Department
for Work &
Pensions

Evolving the regulatory approach to Master Trusts

A review of the Master Trusts authorisation and supervisory regime and the wider market

November 2023

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Ministerial Foreword

Master Trusts are the engines of growth in the pensions market in the UK. By the end of the decade, Master Trusts could triple their assets under management in real terms. This will improve the opportunity to invest billions of pounds on behalf of their members in productive finance, including in the UK economy. And I want to encourage Master Trusts to continue to grow, consolidating the long tail of single-employer trusts where it is in members' interests, so that they can reap the potential benefits through improved investment performance and lower costs that come with scale.

Master Trusts are integral to our pensions system, allowing millions of members to benefit from the sorts of scale efficiencies which may otherwise be out of reach for so many employers. Following 5 years of rapid growth in Master Trusts, this review is conclusive in its finding that the direction of travel for this market is continued strong growth and higher concentration, thanks to a healthy competitive environment. Scheme consolidation into well-run, well governed, value for money Master Trusts is a driver of good pension outcomes. This brings the potential to improve opportunities for investment in the UK, which is core to the government's commitment to making the UK the most innovative and competitive financial centre in the world.

But many of the nearly 24 million members of Master Trusts have been defaulted into saving for their retirement, and whether they know it or not, they bear the risk of their investments. Pension schemes are at their heart, an investments business, and net returns, along with contribution levels, are the strongest determinant of how large a DC pot will be at the end of a lifetime of saving.

That is why are putting savers and value for money at the heart of our policy and regulatory framework. Moving the dial on competition in the market focussing on value not just cost, and ensuring there is effective scrutiny of scheme decision-making will help savers receive the best possible retirement outcome. However, the regulatory framework for Master Trusts currently focusses more narrowly on ensuring schemes are resilient to shocks, prepared for all outcomes and reporting regularly to the Regulator.

The Pensions Regulator (TPR) will shift the focus of its regulatory approach and enhance the supervision of investment governance: through this we can raise standards of trusteeship, build scale and expertise to invest in a diversified range of assets, and ensure that all savers receive value for their money by default. Government will cement this value-focussed approach by taking forward legislation to introduce the Value for Money framework, when parliamentary time allows.

Master Trusts are going to be key to the delivery of the Mansion House reforms, as well as wider policy initiatives. To ensure the success of these reforms which will improve outcomes for members, it is important that the regulatory environment reflects the evolving market. I am pleased that this report demonstrates that the

Pensions Regulator expects to take a more influential approach to Master Trusts to see these objectives achieved.

Our organisations will work together to explore what further interventions may be necessary to protect members in future, where schemes are consolidating, reaching systemically important size.

This review allows us to take stock of how the master trust market has developed and identifies where we can work together and with industry to ensure that we protect, enhance, and innovate the market in savers' interests.

Paul Maynard MP

Minister for Pensions

Introduction

Five years on from the coming into force of the Occupational Pension Schemes (Master Trusts) Regulations 2018, DWP and The Pensions Regulator (TPR) have jointly reviewed the Master Trusts market; looking at market segmentation, costs, charges, consolidation, increasing scale, and the relationship with the Chancellor's Mansion House compact and other DWP policies and policy proposals. We describe ways in which the Pensions Regulator is responding to this evolving market, and areas where the Master Trust Authorisation and Supervisory Regime may need to be updated, with a particular focus on investment governance and working more closely with schemes as they grow. Further evolution of TPR's approach to supervision will also continue in the future, in line with its corporate objectives.

About this report

This review of the Master Trusts market and Authorisation and Supervisory Regime was conducted working jointly with the Pensions Regulator (TPR). There are actions that DWP and TPR will each take separately as a result of our findings, however we will continue to work collaboratively as these are further explored and/or taken forward.

DWP has worked in partnership with TPR to understand the practical application of the Regime. We have also had input from the Financial Conduct Authority (FCA) which regulates FCA-authorised organisations that sponsor Master Trusts, to hear their unique perspective. We have also held insightful conversations with a number of Master Trusts, investment managers, consultancies and others, to gain a greater understanding of the market's dynamics and pressures, from those operating within it.

Summary and context

1. Master Trusts are set to play a leading role in the reforms announced at Mansion House and at the Chancellor's Autumn Statement. DWP analysis shows that the trust-market as a whole could grow from around £140bn in 2023 to about £420bn in 2030 in real terms.[1] This scale will open up opportunities for large schemes to become more dynamic and sophisticated in their investment strategies, and government's hope is that this dynamism will also have positive effects for the UK economy, through long-term investment in UK based assets, where it is in pension members interests, contributing to higher growth.
2. Looking at schemes by size, this could lead to over half of trust-based DC assets being in schemes of over £50bn, nearly two-thirds in schemes holding more than £30bn and over three-quarters in schemes of over £20bn.[2] The investing power of these entities in their potential to create growth should not be underestimated.
3. With the potential growth in members of these schemes, this could mean that over three-quarters of trust-based DC members could be in schemes of over £50bn, approaching 80% of members in schemes holding more than £30bn and over 80% in schemes of over £20bn. Though it should be noted that these assumptions are highly volatile and dependent on future market conditions and potential policy changes.
4. And Master Trusts will account for a huge portion of this. Master Trusts already account for 90% of DC memberships, with 82% of members concentrated in the largest 5 schemes by assets under management. And we forecast that this will continue to concentrate, particularly in larger schemes.[3]
5. Master Trusts[4] entered the workplace pensions market to meet the increasing need for pension provision for millions of savers following the introduction of automatic enrolment (AE) in 2012. In 2018, to combat the emerging risks arising from this scheme type, the Government introduced a regulatory framework for Master Trusts, ensuring that only Master Trusts authorised by the Pensions Regulator (TPR) were permitted to operate.
6. Since the introduction of the Master Trusts Authorisation and Supervisory Regime (the Regime), Master Trusts have become the vehicle of choice for around 1.3 million employers[5] as they make the case that they can provide security, sophistication of strategy, good governance, low cost for employers, and reduced charges for members.
7. 5 years on, we are now anticipating a future where, alongside several smaller Master Trusts,[6] a smaller number of very large Master Trusts are in operation,

