Summary
• Partially transferring members into a master trust can occur for those own-trust DC schemes wanting to offer its members drawdown access at retirement through the master trust, those wanting to remove deferred or AVC members in order to focus on active members or the core pension offering, and as a result of company mergers driving efficiencies.
• Members with underpinned DC rights can prevent a full transfer into a master trust. The practicalities of the process may also put off schemes from doing so.
• Dividing members into different DC schemes is nothing new, but the level of awareness from trustees that different segments of the membership can be divided between the own-trust DC scheme and a master trust is subject to debate.

Best of both worlds

Laura Blows reveals how some employers and trustees are transferring specific portions of their membership into master trusts, while also retaining their own trust-based DC scheme

Master trusts have the world at their feet. After all, the future of pensions is DC, and the future of DC is master trusts. Once the strong have emerged from the master trust authorisation process, these victors will be champions of the (pensions) world.

Or will they? Are master trusts the only way forward for DC, to which all must completely submit?

Barnett Waddingham partner Paul Leandro thinks not. He states that with a single-employer, trust-based DC scheme, there tends to be a benevolent, paternalistic nature to the employer, as the scheme provides "a flexible framework where you can design the scheme to be as pertinent as possible to the membership profile".

"The boards of trustees are engaged, so the sponsor believes it is doing the right thing by its employees by continuing the scheme as it is," he explains.

However, when it comes to master trusts, a growing number of trustees are finding that it does not have to be all or nothing. The benefits of a master trust can still be utilised for those wanting to continue running their own DC scheme, or are unable to fully move their members into a master trust, through a partial transfer of some of their membership.

At-retirement

Just as master-trust popularity grew as a result of auto-enrolment, so have their partial use grown out of another reasonably recent legislation, that of pension freedoms.

"If you have an own-trust scheme, you are not going to offer pension freedoms because that would involve members staying in the scheme until they are 80, 90, until they die. That's not really why you run a DC scheme as an employer. You run it for the people that work for you," LGIM head of DC solutions Emma Douglas says.

Therefore, some trustees are offering their membership the choice to transfer into a master trust as they approach retirement, believing that will provide the members with improved drawdown access compared to what they would find in the retail market.

Willis Towers Watson's LifeSight director David Bird states that it has approximately five employers who

participate in its master trust just on the basis that members can transfer at retirement in order to obtain drawdown.

"The reason is that the occupational scheme doesn't want to run drawdown but they also feel that the individual market for drawdown isn't right for their members," he explains.

Global healthcare company GlaxoSmithKline has recently set up the option for a post-retirement transfer into LGIM's master trust, as did the trustees of Mitchell & Butlers Pension Scheme.

For some larger schemes, LGIM is able to set up a mirror fund range within the master trust, so that members that do transfer at retirement can just re-register the units into the master trust, without any buying or selling, and therefore saving on transaction costs.

Deferred members

Another growing area for partial transfers – which Bird expected to see become more common than it has been as master trusts grew in popularity – is that of only moving a DC scheme's deferred membership across into a master trust.

Capital Cranfield group chairman Anthony Filbin has heard conversations, but has yet to come across any such movement of deferred members. However, in contrast, it is bulk transfers of deferred members where Leandro is seeing the most partial transfers occur, while Bird says he is "starting to see this occur a bit more now".

Employers and trustees managing their own DC scheme may be confident that they are doing right by their current employees by continuing to run it, but may not wish to carry on shouldering the extra regulatory, governance and cost responsibility for their ex-employees.

This may particularly be the case as many DC schemes have seen a very rapid increase in deferred membership as a result of the abolition of short-service refunds in 2015, JLT Employee Benefits senior consultant Philip Moran adds.

"We have done a couple of exercises relatively recently where the trustees have sifted out the deferred members into a master trust so that they can focus their resources on active employees," Leandro says.

Mercer partner Roger Breeden has found the same, that a growing number of mature schemes with increasingly large deferred populations are deciding to undertake bulk non-consent transfers of either some or all of their deferred members to reduce their costs, "which either improves the employers bottom line or can be spent on improving benefits for existing employees".

The same challenges as deferreds can be found for DB schemes that have small DC sections, which is commonly just for additional voluntary contributions (AVCs). This is often just a small adjunct to the main DB scheme, Filbin says, but which requires additional regulatory burdens, such as a chair's statement. He highlights Punter Southall's master trust, Aspire, as actively targeting AVC schemes to move across to the master trust.

Section 32

The removal of deffereds used to, and can still occur, through an individual buyout, known as a section 32.

"The problem with a section 32 is that you are buying something at a fixed point in time, with no real mechanism for that policy to improve and change over time," Bird says.

Douglas agrees, highlighting how a section 32 does not have an independent governance committee looking after it. "Yes *[the members]* will go into a provider contract, but there's no real governance on top of that," she explains. "I think *[moving deferreds into a master trust]* gives trustees a lot more confidence that they are moving members into an environment where they are going to be looked after and where there is someone who has got the responsibility and fiduciary duty to look after their interests."

Mergers

Company mergers can also result in pension schemes' partial transfers into a master trust.

For instance, Bird states that LifeSight is currently onboarding a client with two single trusts that are being merged into one. Past members of both are being moved into the master trust, and the company is providing something else for future service.

Aon head of delegated DC solution Tony Britton notes that mergers very often drive benefits managers to try and 'tidy up' schemes by moving as many members as possible into a master trust.

