it has the power to reform the pensions industry, increasing member engagement and allowing individuals to take control of their pensions – a project that can only lead to greater transparency, efficiency and accountability.

At retirement

The fundamental social purpose of our entire industry is to enable people to enjoy their retirement comfortably. Our own research shows that savers are still confused by the wide range of options open to them through today's pensions freedoms and, in many cases, they are unwilling or unable to make a decision at retirement. We must work harder to help them navigate their options.

Some argue that the market can step in with a broader range of products and it is all about shopping around, but that isn't a solution, as savers are already bewildered by the choices they face. Instead, we would like to see a thorough review of the whole pensions journey, from accumulation to decumulation, to unpack how simplification and innovations, such as the dashboard, can improve the entire system.

This will go some way to establishing the support that individuals need, although we must recognise that it's likely the majority of savers will still not wish to engage and make their own decisions about their retirement over and above deciding they want to start drawing their pension. This is why extra help in the form of a responsible default option – and the emphasis here is on the word responsible – should also be a vital component of the pension landscape and it fits well as part of a MT structure. In a nutshell, in terms of decision making for the member, we need to make DC pensions as much like DB pensions as possible for those unwilling or unable to navigate the at-retirement maze.

As the government and the industry work together towards more adequate regulation, greater governance and transparency through ongoing reforms, master trusts will have a central role to play in achieving the pension utilitarianism – the best possible retirement outcomes for the greatest number of people.

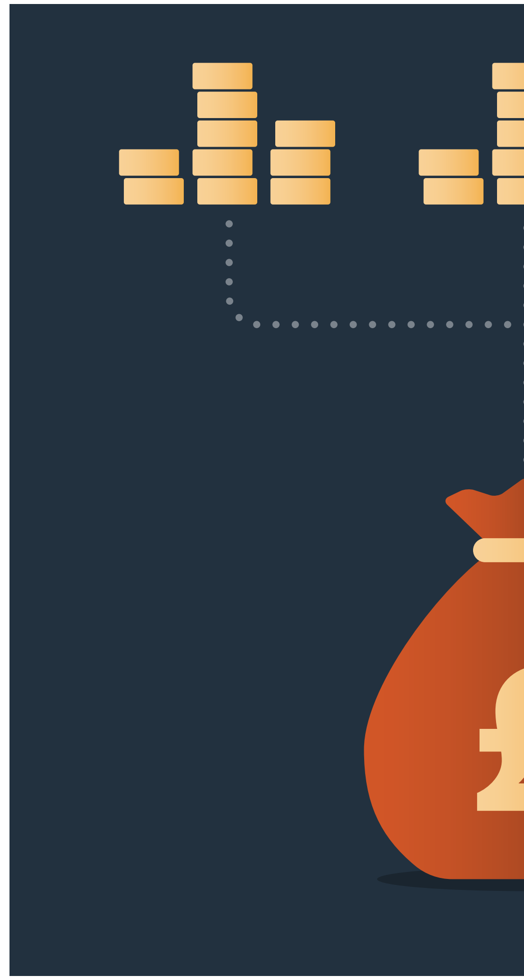
Written by The People's Pension director of policy and market engagement Darren Philp

In association with the people's pension

Summary
• Various pieces of legislation are coming into force to protect pension holders invested in master trusts.
• The growth of master trusts within the industry was spurred by the government's auto-enrolment reforms in 2012.
• Increased regulation is likely to produce increased consolidation as smaller players are priced out.
• There is little consensus on what a master trust is and no firm count as to how many of these exist in the market.

The mother of invention

Peter Carvill asks whether consolidation is set to accelerate within the master-trust sector



There are moves afoot in how master trusts are regulated within the UK. Since the advent of auto-enrolment, great swathes of the population have paid into a pension for the first time. This has led to a boom in the number of master trusts – pension schemes that serve the employees of more than one employer. Figures from JLT Employee Benefits state that the number of members in master-trust schemes jumped from 200 thousand to seven million between 2010 and 2016.

The march towards more legislation began in March 2016 when Pensions Minister Baroness Ros Altmann gave evidence to MPs, saying that she had concerns about master trusts, particularly the 'smaller providers' entering the market. A few months later, the work and pensions select committee, themselves highlighting 'major concerns', called for a regulatory overhaul around auto-enrolment master trusts.

This brings us to the Pensions Schemes Act 2017, which seeks to introduce requirements for master trusts to be authorised; on when a founder wishes to exit or become insolvent, along with protections for members; and powers for The Pensions Regulator (TPR) to grant, refuse, or withdraw authorisation and prepare an ongoing approach to regulation, including reporting requirements.

A further announcement came in August that the government will update the tax regime for providers using the master-trust model, bringing the regime in line with TPR's new rules for the sector.