[1] Trends in the Defined Contribution trust-based pensions market (publishing.service.gov.uk)
[2] Trends in the Defined Contribution trust-based pensions market (publishing.service.gov.uk)
[3] Trends in the Defined Contribution trust-based pensions market (publishing.service.gov.uk)
[4] A Master Trust, as defined by the Pension Schemes Act 2017 (the Act) is an occupational pension scheme providing money-purchase benefits that is used (or intended to be used) by multiple unconnected employers and is not a relevant public service pension scheme.
[5] DC Master Trust League Table 2023 ~ H2 - Go Pensions (go-group.co.uk)The
[6] Which will likely be more bespoke offerings in the non-commercial market segment, or smaller commercial Master Trusts with a unique offering and ambition to scale quickly.

providing members with value for money (VFM) consistent with the joint DWP, TPR, and FCA VFM Framework. Value will be delivered in part via sophisticated investment strategies producing high-performing returns from a wide range of assets, including accessing the opportunities presented by innovation within the UK economy.

8. Many of the millions of members of Master Trusts have not made an active choice to save, as AE has utilised defaults to harness the power of inertia and 94% of Master Trust memberships are within the default investment strategy.[7] Therefore it is vital that TPR is able to continue to strike the balance of regulation and risk, and that the Regime continues to provide TPR with the powers it needs to protect members and drive the best outcomes for members.

Mansion House reforms

9. Master Trusts are set to play a leading role in the reforms announced at Mansion House and at the Chancellor's Autumn Statement. The projected scale of the largest Master Trusts means they will be able to access a broader range of investment opportunities, including those that contribute to UK growth, benefit from cost saving opportunities that come from economies of scale and deliver new and innovative services to members in accumulation and decumulation.

10. Master Trusts, with their increasing ability to consider and assess the value and understand the opportunities of a wide range of assets, are exploring these avenues: 10 organisations, 9 of which sponsor a Master Trust, are now signatories to the Mansion House compact, intending to achieve a minimum 5% allocation to unlisted equities.[8] The Minister for Pensions signalled her support to this at a speech at the Onward Thinktank following the announcement of the Mansion House reforms.

> "*The Chancellor and I are united in our commitment to creating a pension market which delivers for savers, one that is boosted by investment in innovative UK businesses and a broader class of productive assets."*[9]

11. Some Master Trusts, along with Group Personal Pensions (GPPs) are also likely to be among the default consolidators of deferred small pots, as described in the government response to the consultation on "Ending the proliferation of deferred small pots"[10] as their scale allows them to keep operating costs low.

12. The Pensions (Extension of Automatic Enrolment) Act 2023, which received Royal Assent on 18 September introduced powers to lower the age criteria and lower earnings limit for automatic enrolment. Monoline[11] Master Trusts in particular are in a position and likely to provide services to those brought into pension saving by these measures.

[7] 20230926-the-dc-future-book-9-2023.pdf (pensionspolicyinstitute.org.uk)
[8] Mansion House Compact Signatures (theglobalcity.uk)
[9] Source: DWP
[10] Ending the proliferation of deferred small pots - GOV.UK (www.gov.uk)
[11] A Master Trust which entered the market in response to demand for pension provision created by the AE mass market. As discussed in chapter 1.

13. Master Trusts will also likely be the pension provision of choice for schemes winding up under the 'value for members' assessments, and proposed Value for Money (VFM) framework.[12] In the contract-based pensions market, this role could be fulfilled by GPPs and Group Self-Invested Personal Pensions (Group SIPPs).

14. In response to the consultation on "Helping savers understand their pension choices*",*[13] all trustees will be required to offer decumulation services with products to members and develop default solutions, based on the general profile of their members either directly, or in partnership with another organisation. This will include trustees of Master Trusts.

15. In addition, we also envisage that Master Trusts will play a role in establishing a market for collective defined contribution (CDC) schemes, and we will be consulting on draft regulations to expand CDC to multi-employer schemes early next year.

16. It is therefore vital that these schemes are delivering the best value for their millions of members, and that members are adequately protected. As such, we have reviewed the Master Trusts market, and are exploring areas where the Regime may need to be revisited to equip it for the future.

The Value for Money Framework

17. The VFM framework will have a significant impact on the DC market in the coming years. The policy objectives of this initiative are to drive up standards and consolidate the market around a smaller number of well-performing, well-governed large schemes. The regulators (FCA and TPR) are working together to develop a framework that can be applied holistically across the entire market.

18. We expect that most Master Trusts, given their scale and governance and their additional authorisation and oversight, will be proactive in ensuring their scheme meets 'value for money' metrics. But Master Trusts should not stop there – these schemes should be striving for the best possible outcomes for their members, focussing on continuous improvement. As part of this review DWP and TPR have identified that there is a role for TPR to play in driving better outcomes *within* the Master Trust market, which can begin before the introduction of the VFM framework in legislation.

19. TPR will enhance their approach in the supervision of investment governance in Master Trusts.

- As part of an enhanced focus on investment governance TPR will build on the current provision of investment data, seeking an increased flow of more timely investment information. This will enable TPR to closely review the changes to strategies and understand trends in investment, building a market-wide picture and allowing TPR to intervene to warn members at timely moments.

[12] 2023 Defined Contribution Pension and Savings Report - WTW (wtwco.com)
[13] Helping savers understand their pension choices: supporting individuals at the point of access: consultation response - GOV.UK (www.gov.uk)

- This information will be used (alongside information already gathered) to drive better performance by challenging schemes at key moments and will include challenging how decisions are made and the expertise on trustee boards, and prompt schemes to consider their strategy if they are underperforming relative to others in the market and focus on continuous improvement.
- TPR will evaluate this strategy and explore further with DWP whether any legislative changes may be necessary in future to support this enhanced level of scrutiny.