When looking at efficiencies, schemes may wish they could simply transfer all their members into a master trust, but instead are hindered by certain restrictions. In that case, it would still be the majority of members that would move across.

Challenges

"One scheme we are working with has about 2,000 members and approx 150 of them have got underpins," Britton says. "So, the trustees have got two options. One is to try to buy out those underpins in some way, i.e. guarantee them. That's probably what they will do when the population decreases enough to be really small. But in the meantime, they're going ahead with their transfer to a master trust for the majority of members, and they're going to leave those members *[with guarantees]* in the trust-based scheme," Britton says.

Breeden has also found that where some of the membership has guaranteed minimum pensions (GMPs) underpinning their DC benefits, they are left in the legacy trust-based DC scheme, with the rest of the membership transferred into a master trust.

Another example Britton has come across is a scheme with members that have some complex with-profits, which cannot be accommodated into many master trusts. In these cases, sometimes the DC members with guarantees can only be moved into a master trust with their active consent.

In those instances, it is unlikely that all members will provide active member consent, so even though the trustees and sponsor may want to completely move the DC section across to a master trust, they may still be left with some people in the 'old' scheme.

There are also a number of other practicalities those wanting to implement a partial transfer need to address.

The People's Pension chair of the trustee Steve Delo stresses the importance of quality admin records. "Incomplete member records will make a process vastly more difficult and the transfer less attractive to the master-trust market. Trustees of single-trust DC schemes therefore need to pre-plan and get on top of their data," he advises.

Breeden states that a review of the scheme rules may be required, with legal or technical advice needing to be obtained.

The process itself can be onerous, as a master trust has to be selected, members signposted to it and records transferred. However, the master trust "would be very willing to pick up the majority of the work", Douglas adds.

On the investment side, the amount of investment choice, ongoing charges, out-of-market risk and transaction costs need to be considered when transferring members, Leandro says.

Ultimately, when transferring members into a different scheme, trustees have to ensure that the members will be as well off, if not doing better, as a result of the move.

However, removing the need to handle a small AVC scheme, or manage deferreds "tends not to be the number one priority for sponsors and HR departments", Filbin adds.

After all, as long as at least two members remain in the DC scheme, the sponsor and trustees still have to continue with their governance responsibilities. An upfront cost is also required for the partial transfer and regular exercises may have to occur, for instance to continually move deferreds out of the scheme, Breeden says. So some may decide not to bother.

"One of the things that stopped, and still stops, some businesses from doing partial transfers is the belief that it's a complex project and will be a lot of work," Britton says. "It's been quite interesting, some of the debates that I've had, that actually people have been surprised that a well-run project is not a huge amount of work and not a huge drain on people. So, I think that has also inspired people to think a bit more creatively about what could be done, and hence splitting out scheme."

Taking action

If employers and trustees are talking about splitting out the scheme, now could be the time to take action. Leandro notes that there is a "land grab" by master trusts at the moment. "If companies are considering transferring, whether it's a partial transfer or full, now's the time to do it because the terms and charges being offered are currently very competitive," he says.

Some master trusts are even offering to pay the transaction costs, which can be a significant amount, such as £200,000 for a transfer of £100 million of assets, Leandro adds.

So, if it is surprisingly easy, and now is a particularly good time to transfer into a master trust, won't those (that are not restricted to do so) simply implement a full transfer and wind up their own trust-based scheme?

Indeed, Breeden states that Mercer has a number of clients that have conducted a partial transfer before moving onto a full master-trust transfer.

Some may have a first visit before completely entering the world of master trusts, but according to Douglas, most schemes are happy to keep it as a partial transfer. "It tends to be larger schemes, with keen and eager trustees and a supportive employer, that are quite viable in their own right. *[So a partial transfer]* is just a way of focusing their attention on the active members and not having to worry about the set of the scheme population that no longer works for you," she explains.

Having a range of DC schemes for different members is after all, nothing new. Some companies used to put certain groups of employees into Nest, for example, and then offer a different trust-based scheme for the rest, although this division of staff is less likely to occur now, Douglas adds.

Smart Pension independent chair of trustees Andy Cheseldine also notes that it is possible that employers may even split employees into different master trusts for different needs, such as those on different earnings frequencies contribution rates. Two master trusts could also be used for firms with a portion of staff that are seasonal workers, for example, with fluctuating numbers, and those who are more static, longer-term employees. Alternatively this could also be a split by different investment requirements – for instance employees that demand more ethical investments such as a Sharia fund.

However, "in practice employers will typically look for a scheme or combination of schemes that offer the best overall value to members while being simple to administer", he says.

So how common is a partial transfer into a master trust?

Filbin says that awareness of partial transfers into master trusts is not mainstream yet. However, Breeden says the various examples in which a partial transfer can occur is "common practice", although he warns that it may have already plateaued, with more employers moving to a full transfer to a master trust, due to better regulations about bulk non-consent transfers introduced in 2018. In contrast, Douglas notes that partial transfers are "definitely increasing", especially for providing options at retirement.

The extent that partial transfers into master trusts occur may be subject to debate. But for those trustees that feel some of their members will be best served within a master trust and others within their own single-trust DC scheme, awareness of a partial transfer option is growing, and needs to continue to grow, so they can enjoy the best of both worlds.

Written by Laura Blows