

# Investment News

## Monthly Bulletin from the Insurance & Investment Team

November 2016

### Last Month in Brief

The latest GDP growth figures published by the Office for National Statistics (ONS) show that growth in the UK's economy exceeded expectations and rose by an estimated 0.5% in the three months following the Brexit vote. This third quarter growth was largely attributable to the service sector as manufacturing production, construction and agriculture all contracted. The latest survey of the manufacturing sector showed that the continued fall in the value of the pound did however boost UK manufacturing exports in October but increased purchasing costs for businesses. The net result was a contraction of 1.0%.

The Governor of the Bank of England, Mark Carney announced that he will remain in the role until 2019 and assist an orderly transition to the UK's new relationship with Europe. The BoE are due to present their quarterly Inflation Report at the start of November, in which they will present new forecasts following the latest growth figures and continued fall in the value of the pound. Consumer Prices Index (CPI) rose by 1.0% in the year to September 2016, compared with a 0.6% rise in the year to August. Most commentators agree that the effect of the falling pound is likely to lead to further price increases being passed on to consumers.

The US Federal Reserve have avoided increasing short-term interest rates in the lead up to the US presidential election, but have given a clear signal that there is a stronger case for doing so. Most currencies have weakened against the US dollar with expectations that rates will be increased in December.

Chart 1: Equity Indices

Equity markets were stable over the month



Chart 2: Sterling Credit Spreads

Credit spreads were steady over the month

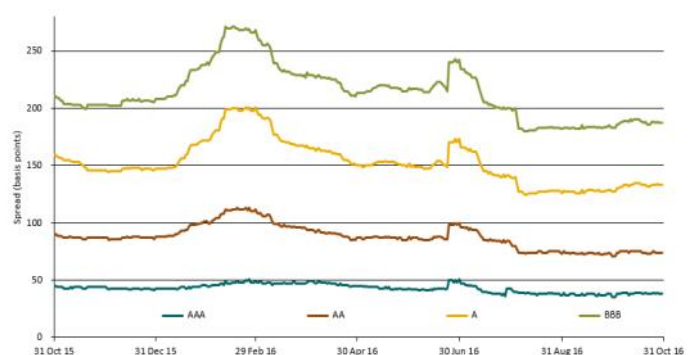


Chart 3: Gilt Yields

Long term gilt yields rose very slightly during the month

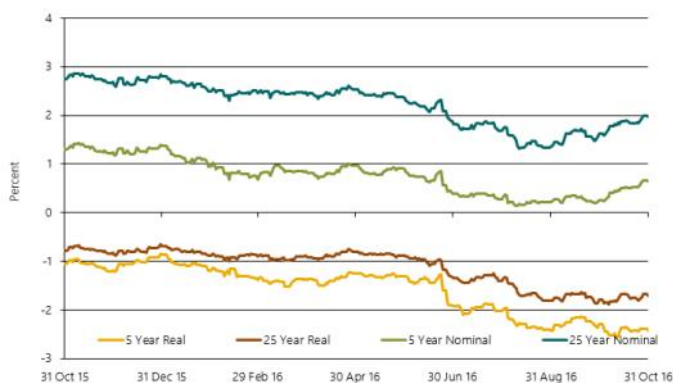
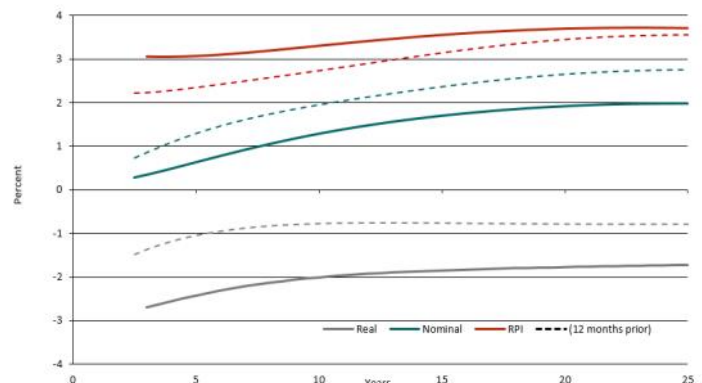


Chart 4: Gilt Spot Curves

Yield curves remained upward sloping



Source: Financial Times, MSCI, Merrill Lynch Bank of America, & Bank of England

	Latest	Previous		Latest	Previous
CPI increase (annual change)	1%	0.6%	Base rate	0.25%	0.25%
PPF 7800 funding ratio	77.5%	76.1%	\$/£ exchange rate	1.22	1.30
Halifax house prices (monthly change)	+0.1%	-0.2%	VIX (volatility) index	17.06	13.29

For monthly published indices "Latest" and "Previous" refers to the two most recently published statistics, otherwise numbers are quoted as at the month end.