20. This is part of TPR's evolving approach, speaking at the PLSA conference 2023, TPR's CEO Nausicaa Delfas said "*In this new pensions landscape, as a regulator we need to go beyond basic compliance, influenc[ing] the market for greater saver outcomes.* "[14] As the risks of scheme failure in a more mature market will be lower, TPR's approach can manoeuvre from primarily seeking to prevent and mitigate against failure (although this work will of course continue), to a collaborative supervisory approach, challenging schemes to be in a mindset of continuous improvement. The Department is supportive of the Regulator's value-led approach and the importance it has placed on increasing its focus on value at pace and over the near term.
21. Going further, should these additional measures require, DWP will seek to legislate to place them on a statutory footing, consistent with the developing evidence-base.

Consolidation

22. The Master Trust market has seen huge growth. Signs of continuing growth from continuing contributions are very strong, and we must also consider the potential impacts of the Mansion House reforms in further increasing the scale of Master Trusts.
23. Master Trusts are in strong competition to scale up quickly, and to do this they need to either attract employers, consolidating single-employer trust schemes, or grow by acquiring other Master Trusts. Both strategies are resulting in consolidation across the trust-based DC market. Market dynamics are at work, and small or slower growing Master Trusts have already become targets for further consolidation, with a number of anticipated mergers underway. As Master Trusts continue to grow in scale, they will become an even greater proposition for employers as they use this scale to develop sophisticated investment strategies, with access to the best expertise, trusteeship and are able to use economies of scale to operate at a low cost. We are encouraged by these market dynamics, which we believe can serve in members' best interests, with the right focus on value over the risks associated with low cost, and effective competition.

Recommendations

24. In investigating the Master Trusts market, we have found that the Regime is overall fit for purpose at this stage. In the majority of cases, it allows TPR adequate oversight and engagement with Master Trusts. However, there are

[14] PLSA Annual Conference: Keynote speech | The Pensions Regulator

areas which warrant further action by TPR in the medium term, and possible further regulatory intervention or regulation by DWP, subject to further evidence.

TPR:

- Will adopt a collaborative supervisory approach, which will focus on value and continuous improvement.
- As part of an enhanced focus on investment governance TPR will build on the current provision of investment data, seeking an increased flow of more timely asset management and investment information. This will enable TPR to closely review the changes to strategies and to understand trends in investment, building a market-wide picture and allow TPR to intervene to warn members at timely moments.

  This information will be used (alongside information already gathered) to drive better performance by challenging schemes at key moments and will include challenging how decisions are made and the expertise on trustee boards, and prompting schemes to consider their strategy if they are underperforming relative to others in the market, focussing on continuous improvement.
- Will evaluate this strategy and explore further with DWP whether any legislative changes may be necessary in future to support this enhanced level of scrutiny.
- Will expect that trustee boards have appropriate levels of expertise in investments.
- Will work to define and identify schemes reaching systemically important size and consider what additional oversight these schemes may require.
- Will consider how to mitigate against potential conflicts of interest arising from multiple trustee appointments.

DWP:

- Will support TPR in its focus on value, enhanced investment governance and forward-looking strategy, and will consider legislative changes if necessary.
- We will keep under consideration and may further explore changes to the Regime which have been highlighted through this work. This may include:
  - Amending the Regime to consider market withdrawal in the cases of mergers and acquisitions, ensuring that the Regime is appropriate for these circumstances, and that TPR have proper oversight.

- The addition of the Chief Investment Officer to the list of persons who are required to undergo a ‘fit and proper’ persons check.
- The addition of risk notices as part of the Master Trusts Regime.
- The removal of pre-agreements in tightly prescribed circumstances, to promote further market competition, if necessary.

As scale in the market is built and the VFM framework is embedded, we intend to work with TPR to understand competition in the market and any further emerging risks resulting from scheme size.

25. As part of this work, we also identified that employer motivations are often cost-driven. In addition to the VFM framework, there may be several levers which could make a positive impact on this picture, shifting the focus onto value, including publishing further information for employers on selecting a pension scheme, as proposed in the response to the call for evidence “Pension trustee skills, capability and culture”.[15]
26. TPR’s overall approach to supervising the Master Trust market will continue to evolve as the market changes. DWP supports this commitment to protect savers’ money, to enhance the pension system and, as we look to the future, help to drive innovation which is member-centric and in savers’ interests.

Background

27. A Master Trust, as defined by the Pension Schemes Act 2017 (the Act)[16] is an occupational pension scheme providing money-purchase benefits that is used (or intended to be used) by multiple unconnected employers and is not a relevant public service pension scheme. The Pensions Regulator (TPR) was given the role of authorising and supervising these multi-employer schemes, and therefore Master Trusts must satisfy TPR that they meet the 5 authorisation criteria set by the Act in order to be granted authorisation. TPR supervise Master Trusts on an ongoing basis in line with the authorisation and supervisory regime (the Regime) and following its introduction, the market has consolidated with the withdrawal of over 50 schemes.
28. Master Trusts operate as part of a wider workplace pensions market that includes single-employer trusts, as well as contract-based workplace pensions. The Financial Conduct Authority (FCA) regulates the contract-based workplace[17] pensions market, and TPR regulates the trust-based market.

[15] Government response to ‘Pension trustee skills, capability and culture: a call for evidence’ - GOV.UK (www.gov.uk)
[16] Pension Schemes Act 2017 (legislation.gov.uk)
[17] and non-workplace contract based pensions

29. Prior to 2018 there was no minimum requirement to enter the Master Trust market and little protection for members if a scheme were to fail. These risks had the potential to be exacerbated by the loss of direct employer oversight. The Regime had the following objectives:

- to ensure that only well-run schemes which could reach financial sustainability, were permitted to operate,
- to ensure that members of Master Trusts were as well insulated from risks that were largely unique to the Master Trust market (protecting member pots in the event of scheme failure) as possible and,
- to ensure that risks arising from scale or scheme structure are identified, and that there is an appropriate balance of risk prevention and intervention.

30. Government expected the market would contract by way of merger of schemes as a result of some being unable to meet the requirements placed on them with the coming into force of the Master Trust Regulations 2018[18] and strict authorisation criteria. It was also anticipated that some schemes would withdraw prior to Royal Assent of the Act, which is why it was given retrospective effect, to protect members of exiting schemes.

