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Master trusts: At the heart of change – *The People's Pension's director of policy and market engagement, Darren Philp, chats to Pensions Age about the developments occurring within the pensions industry and master trusts' role within this new order **p36***

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Master trusts focus:

Taking centre stage

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

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Master trusts: At the heart of change

Darren Philp chats to *Pensions Age* about the developments occurring within the pensions industry and master trusts' role within this new order

The People's Pension's director Ruston Smith is part of the auto-enrolment review board – do you know what we might see in the review? Or what are you hoping it may contain?
I think it's quite a timely review. People could argue it's slightly early as contributions are not yet up to that magical 8 per cent yet. But I think now is the time to consider issues around what the levels of contributions should be going forward, looking at how much heavy lifting auto-enrolment should be doing in terms of contributions to give people a decent retirement outcome.

Auto-enrolment has been an incredibly successful policy intervention. It has got a lot of people saving a lot more. But we have to give serious consideration to excluded groups. It is those excluded groups – quite often excluded for labour market characteristic reasons – that tend to end up underpensioned. So getting multiple job holders and the self-employed saving should be a key plank of the review.

I also think it's important to look at the engagement side. Not least because people are being defaulted into a pension, into minimum contributions and into a default fund; we're really harnessing inertia when it comes to getting people to save. We need to make sure the default is delivering and working for members.

The accumulation stage does rely on inertia, but following freedom and choice the decumulation stage is the opposite; requiring savers to make an active choice at retirement. Will this contrast cause problems?
It is a big contrast. If you rely on defaults and then expect people to engage; that will be quite a shock for people.

People harp back to the days of annuities, and defaulting into an annuity made investment glidepath decisions more straightforward, but you still had the engagement problem. Because people were forced to buy an annuity, the market didn't work particularly effectively. I think insurers became lazy with pricing; annuities were mis-sold or mis-bought. So people had to shop around for what is quite a complex financial product to get the best deal. People that harp back to the annuity world forget that we still had the same problem regarding defaults and engagement. It was just a narrower set of options people had.

In the future schemes will have to think about in-scheme options to guide people to a suitable retirement product, based upon simple choice criteria, to give the best chance of acquiring a half-decent retirement outcome. You can also use engagement tools to optimise decisions.

Tax relief is supposed to be an incentive to engage savers. But how effective is it really at encouraging people – particularly lower to mid earners – to save for retirement?
Tax relief just doesn't work. How can you have something so complicated, so opaque, so hidden, and still have it be an effective incentive to save? It may work for higher earners, but for 80-90 per cent of the population, I don't think it makes a jot of difference in terms of it being an incentive. If it worked as an incentive we wouldn't have needed auto-enrolment.

Tax relief is quite a nice narrative to say 'you put a bit of money in, your employer puts a bit of money in, the government puts a bit of money in'. And that's why I'm a fan of flat-rate tax relief.

If you look at the resources that the government spends on tax relief, a lot of it goes to DB. Do you really need to incentivise DB saving from the employee perspective? Probably not. A lot of it also goes to higher earners in DC. Well they can look after themselves. We think a flat rate, targeting the auto-enrolment population, will do a lot to instil confidence and give a boost to saving.

There is a concern that people who are only just higher-rate taxpayers will undersave if the flat rate was around the basic tax rate. So I think around 30 per cent feels quite reasonable.

A move to flat-rate tax relief would be yet another change for pensions saving, despite the industry calling for stability in the system to help ensure saver confidence. Is a period of calm now needed instead?

It always makes me chuckle hearing the industry call for stability. We are asking people to lock their money away for 40-plus years. So I think it's really important to have that long-term system and political consensus that delivers that long-term system. But you can only really call for stability when you have a system that actually works in the savers' interests. We are not there yet.

From a joined-up government perspective, I would like to see tax relief considered as part of the 2017 AE review. If you are going to be looking at the future of contributions, then there should be a debate about who pays how much, and the role of tax relief within that.

Along with the AE review, TPP is also involved in the development of the pensions dashboards. What developments do you see occurring?
I'm not personally a fan of multiple dashboards. We need to get the infrastructure right first, and the prototype demonstrates that can be done. So now we need to focus on what is the financing model, the governance model, and how the risks are going to be controlled.

After that is the time to think about opening this infrastructure to allow robo-advice engines, for example, to patch into it. Also, one of the big problems with the project at the moment is that it is too focused on fintech. It is not focused enough on the individual and the member.

We think there should be a 'public good' dashboard run by the new single guidance body, as this is people's data. They need somewhere safe to go, not being sold at or exposed to scams.

I really don't see the smaller DB or even DC schemes wanting to do this voluntarily. But it would be quite dangerous if we present a dashboard that is all singing and dancing but does not have the full information on there. So that's where the compulsion debate comes in.

This could be achieved through a staged approach, like what occurred with the AE roll out, starting with the larger firms, such as TPP, and then by a certain date all schemes would be included.