## Master Trusts

### What are master trusts?

There are typically two types of pension schemes; Defined Benefit (DB) where the pension is based on the member's salary and service, and Defined Contribution (DC) where the final pension is based on how much is paid in and investment returns.

In recent years there has been an increase in pension schemes known as master trusts. A master trust is a multi-employer DC scheme set up by a third party, e.g. an insurer or investment manager. Each participating employer retains a say in how the scheme is run.

The main driver behind the growth of master trusts is the introduction of Automatic Enrolment legislation in 2012. Since then more than 100,000 employers have enrolled over six million employees into a workplace pension scheme and it is estimated that two thirds of employees are enrolled into master trusts in the UK.

There are over 70 master trusts now available for UK employers to choose from, including the National Employment Savings Trust (NEST) established by the Government.

### What are the benefits of master trusts?

Master trusts offer a number of benefits to employers and employees:

- > A master trust ensures the employer is compliant with automatic enrolment legislation. The Pensions Regulator (tPR) estimated that 94% of employers were using master trusts for this reason (March 2015).
- > By pooling different schemes together employers can benefit from economies of scale, reducing running costs.
- > Being part of a larger scheme gives access to a wider range of investment opportunities.
- > The trustees of master trusts are independent of the participating company, reducing likely conflicts of interest.
- > A competitive industry ensures there are master trusts available to employers who want more flexibility than that offered by NEST.

### What are the risks/ limitations of master trusts?

Whilst master trusts have been around for a number of years, the recent market growth is presenting the industry with new risks:

- > There is a lack of regulation surrounding master trusts. This could allow rogue or inadequate providers to enter the market.
- > tPR views the trustees of master trusts as professional trustees. However, the lack of legislation means it is not clear what standards the trustees should be held to.
- > It is not clear what powers tPR have to intervene where master trusts are failing.
- > The lack of regulation may expose the participating firms to high fees, for example significant exit charges to leave.

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- > Employees could be exposed to the risk of some schemes collapsing, thereby losing their savings.
- > The complexity of master trusts means it is difficult to ensure their sustainability.
- > A recent report by the National Audit Office (NAO) found despite NEST having assets worth £420m, it is not yet self sufficient and is reliant on further funds from the Department for Work and Pensions (DWP).
- > An employer has less control than a single trust scheme.

### What is the Government doing to protect those participating in master trusts?

DWP recently introduced a new Pension Schemes Bill aiming to strengthen the regulations surrounding master trusts and the legislation on exit charges. The Bill gives more powers to tPR and requires master trust schemes to demonstrate they meet 5 key criteria as described below in Box 1.

#### Box 1: The 5 key criteria master trust schemes will be required to demonstrate:

- > *The persons involved in the scheme are fit and proper*
- > *The scheme is financially sustainable*
- > *The scheme funder meets criteria requirements in order to provide assurance about their financial situation.*
- > *Systems and processes requirements, relating to the governance and administration of the scheme are sufficient.*
- > *The scheme has an adequate continuity strategy.*

The increased protection for participating firms has been largely welcomed by the industry, however, certain commentators feel the measures introduced do not extend far enough. Following feedback, tPR have confirmed that the retrospective provisions in the Bill apply to members of existing master trusts.

### What is the future for master trusts?

With the widely lauded success of automatic enrolment in the UK and the growth of master trusts as a consequence, it is expected this industry will continue to grow. However the introduction of more rigid regulatory requirements might reduce the number of master trusts.

It is clear master trusts can play an important role in improving outcomes for members. However, the reputation of master trusts could be damaged by market failures of more marginal providers. It is clear, therefore, this will continue to be an industry under intense scrutiny as highlighted by its mention in the recent Queen's Speech.

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