31. It has been 5 years since the Master Trusts regulations came into force. Automatic Enrolment (AE) has been successfully rolled out which has resulted in high participation and low opt-out rates and increased pension saving. In 2022, £29bn more in real terms was saved into pensions in that year compared to 2012, when AE was rolled out.[19] 90% of members, and 95% of active members in the trust-based market are in Master Trusts,[20] and we have already discussed the projected scale of this market. Therefore, now is the right time to review the Master Trust market to explore:
    - how it has grown and how schemes are performing,
    - how market forces are shaping it,
    - what consolidation activity is happening, and
    - how it can be further developed for the benefit of savers now and in the future, before the market truly enters 'super' scale.

32. We know that scale generally improves member outcomes, (although within the Master Trust market there is a wide variation in returns) as schemes make efficiencies and improve governance.[21] As such, government has been making the case for greater consolidation since 2019 in the consultation "Investment Innovation and Future Consolidation."[22] Consolidation primarily can help improve member outcomes, but has a secondary effect in increasing

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[18] The Occupational Pension Schemes (Master Trusts) Regulations 2018 (S.I. 2018/1030)
[19] Workplace pension participation and savings trends of eligible employees: 2009 to 2022 - GOV.UK (www.gov.uk)
[20] DC trust: scheme return data 2022 to 2023 | The Pensions Regulator. Excludes memberships of hybrid schemes and memberships of micro schemes.
[21] 20171108-the-impact-of-dc-asset-pooling-international-evidence.pdf (pensionspolicyinstitute.org.uk)
[22] Investment innovation and future consolidation: a consultation on the consideration of illiquid assets and the development of scale in occupational defined contribution schemes (publishing.service.gov.uk)

scale. The overall DC trust market has seen steady consolidation, from 2,180 schemes in 2018, to 1,220 in 2023, and could fall to around 500 schemes by 2030 on current trends.[23]

33. But as well as reducing the number of small schemes, we would welcome consolidation at the large end of the scale where it is in the members interests, so that Master Trust members can further realise the economies of scale and efficiencies that can come from mergers even at the largest size, as seen in Australia,[24] where seven of the eight largest 'My Super' entities have around £30bn in assets under management – with the largest entity managing almost £100bn. Though we must also be mindful of the risks of market consolidation, should this reduce employer choice, concentrate risk, and create an oligopoly. Therefore we want to continue to see smaller Master Trusts with unique propositions/technology and the appetite to scale quickly, challenging the largest schemes, creating competition and driving up standards. Until very recently, consolidation within the Master Trusts market slowed after an initial contraction following introduction of the authorisation and supervisory regime. We have considered market dynamics affecting this plateau and if there are barriers in the Regime to mergers and acquisitions.
34. We are working towards a future where a smaller number of very large Master Trusts are in operation, (alongside several smaller Master Trusts) providing members with sustainable returns, from a wide range of assets, providing excellent governance and good user experience. There is a direct link to the Value for Money framework jointly proposed between DWP, TPR and the FCA, where schemes will be required to assess and disclose their investment performance, asset allocation, member charges and quality of services. The VFM framework has the potential to create further competition and raise standards across the market, but there is also a role for TPR to play to drive value within the Master Trust market.

35. We have seen from other industries that as entities reach systemically important size, there is a need for close regulation, due to the consequences of failure. However, where efficiencies in regulation can be realised for both industry and the TPR, there may be areas where the burden of regulation may be relaxed in future.

36. When the Regime was introduced, government sought to allow the Master Trust market to evolve in a way which supported good member outcomes through healthy competition, and which achieved the appropriate balance between protection of scheme members and the regulatory burden on business – these priorities remain true.

[23] Based on current reduction of 11% year-on-year. DWP analysis based on TPR DC trust: scheme return data 2022 to 2023 | The Pensions Regulator

[24] Drivers of Performance: Insights from a Member Outcomes Perspective (apra.gov.au)

Undertaking the review

37. When the Master Trust Regulations 2018 were introduced, The Department for Work and Pensions committed to "keeping these policies under review and should any issue arise with these policies, it will assess the evidence and, if appropriate, consider whether any changes may be necessary."[25]

38. An independent review of TPR was published in 2023, and although the review of the Master Trusts market and authorisation regime does not directly address the recommendations in that report, it is conscious of TPR's regulatory responsibilities and how they might evolve as the market grows and changes. In particular we consider TPR's role relating to investments which was also explored as part of the independent review. The lead reviewer recommended that "I do not believe that TPR should be given a statutory duty in respect of economic growth but – considering its statutory duty towards the interests of savers – it should have a view on how regulation can drive investment behaviour that is in savers' best long-term interests."[26]

Chapter 1: The shape of the market

Development since authorisation

39. Master Trusts dominate the trust-based Defined Contribution (DC) landscape. There are currently 35 authorised Master Trusts in operation.[27] These 35 schemes hold 95% of active members, 74% of assets, and 90% of asset growth within the trust-based DC market (excluding hybrid schemes[28] and micro-schemes[29]).[30]

[25] The Occupational Pension Schemes (Master Trusts) Regulations 2018 (legislation.gov.uk)
[26] Independent review of The Pensions Regulator (TPR) - GOV.UK (www.gov.uk)
[27] List of authorised master trusts | The Pensions Regulator
[28] Hybrid scheme means an occupational pension scheme which is not a money purchase scheme, but where some of the benefits that may be provided are money purchase benefits attributable to voluntary contributions of the members, or other money purchase benefits.
[29] Micro schemes have 2-11 members and represent less than 1% of members in the Trust based market.
[30] DWP analysis based on TPR DC trust: scheme return data 2022 to 2023 | The Pensions Regulator

Figure 1: Active memberships in Master Trusts vs. Single-employer trusts (2023)[31]