"Tax relief just doesn't work. How can you have something so complicated, so opaque, so hidden, and still have it be an effective incentive to save?"

This could also help the industry with improved record keeping – such as potentially the member being able to automatically update their address for all pension schemes through the dashboard. The improvement in data quality and the reduced costs would be astronomical.

A member statement may no longer need to be sent out, changing the way we communicate with people. So I don't feel the industry should see this as a burden or cost.

How will dashboards impact upon master trusts, such as The People's Pension?
Once the dashboard is in place it can help with consolidation of small pots. That will be a key advantage of AE schemes such as master trusts when using the dashboard. A member could decide that small pot sizes, such as sub-£100, gets automatically transferred – which is helpful as it is not cost effective to manage such small pots of money.

And with master trust and its regulation, the member can be sure that they do not risk transferring to a poorer-quality scheme.

Do you think more consolidation is needed – not just with pension pots, but within the industry itself?
I don't take the view that scale is absolutely everything. I think you can get some pretty well-run smaller schemes, but it relies on having an engaged employer. A lot of single-employer trust schemes have fallen off from DB arrangements, and as they continue to close, single-employer trusts will fade away except for a few larger, engaged employers. So you will see natural consolidation as a result of this.

These changes, such as creating dashboards, consolidation and the AE review, aim to improve outcomes for retirement savers. Is enough being done with regards to this goal, or is there more you would like to see occur?
We have go to put ourselves in the shoes of the saver. They don't care what type of scheme they are in, they expect the same standards no matter what the scheme is. We have seen a good push in improving standards for master trusts through the new Bill, which was much needed and we at TPP very much welcomed.

There is still a debate about what the regulation around single-employer trusts needs to be, to make sure they are of that same quality, and likewise around contract-based schemes as well. There have been some good steps forward but ultimately they are regulated as retail financial services products. IGCs have done an alright job so far, but can you ever have a proper alignment of interests with the member unless you have that fiduciary duty?

Retail financial services products are absolutely fine if you have got good information flows, a competitive market and an engaged consumer. Do we have that in pensions? We probably don't, and that's the fundamental problem.

I would like to see to see more work going into achieving a long-term consensus and securing stability in policy making. Having someone hold the government to account with this would be useful. Having an independent body would go a long way into helping overcome some of the issues both the industry and long-term savers face.

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Summary

- The huge success of auto-enrolment has led to a massive increase in the use of master trusts over the past four years, with many new trusts launched to meet demand for pension provision from employers that could not or would not set up or adapt in-house schemes.
- There has been worries that some have been set up as speculative ventures and based on over-optimistic business plans. Questions remain around the current numbers of master trusts within the market.
- Under the Master Trust Assurance Framework, designed by The Pensions Regulator and the accountancy sector association ICAEW, only 19 master trusts have so far achieved accreditation.
- In 2016, the government began to take further action, in the form of the new Pensions Bill. It will compel master trusts to seek authorisation from the regulator, which will also have the power to intervene if a trust is at risk of failure.
- Questions remain however around what method TPR will use to determine exactly how much capital each master trust should have in reserve.

The right level of trust

David Adams explores the predicted future trends in the master trust space and any hindrances that need to be ironed out for the benefit of members

The huge success of auto-enrolment has led to a massive increase in the use of master trusts over the past four years, with many new trusts launched to meet demand for pension provision from employers that could not or would not set up or adapt in-house schemes.

The best master trusts use economies of scale and good processes, systems and governance to provide a high quality, cost-effective pension solution. But not all can do so. Some, set up as speculative ventures and based on over-optimistic business plans, will not be sustainable in the longer term.

Calls for improved regulation of master trusts, to improve protections for scheme members, have been a constant refrain in recent years. One indication of the need for better regulation is the fact that it is difficult to be sure how many master trusts actually exist – current estimates suggest a total of somewhere between 70 and 90.

Developments?

The first step taken to address the problem was the launch in 2014 of the Master Trust Assurance Framework (MAF), designed by The Pensions Regulator (TPR) and the accountancy sector association ICAEW. Trusts seeking accreditation from the MAF must submit to an independent review of their governance and administration. But this is a voluntary system: as of April 2017 only 19 had achieved accreditation.

In 2016, the government began to take further action, in the form of the new Pensions Bill. It will compel master trusts to seek authorisation from the regulator, which will also have the power to intervene if a trust is at risk of failure. Anyone managing a master trust must now pass a fit and proper persons test, while schemes will also have to meet new solvency capital requirements; and to provide proof of adequate capital and a plan to enable an orderly wind-up. Precise details of how these requirements will be applied to the various different types and sizes of master trust will be defined in secondary legislation.

But at the time of writing it is not yet absolutely certain that the Bill will come into force, because although it has passed through all necessary parliamentary stages, it has not yet received Royal Assent. With the General Election now due to take place in June, this will have to happen on or before 2 May.

