Master trust: Scratching beneath the surface

6 February 2019

1. Introduction

The master trust market has grown rapidly in recent years, with membership increasing from 270,000 at the beginning of 2012 to almost 10 million in 2018.[1] In this article we provide some background to the expansion of the master trust market, as well as the transformation of the regulatory regime currently underway. We also look at key factors to consider when choosing a master trust, including a key governance pitfall to watch out for.

2. What is a master trust and why are they so popular?

A master trust is an occupational pension scheme that offers benefits within a trust structure for multiple non-associated employers. They offer an alternative means of group pension provision to a single-employer trust, and for defined contribution (DC) schemes specifically, also to contract-based arrangements, such as a Group Personal Pension (GPP). In the DC world, master trusts are primarily made available by auto enrolment providers, as well as some insurance companies and employee benefits firms.

Each employer has its own section and keeps the ability to make decisions about contributions, investments (if they wish), and benefits. As with a single-employer trust, there is a trustee board which is accountable for running the trust, and this has a regulatory responsibility to focus on the delivery of good member outcomes.

A key driver underlying the growth of master trust arrangements is that they provide employers with access to strong governance capability and oversight, but typically with lower operating costs than might be achieved via a single-employer arrangement, due to the opportunities the providers have to leverage economies of scale. They can also be used by employers to comply with auto-enrolment requirements.

3. How are master trusts regulated?

A master trust is regulated in a similar way as to a single-employer trust. However, many master trusts also seek to comply voluntarily with an assurance framework that was developed by the ICAEW (Institute of Chartered Accountants in England and Wales) in partnership with the Pensions Regulator, and which is designed to help trustees assess whether their scheme meets equivalent standards of governance and administration to those set out in the Regulator's DC code. The Regulator publishes a list of schemes that have obtained master trust assurance on its website.

[1] tPR: DC trust: presentation of scheme return data 2017 – 2018

From 1 October 2018, all new master trusts must apply for and obtain authorisation from the Pensions Regulator before they can operate, and existing master trusts have to apply for authorisation before the authorisation window closes on 31 March 2019. The authorisation process has been introduced with the aim of raising standards for members saving in master trusts. When applying for authorisation, schemes must demonstrate that they meet required standards in five key areas. These are:

- Fit and proper – all the people who have a significant role in running the scheme can demonstrate that they meet a standard of honesty, integrity and knowledge appropriate to their role;
- Systems and processes – IT systems enable the scheme to run properly and there are robust processes to administer and govern the scheme;
- Continuity strategy – there is a plan in place to protect members if something happens that may threaten the existence of the scheme, including how a master trust would be wound up;
- Scheme funder – any scheme funder supporting the scheme is a company (or other legal person) and meets the requirement that it only carries out master trust business; and
- Financial sustainability – the scheme has the financial resources to cover running costs and also the cost of winding up the scheme if it fails, without impacting on members.

Information published by the Pensions Regulator in October 2018 confirmed that following a number of expected scheme wind ups, 58 master trust schemes expect to apply for authorisation in the coming months. Many industry commentators have speculated that the eventual number of master trusts will become significantly less – perhaps less than 20. It's anticipated that the remaining providers will be made up of the well-established auto-enrolment suppliers, the larger insurers and some employee benefit firms, but there is no sign that any of the 58 master trusts are happy to exit the market.

The authorisation regime should be good news for members and prospective employers, not just because of a more stringent regulatory regime, but also because a residual smaller number of master trust providers should be able to achieve a scale which they can further leverage in order to improve their offering to members.

4. What to consider when choosing a master trust

If an employer has settled on using a master trust for its employees' pension benefits, then a rigorous selection process is key to unlocking the advantages of this solution. Factors that are typically considered include:

- Governance - the quality of the trustees and the effectiveness of the governance framework;
- Compliance - whether the trust complies with the current assurance framework and of course, in due course obtains authorisation;
- Transition - the ease of the scheme and member take-on process;
- Investment - the suitability of the investment options, including default funds and choices available;
- Member engagement - the range of communications media and support offered at different stages of the employee lifecycle;
- Administration - the quality of administration service and standards offered to both members and employers;

- The ability of members and employers to provide feedback and influence the services provided (perhaps through member surveys and/ or an employer forum);
- Security – what protections are in place should the investment platform or providers fail, as well as the financial strength of the provider; and
- Value for members – this should consider an assessment of the effectiveness of the entire proposition and not just charges.

5. A potential pitfall to watch out for

As noted earlier, a key reason that master trusts are attractive to employers is the strong governance framework they offer, and particularly the existence of an independent trustee board focussed on delivering good member outcomes. However, in our experience, there is some variability in the market regarding the effectiveness of trustee boards. This can be one of the more difficult aspects to assess at the selection stage.

There are a number of areas which should be explored in order to form a view as to whether the trustee board exists to 'tick the regulatory box', or if it is genuinely supported by the provider and effective in carrying out its role. The questions to ask will vary in each case, but some examples include:

- Are the trustees capable of and do they have the means to provide meaningful oversight and challenge at both a strategic and operational level? The number and professional backgrounds of the individual trustees as well as the diversity of their experience can help to indicate this. Similarly, the frequency of trustee board meetings as well as the appropriate use of committees might be considered;
- How are conflicts managed and are the trustees truly unfettered in their ability to discharge their duties? The providers of most master trusts run them as commercial entities with the intention of making a profit. As a result, there may be pressures on the trustees to choose the provider's fund platform, administration and other services. There may also be other areas requiring investment where good governance comes second to commercial factors;
- What visibility do trustees have of employer and member feedback? Is there evidence that they have been able to consider and act on this where appropriate? and
- Is the trust regarded as just another 'product' by the provider or is there a demonstrable difference in how the trust is run relative to an arrangement such as a group personal pension?

6. Conclusion

Master trusts have provided a very valuable addition to the pensions landscape and are a viable solution for many employers looking to provide pension benefits within a well governed and efficient structure. The strengthening of the regulatory regime combined with anticipated further consolidation can only add to this. However, employers need to look beneath the surface when assessing master trusts, and in particular be confident that the much-touted governance benefits are delivered in practice.