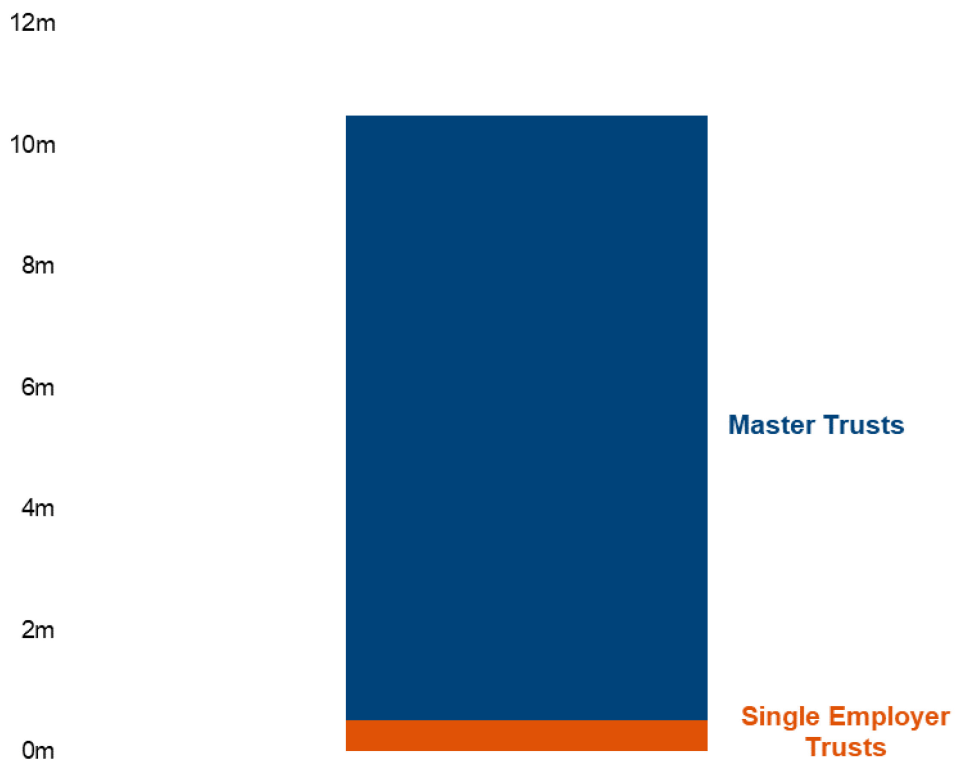
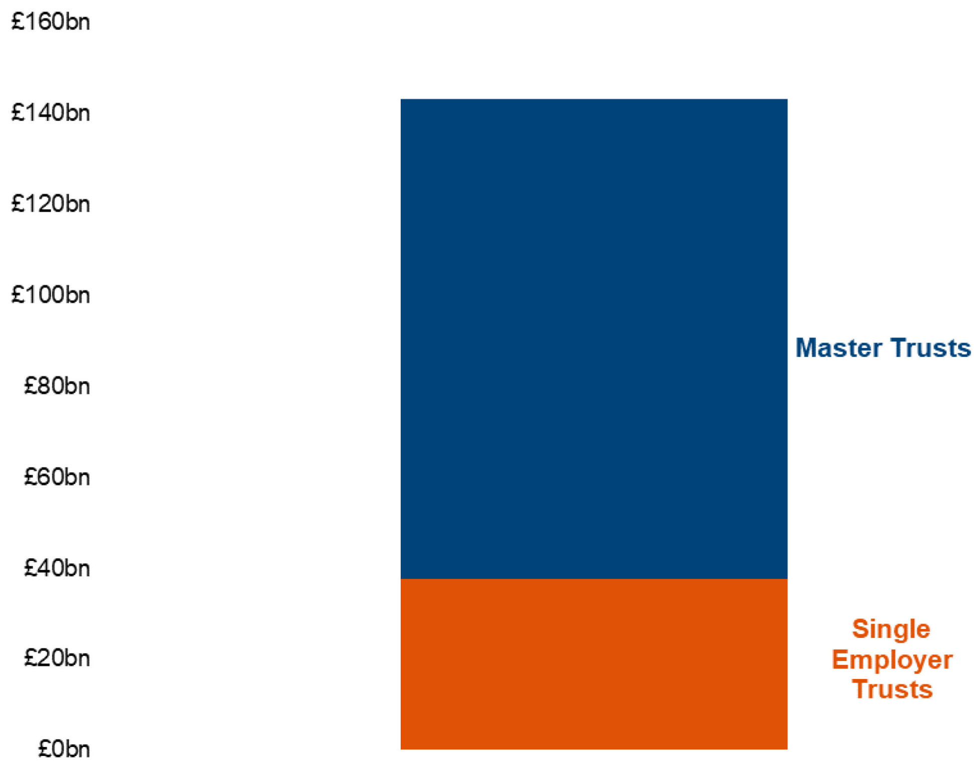
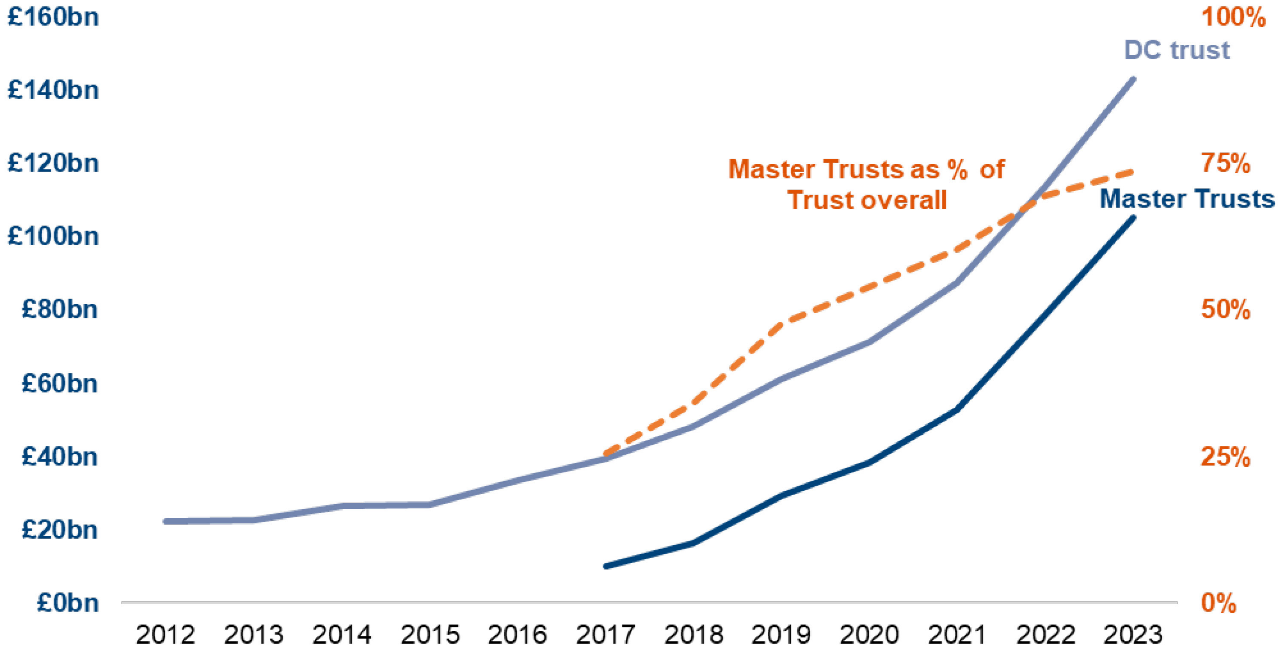


