Calling security

Master trusts have been experiencing a boom in popularity ever since the introduction of auto-enrolment. But with this growth has been increasing concerns over the viability of so many master trusts in the system and their protections (or lack thereof) for members. David Adams explores how the recent Pensions Bill, along with industry efforts, will begin to overcome these challenges

Master trusts have been around for decades. They were originally introduced by insurance companies, for the use of employers that could not afford to run occupational pension schemes. But auto-enrolment has given the concept a huge boost, with many new trusts formed over the past four years to cater for the millions of auto-enrolled employees whose employers could not, or did not wish to set up their own scheme. The largest, the government-backed National Employment Savings Trust (Nest), is obliged to accept any individual or employer that wants to join.

A well-run master trust can provide a cost-effective pension solution for employers and a reliable, well-managed savings vehicle for individuals, offering the benefits of economies of scale, plus proven processes, systems and governance.

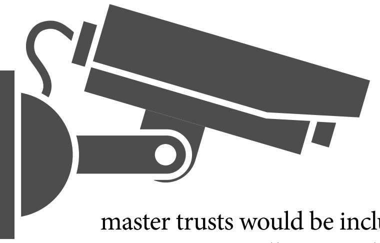
Summary
- A number of master trusts – estimated at over 100 – have appeared since the emergence of auto-enrolment.
- There are concerns that some master trusts have been set up as speculative ventures, based on extremely optimistic business plans and managed by people who do not possess the required expertise. Therefore calls have been made to tighten master trust regulation.
- In 2014 TPR launched the voluntary Master Trust Assurance Framework to address these issues. The recent Pensions Bill will also give TPR new powers to authorise master trusts and to intervene if they are at risk of failure.
- The Bill means those involved in the management of master trusts will now need to pass a fit and proper persons test and schemes will need to prove they are financially sustainable, that governance and administration systems and processes are robust; and that the scheme has an adequate continuity strategy that would enable an orderly wind-up if necessary.
- Extensive consultations and secondary legislation are expected as a result of the Bill. Significant consolidation is also likely to occur.

Quality control

The trouble is, not all master trusts match that description. Some appear to have been set up as speculative ventures, based on extremely optimistic business plans and managed by people who do not possess the required expertise. There have been calls for a tightening of the regulations around master trusts for several years, to protect members against the consequences of the collapse of unsustainable schemes.

In 2014 The Pensions Regulator (TPR) launched the Master Trust Assurance Framework (MAF), designed with assistance from accountancy sector association ICAEW. The accreditation process is robust, offering an independent review of the design and operation of schemes' governance and administration. But MAF accreditation is voluntary. At the time of writing only 12 master trusts have attained it, out of the 100 or so that are believed to be in operation.

But some of those schemes may not last very much longer. In May the government announced that increased protections for individuals saving in



master trusts would be included in the new Pensions Bill. In October more detailed proposals were revealed in the First Reading of the Bill at the House of Lords.

The Bill will give TPR new powers to authorise master trusts and to intervene if they are at risk of failure. Those involved in the management of master trusts will now need to pass a fit and proper persons test. The schemes will need to prove that they are financially sustainable, that their funders can provide assurance on their financial viability; that governance and administration systems and processes are robust; and that the scheme has an adequate continuity strategy that would enable an orderly wind-up if necessary.

"We welcome the Bill," says TPR executive director for regulatory policy Andrew Warwick-Thompson. "We've been pressing for tighter regulation of the master trust market for several years. We want to stop people who are not competent to run pension schemes – or who are even crooks – from doing so."

He also highlights the importance of proposed capital requirements. "What The Pensions Regulator would like to see is that master trusts have to hold sufficient assets to cover operating costs until they break even or make a profit. We'd also like to see money ringfenced to cover the costs of a wind-up."

He acknowledges that the industry will now enter a period of extensive consultation about how the regulations will be structured and implemented. "A lot of the detail will appear in secondary legislation over the next 12 months or so. There will be a lot of discussion about that over the next 12 months."

The Pensions and Lifetime Savings Association (PLSA) also welcomed the draft Bill. PLSA chief executive Joanne Segars says the organisation would examine the Bill closely and would engage with government on the planned secondary legislation, to ensure it is "proportionate", noting that the capital reserving and financial sustainability provisions "will require particular scrutiny".

The day before the First Reading of the Bill the PLSA announced the creation of a Master Trust Committee, to act as the voice of master trust pension provisions within the organisation's membership. Segars says the new committee would "act as an advocate for master trusts as a model of strongly governed and value for money schemes, to develop a strategic and proactive policy framework ... helping to ensure the coming Pensions Bill delivers for savers".

"Broadly speaking we're very pleased," says PLSA DC policy lead Tim Gosling. "But we've got an enormous amount of work to do to ensure that the secondary legislation is put through in appropriate manner. It must balance consumer protection with allowing good schemes to continue to operate in the market."

The People's Pension director of policy and market engagement Darren Philp says "we very much welcome this bill". He anticipates lengthy discussion about the details in secondary legislation, particularly around capital requirements: "I think there's still a debate to be had about those requirements. You don't want to set capital requirements too high, to make it too difficult for a good number of schemes to operate in the market."

But master trust NOW: Pensions chief executive Morten Nilsson stresses the need for a de minimus capital requirement for new providers. He says he also regrets the lack of a proposal to make MAF accreditation compulsory.

Survival?

The Bill makes it even more likely there will soon be significant consolidation within this crowded marketplace. "There are definitely too many providers," says Nilsson. "You need a market that is competitive and has new entrants coming in, but you need capital to back your business."

The mechanics of the process by which successful master trusts take on the members and assets of those that do not survive will need to be designed very carefully. Both Nilsson and Philp like the idea of a panel of the larger master trusts, perhaps working with the regulator, cooperating to ensure members of failing schemes are transferred into viable trusts.

"I think the DWP and the regulator would like to see an industry response, because it's in everyone's interests that we don't have a big scandal or a big failure," says Philp. "The worst thing that could happen would be for the master trust brand to be damaged. Statements from the DWP or the regulator encouraging the industry to do something like that would be really helpful."

A spokesperson for TPR said the regulator could not comment on any specific proposal, "but we are always pleased to see industry looking to tackle issues and develop solutions to protect members' interests".

At present it does not look as if a PPF-style 'lifeboat', funded by a levy, is under consideration. There are concerns that such a model would be unfair to members of financially sustainable master trusts, who would ultimately subsidise poorly managed or financially weak schemes.

Transfers

Meanwhile, Warwick-Thompson believes some employers sponsoring DC schemes will seek to move those schemes into the master trust market. He thinks this might be a particularly attractive option for employers running smaller schemes.

"For some of those schemes, being consolidated by a dynamic master trust market is probably going to be in the interests of their members," he says. "We know there are already master trusts approaching sponsors of quite large DC schemes and suggesting they move their members into master trusts. But that process will take many years."

It is also possible that members of DB schemes may want to transfer pension assets to (DC) master trusts, in order to access pension pots under pension freedoms rules. Such a trend would also be appealing to employers sponsoring DB schemes that are in deficit.

"It's an idea that's getting a lot of interest from advisers and sponsors," says Xafinity principal consultant Paul Armitage. He suggests the key factor is the current unusually high level of transfer values, even before any type of value enhancement.

Overall then, it seems the master trusts marketplace may be on the cusp of significant change, which will hopefully bring benefits to both scheme members and employers. Warwick-Thompson is very optimistic. "I see this as the start of a golden age for master trusts," he declares. "Those that become authorised will form a cornerstone of the workplace savings and retirement market for the next generation."

Written by David Adams, a freelance journalist