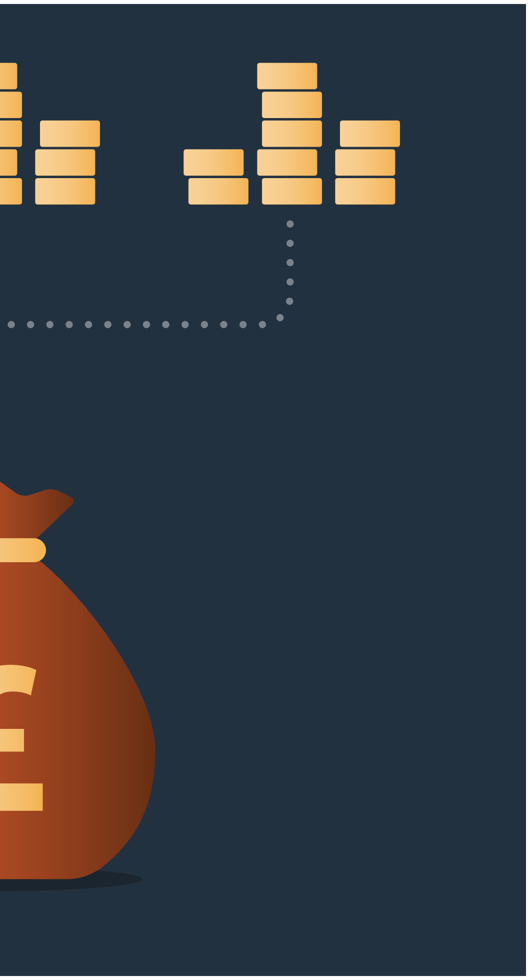
And yet more has happened. In September, the Competition and Markets Authority said they were to look at the controls for fiduciary management and master trusts, looking at the extent to which the schemes were tendered for and scrutinised. This came in the same month when the Treasury published a policy paper looking to extend HMRC's power to refuse to register and de-register pension schemes, which would be applied where master trusts have no authorisation from TPR under its new authorisation and supervision scheme.

Further regulation is expected in the Winter Finance Bill, which will implement new rules from April. These will mean only active sponsoring employers will be able to register pension schemes and benefit from tax relief.

The reason for such moves is a simple one – a desire from the government to avoid embarrassment should one of these master trusts go under.

Aries Insight director Ian Neale offers this take: "One of the features of auto-enrolment," he says, "has been that contributions for many people have been very small. That cannot be profitable for a master-trust provider. They've been 1 per cent from employers and the same from employees for qualified earnings. If only that is going in, it'll be years before it becomes profitable. The government has realised that there was significant risk that a provider may collapse because the capital input required may not have been reached."

There has been some criticism that legislation is only happening now, and that it had not been put in place prior to so many master trusts entering the market. Some say it is akin to bolting the stable door after the horse has bolted. The People's Pension head of policy Darren Philp says it is right thing for government to put together a robust regulatory scheme for master trusts. However, he adds: "You would have thought they would have done this before the start of



auto-enrolment. We have been calling for this since we created one because we recognise the risk involved."

Other criticisms have been levelled. Dean Wetton Advisory's lead adviser and founder Dean Wettonalso has one, seeing the various machinations and developments as "a fairly-blunt tool to weed out the weaker service providers".

He says: "I've been involved with master trusts since eight years or so ago and we made this point to the regulator back then, that you are probably better off preventing the weaker players coming in rather than trying to sort it out afterwards. This tends to increase the burden on those who would have complied. Those that don't care won't feel that pressure."

The consolidation of master trusts has come thick and fast in a year, beginning with My Workplace Pension being wound down by the scheme's trustees and transferred to Smart Pension. This was accompanied by the Wessex Pension Trust and the Pensions Umbrella Trust being picked up by TBPS, itself owned by BlueSky Pensions UK. It was thought at the time that TBPS would soon pick up a third master trust.

Any incoming legislation is likely to squeeze the smaller master trusts, particularly those set up hurriedly in order to take advantage from the inflows resulting from auto-enrolment. Capital adequacy and price competition will likely exert a fist-like grip on those struggling to survive commercially.

Philp says that consolidation will come in waves, each prompted by every new piece of legislation. He calls each of these 'touch points', adding: "The secondary legislation, expected before Christmas, will set out the detail of capital. It fills in the gaps of the details of the regulation. At these touch points, founders will ask themselves if they really want to continue."

Neale says that it is difficult to predict how much consolidation will take place, saying that it is not entirely clear how many master trusts actually exist. Different figures abound as to the actual number of master trusts in the market. One figure, given in a March report, put the number of providers entering the market since auto-enrolment was introduced in 2012 at 100. However, other figures put this much lower at around 80. When Altmann voiced her concerns about master trusts, The Pensions Regulator put the figure at 70 operating in the auto-enrolment market. Most recently, those figures have been revised with the same organisation estimating the number of master trusts to be 81, with 58 engaged in auto-enrolment. The key word in that sentence is 'estimating'.

It is a point that Wetton also picks up on, saying that a common definition of master trust is still lacking. "I do worry that the number is being massively exaggerated," he says. "The regulators work on a definition that says they are multiple employee schemes for unrelated employers. That's too broad." He cites an example: "If a huge organisation arose out of an acquisition structure of merging different employers, that's an agglomeration because they're all related. But if some of those things are sold off and the pensioners are unrelated, then they're unrelated employers."

The best Neale can offer is a broad guess. "The number's between 40 and 80 at the moment," he says. "If we look at the market five years from now, the number is more likely to be between 10 and 20, probably towards the bottom of that scale. It's difficult to say because the provisions of the act have not commenced yet." However, he does acknowledge that the compliance regime will be a major driver towards consolidation.

Van Rees expects more consolidation. One aspect, she says, will be an application fee for those schemes who register. "If those costs are substantial," she adds, "that may put some off registering. A master trust is a long-term thing and is going to need a lot of people for money to be made from charges to members. If there's an master trust with less backing and they're having to pay more to register, they may say it's not financially viable and so transfer to another master trust."

One thing that is sure is that consolidation is due to increase. And, yet, that may be too simple an equation. Not all master trusts are the same and if the legislation is a 'fairly-blunt tool', it may risk doing more harm than good. Blunt tools do not have a reputation for finesse. Philp says: "Should smaller schemes go? No, but they still need to be well run, governed, and resourced. If they can pass that test, it doesn't matter."

Written by Peter Carvill, a freelance journalist

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