Figure 2: Asset split between single and master trusts (2023) [32]



[31] DWP analysis based on DC trust: scheme return data 2022 to 2023 | The Pensions Regulator
[32] DWP analysis based on DC trust: scheme return data 2022 to 2023 | The Pensions Regulator

Figure 3: DC trust assets, Master Trust assets, and Master Trust assets as a proportion of DC trust assets (right-hand axis)[33].

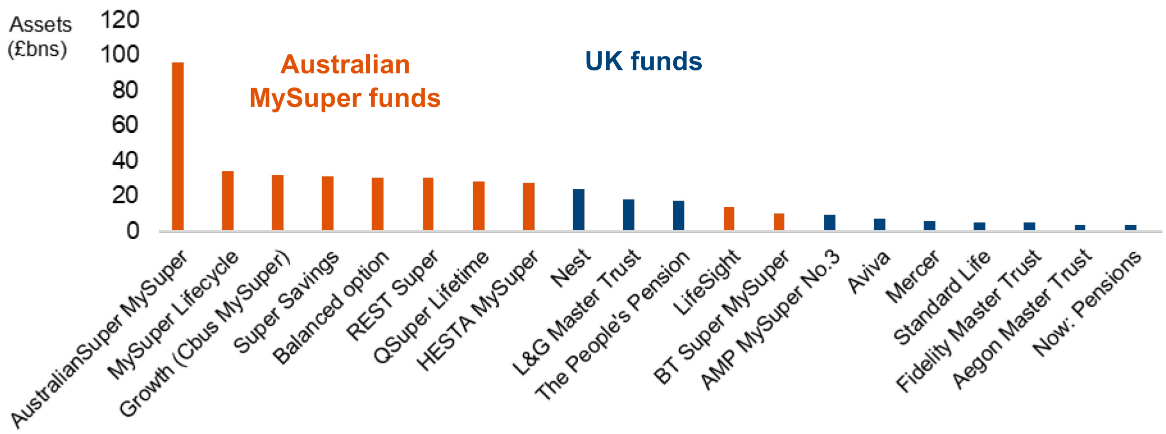


40. There is concentration within the market of memberships and assets. The top 5 (by AUM) Master Trusts account for around 60% of trust assets held and around 80% of savers in the trust market.[34] By 2030, we expect the largest 5 schemes by AUM to have over 80% of the share of memberships. And DWP analysis shows that a large majority of savers could be in schemes of over £30bn (albeit this analysis uses assumptions which are volatile and subject to future market conditions and policy changes).[35]

41. Compared to the more mature Australian market (whose equivalent of AE started in 1992 and where contribution levels are greater than the UK), made up of more than 50 'My Super' entities (as well as a large number of small funds),[36] the UK Master Trust market is already more concentrated, with the UK's largest Master Trusts beginning to reach comparable scale. The UK Master Trust market will continue to develop, particularly as a result of the structural shift away from Defined Benefit schemes (where less than 1m people save into a private sector DB scheme[37]) and the continued rise of DC, combined with various policy initiatives to drive scale and consolidation.

[33] DWP analysis based on DC trust: scheme return data 2022 to 2023 | The Pensions Regulator
[34] DWP workings from TPR data and Go Pensions data
[35] Trends in the Defined Contribution trust-based pensions market. DWP 2023
[36] Annual superannuation bulletin June 2015 to June 2022 - superannuation entities.xlsx (live.com)
[37] The Purple Book 2022 (ppf.co.uk)

Figure 4: AUS/UK scheme Assets under Management (2022)[38].