This should be perfectly possible, but the altered political timetable now makes it more difficult to say for certain when secondary legislation will be introduced. At the time of writing it is generally assumed the election will result in a Conservative government, but we can't yet be absolutely sure of this. You will have noticed that politics has been a little unpredictable of late, to put it mildly.

For the time being, however, the industry is assuming that the Bill will receive Royal Assent and that secondary legislation will follow, perhaps in the autumn. So will the regulation of master trusts then have reached a satisfactory level?

The regulator seems satisfied, so far, at least. "The Bill gives us a higher barrier to entry and stronger powers in terms of authorising schemes and supervision," says TPR policy lead Victoria Holmes.

"This will mean master trusts will be sustainable and well governed."

The People's Pension master trust director of policy and engagement Darren Philp also welcomes the Bill. "Regulation was woefully inadequate," he says. "It is a strange situation where you have industry participants calling for more regulation. Better late than never, I think we would say."

But there are still some important details to be ironed out. Pensions and Lifetime Savings Association (PLSA) DC policy lead Tim Gosling says his organisation is keen to find out what method TPR will use to determine exactly how much capital each master trust should have in reserve – the Bill says TPR will set a level somewhere between six and 24 months' worth of running costs. Gosling also highlights the difficulty of developing an effective fit and proper test that can be applied effectively, both to large master trusts backed by, for example, major insurance companies, as well as smaller, more specialised vehicles.

Consolidation

Once the new regulatory regime is in place it is generally assumed there will be further consolidation in the master trust market. "We've already seen some very small players begin to leave the market," says Gosling. "It is possible that the exact nature of things yet to be decided, like the capital requirements, might lead to further exits from the market." And it is also possible that some entities will not be authorised by the regulator, he adds.

Standard Life's head of pensions strategy Jamie Jenkins believes the number of players in the market will reduce significantly over the next two years. "Master trusts most likely to cease participating in the market are likely to be the less well-capitalised ones," he says. "The key issue has to be how do we deal with a failing master trust in a way that doesn't adversely affect members? That's a crucial gap in regulation."

Not everyone is convinced there will be consolidation on a grand scale. "The market is still growing," says NOW: Pensions director of policy Adrian Boulding. "We're still seeing new master trusts being set up to meet demand: there are still plenty of employers coming through the system."

In addition, Boulding continues, there is a growing trend for employers running their own DC schemes to consider moving their employees into master trusts instead, to benefit from economies of scale and avoid the costs and risks associated with running a small, single employer scheme. He says he knows of around 50 employers that have taken this step during the past year. It is also notable that the percentage of FTSE 350 companies using master trusts has increased from 8 per cent in 2015 to 15 per cent in early 2017, while use of master trusts in the FTSE 100 has risen from 8 to 13 per cent, according to research from Willis Towers Watson.

"As employers wind down their DB schemes some will ask themselves if they really want the hassle and cost of running a pension scheme," Philp notes. Yet even if demand is yet to peak, he thinks the number of master trusts will fall. "There's nothing wrong in principle with small, single-employer schemes, or small master trusts, but ultimately mass market DC provision is a scale game," he says.

Another question to be settled is what will now happen to the MAF. "To a large extent the authorisation process will regularise the standards required to get MAF accreditation," says LifeSight head of proposition David Bird. "So for schemes that want to mark themselves out as better than that, will there be some other form of accreditation process?"

Drawdown and decumulation

Nor are regulatory requirements the only influence on the market. Another longer-term development may be more master trusts starting to provide drawdown and other decumulation products. "The regulator's Code of Practice doesn't have a lot to say about drawdown," says Bird. "When the member is in the savings phase there's a certain amount of oversight from employers, but when they start to draw down they deal only with the master trust. I expect more regulatory attention to be paid to that changed relationship in future."

Holmes says the regulator is actively engaged with this issue and will consider changes to the Code of Practice if necessary.

Clearly, employers trying to choose a master trust that they can be sure will be around for the long haul should consider those that can satisfy current and emerging regulatory and assurance requirements. They will also want to see evidence of strong investment performance, although investment design is still at an early stage in many master trusts, according to research commissioned by the Defined Contribution Investment Forum. As with the question of decumulation products, this will become a more important issue as average pot sizes increase.

For now, National Employment Savings Trust (Nest) business development director Paul Budgen suggests employers assess three and five year returns, rather than the latest investment performance figures. He also emphasises the value of responsible investment policies; and the importance of user-friendly online and telephone support to help members engage with the trust.

The hope must be that the introduction of a new regulatory regime will make all of these aspects of good practice much more common within the market, rather than just the preserve of a few master trusts. If that comes to pass then the longer-term outlook for members of those master trusts that can meet higher standards is surely healthy – whatever happens in politics in the shorter-term.

Written by David Adams, a freelance journalist

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