The past, present and future of master trusts in DC pension provision – 5 February 2016

DC master trust provision is seen as a half-way house between single employer trust and contract-based schemes, providing a balance between high quality pension provision and low maintenance (and cost) for the employer.

Evolution of master trusts

Before 2011, master trusts had significant weaknesses and hence did not achieve any real market penetration, being perceived as a solution for a small group – such as when dealing with DC assets for schemes entering the PPF. In 2011, DC master trusts came to the fore in response to auto-enrolment: marked by NEST, ATP's NOW: Pensions; and B&CE's People's Pension. Big-name employers started to select master trust as an auto enrolment solution. Traditional life companies have entered the market or are considering entry. The master Trust profile has been enhanced by support from advisers and employee benefit consultancies, which have subsequently launched products.

Types of master trust

There are different ways to segment the master trust market. However, there are some broad differences in propositions within each segment, with good/bad/indifferent players throughout (just as we find for other types of DC vehicle).

Some sources list 70+ master trusts, but these are likely to include some DB and Death in service master trusts. It is perhaps a surprisingly large number, given master trusts need a large market share as early as possible. With few barriers to entry and concerns around durability, it is no surprise that the Master Trust Assurance Framework (MAF) accreditation was brought in. Master trusts can also seek the Pensions Quality Mark Ready status via the Pensions and Lifetime Savings Association.

In summary, the market is diverse and is evolving.

Role of master trusts for employers

Particular reasons to review pension arrangements may come from changes in businesses, mergers and acquisitions, divestments or changes in strategic direction, and changes in how employees are rewarded. Reviews may be triggered in light of recent Pensions Tax changes, post auto-enrolment reviews and to appraise how to meet increasing DC Governance requirements and associated costs.

Master trusts can help meet a variety of needs, such as auto-enrolment solutions; outsourcing and being the preferred future pensions vehicle for all employees; off-loading legacy DC trust-based plans into sound arrangements; and as an "At retirement" partner to offer drawdown and UFPLS solutions for single employer trusts.

However, master trusts are not the best solution for all employers. Our role as consultants is to help ensure that our clients are provided with the 'best fit' solution to their specific needs – be it contract-based, trust or master trust.

Challenges to meet in moving to a master trust:

Moving to a master trust can be split into five key stages: Feasibility, Consultation/communication, Decisions, Implementation and Business as usual. From experience, these projects will take at least 9 months – some considerably longer.

The feasibility phase can take the longest, ensuring a master trust route is viable. Legal advice is imperative to ensure the Rules permit a move and to understand what the actuarial certificate does and does not cover.

We have seen legal advice that stresses the limited scope of the certificate – the focus is on transfer credits being broadly no less favourable after transfer, where transfer credits is interpreted solely as the "fund value" transferred.

This potentially removes views on future investment funds and charges from the actuarial certificate and places it into the camp of the trustees' considerations regarding whether a transfer without consent is "reasonable". Trustees can consider this aspect in terms of balancing expected returns with risk and volatility of these returns, not just purely focussing on charges.

Linked to this, a well-planned asset transition piece is key, to remove transfer costs and out-of-market risks. Use of methods such as re-registration and pre-dealing will help with these aspects.

The transition process also includes transfer of a vast amount of data – potentially very different to DB transfers. The more history a provider can store, the less risk for members. This should form a key part in selection criteria when choosing a master trust provider.

A further key selection criteria is the investment range and price of funds offered. Even where trustees can influence and select identical investment funds at outset, once the transfer to a master trust is complete, this area falls under the remit of the new trustees, even where some ongoing influence can shape the future provision via user group forums – so the ceding trustees/employer need to feel comfortable about the ongoing future investment governance.

Employers grapple with governance challenges arising from increasingly mobile employees leaving deferred pots after potentially short service; concerns around ongoing governance under drawdown within a SET; and ensuring continuity of skills and expertise. They may want to outsource a lot – but they can't outsource everything, and want to retain control of the financial costs of the scheme. Employers need to understand who is responsible for what after the transfer to master trust.

Looking ahead:

How can we as consultants advise our clients on which provider, if we don't have full information about the master trust space? It is understandable that we may, unintentionally, have bias towards particular providers and products. However, some consultancies with master trust offerings will not engage with researcher/adviser arms from competitors with master trusts. And some whole-of-market advisers will ban competitor consultancies' master trusts from their selection lists. Can we honestly say we are being objective with only half the picture? Is that really in the best interests of our clients, their members or the pensions industry? There must be a way that we can manage perceived conflicts sensibly so that clients and members get the best solution.

We expect that across all DC provider areas, we could see market consolidation as small products/providers exit the market, especially if this is driven by mandatory accreditation and quality levers. Certainly within contract-based and master trust markets, market consolidation can provide economies of scale – but alongside this benefit comes less choice for employers and potentially less competition. And competition is good, if not critical, for innovation and evolution of products and member-focussed solutions. So there are benefits to keeping a marketplace that has a combination of contract-based, SETs and master trusts available to offer appropriate solutions given the many differences in employer issues and considerations – just as long as the propositions are sustainable, well governed and good value for members.