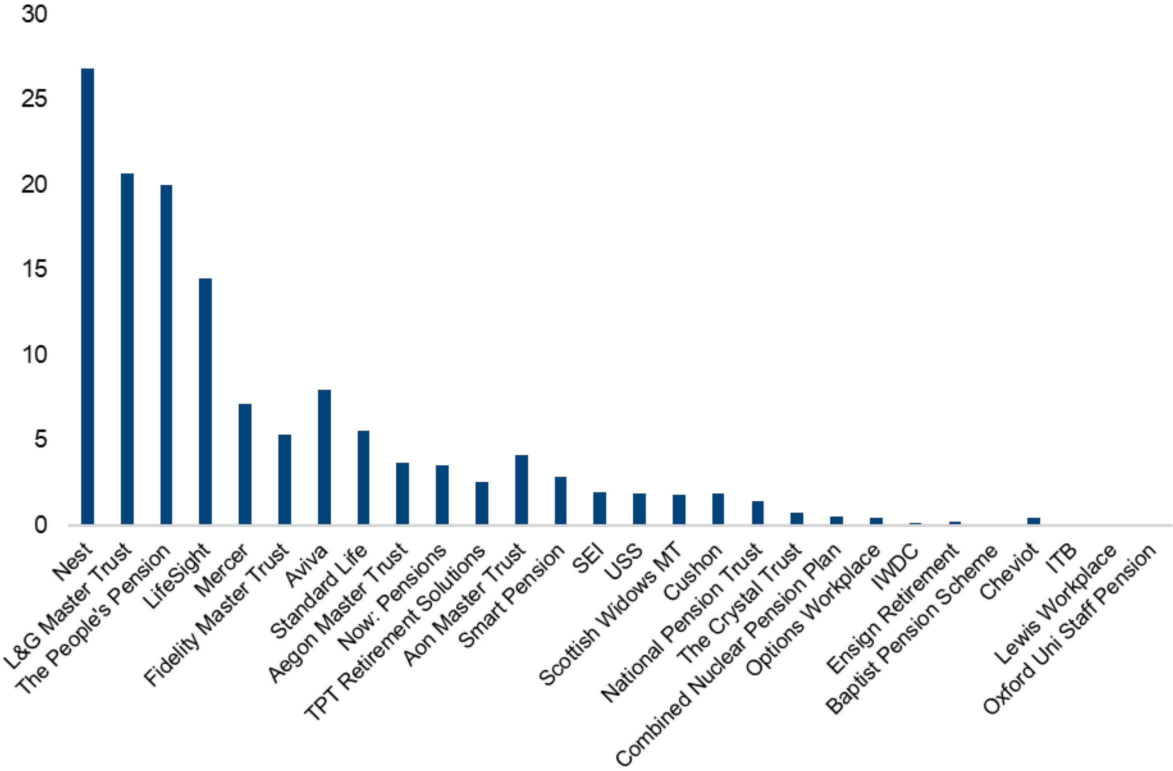


42. The asset value contained within Master Trusts is also more concentrated in the UK than in the Australian market. In Australia, the largest ten funds account for almost half of market assets and one third of its memberships, whereas, according to Go Pensions data the largest five Master Trusts account for slightly less than two thirds of assets.[39]

[38] DWP analysis. Australian data from Annual MySuper statistics | APRA. Australian data converted from Australian dollars to GB pounds using rate of 0.55 AUS$ to 1 GB£ on date of publication of 14th December 2022, as found here. UK data from August 2022 from Latest Insights - Go Pensions (go-group.co.uk).

[39] DWP workings from TPR data and Go Pensions data

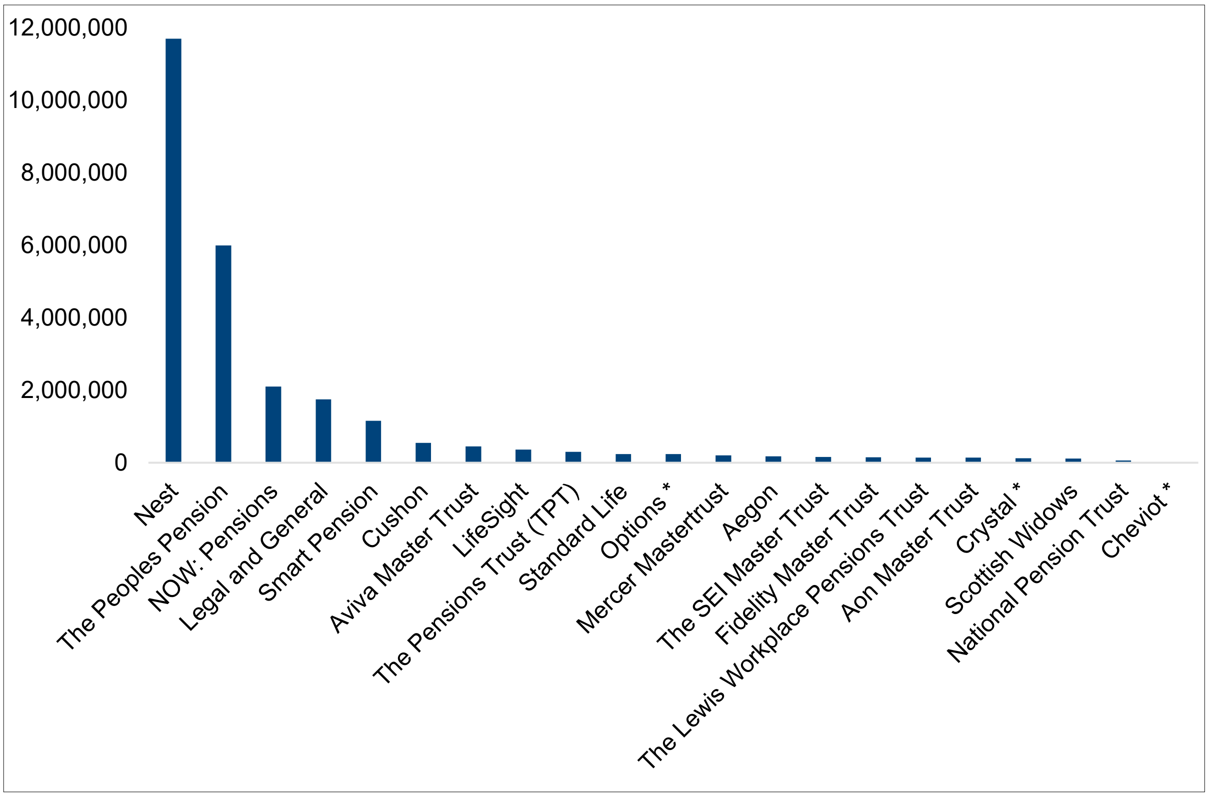
Figure 5: Assets of DC trust scheme default funds (£billions)[40]



43. Membership too, is very concentrated within the UK Master Trust market. Around 80% of members across Master Trusts are concentrated in just 5 schemes.[41] Also of note is the shifting balance between active and deferred memberships. As of 30 September 2023, 64% out of a total of 27.3m Master Trust memberships was deferred status, and TPR data indicates that the ratio is likely to continue to widen.[42] This statistic indicates that the management of smaller, deferred pots is likely to remain a key consideration for providers in the future.

[40] USS data from here; CNPP data from here; IWDC data from here; Ensign data from here; Baptist Pension data from here; ITB data from here; Oxford University data from here; all others from Go Pensions Latest Insights - Go Pensions (go-group.co.uk)
[41] DWP workings from Go Pensions data
[42] TPR Aggregated Master Trust financial data submissions. October 2023.

Figure 6: DC Master Trust by number of members[43]



44. The concentration of assets and memberships within the Master Trust market is significant. It suggests that scale is being achieved within these schemes, which is likely to impact on member outcomes as economies of scale are realised.

45. Commercial Master Trusts[44] remain optimistic about their growth potential although TPR estimate that long term, this optimism has the potential to exceed the actual size of the available market given the significant overlap in the growth strategies and target markets of some Master Trusts. This points to the further consolidation of Master Trusts that we are beginning to see, as not all schemes' growth strategies may be as successful as anticipated.

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[43] DWP workings from Go Pensions data

[44] Discussed from in chapter 2, commercial Master Trusts are seeking to increase their scale by attracting employers from different sectors (though each Master Trust will target different employer demographics. Non-commercial Master Trusts are often sector-specific and are not actively pursuing external employers to grow).

Figure 7: DC Master trusts – projected AUM growth by market segment[45]

46. Scale is vital for longevity, and schemes that can demonstrate that they have plans for growth may be a more compelling proposition for business. Figures 8 and 9 below show growth in the Master Trusts with the highest and lowest Master Trusts by forecasted 3-year growth in assets under management (AUM). In the top 5 are Master Trusts that have been active consolidators in the very recent past, which indicates that a combination of organic and inorganic growth strategies can provide competitive growth. These fastest growing schemes are at the smaller end of the scale, as they can increase faster proportionally owing to their smaller size. Conversely, out of the bottom 5 performers 2 of these (bars highlighted in orange) are at various stages of the consolidation process, showing that there is a commercial imperative underpinning the survival of Master Trusts, and not all schemes have been able to effectively commercialise their operations.

[45] TPR aggregated Master Trust financial data submissions. October 2023. This includes a range of underlying assumptions for inflation and investment returns.

Figure 8: Highest 5 schemes by forecast 3-year growth in AUM[46]

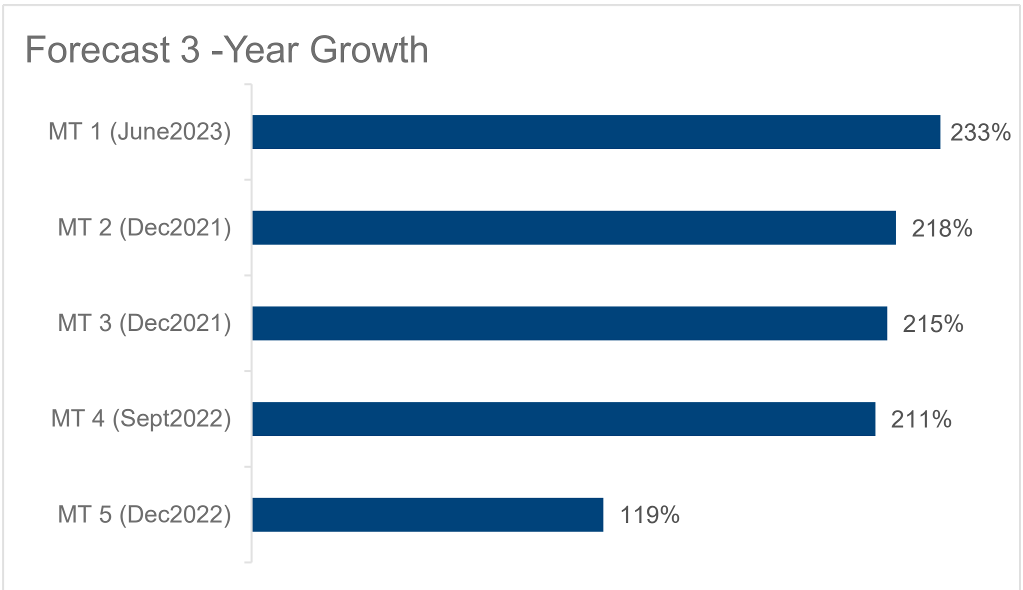
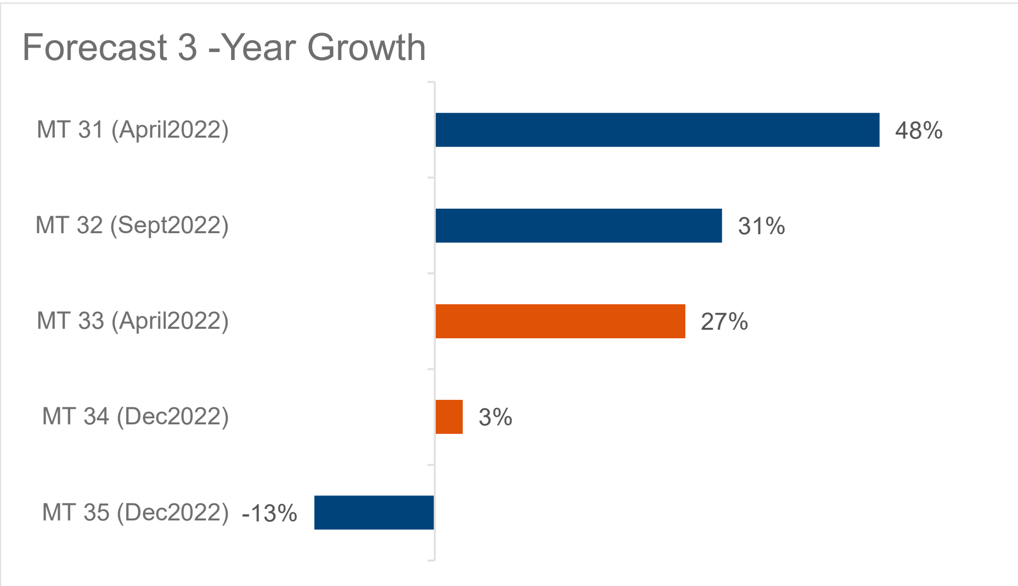


Figure 9: Lowest 5 schemes by forecast 3-year growth in AUM (orange highlight indicates a consolidating scheme)[47]



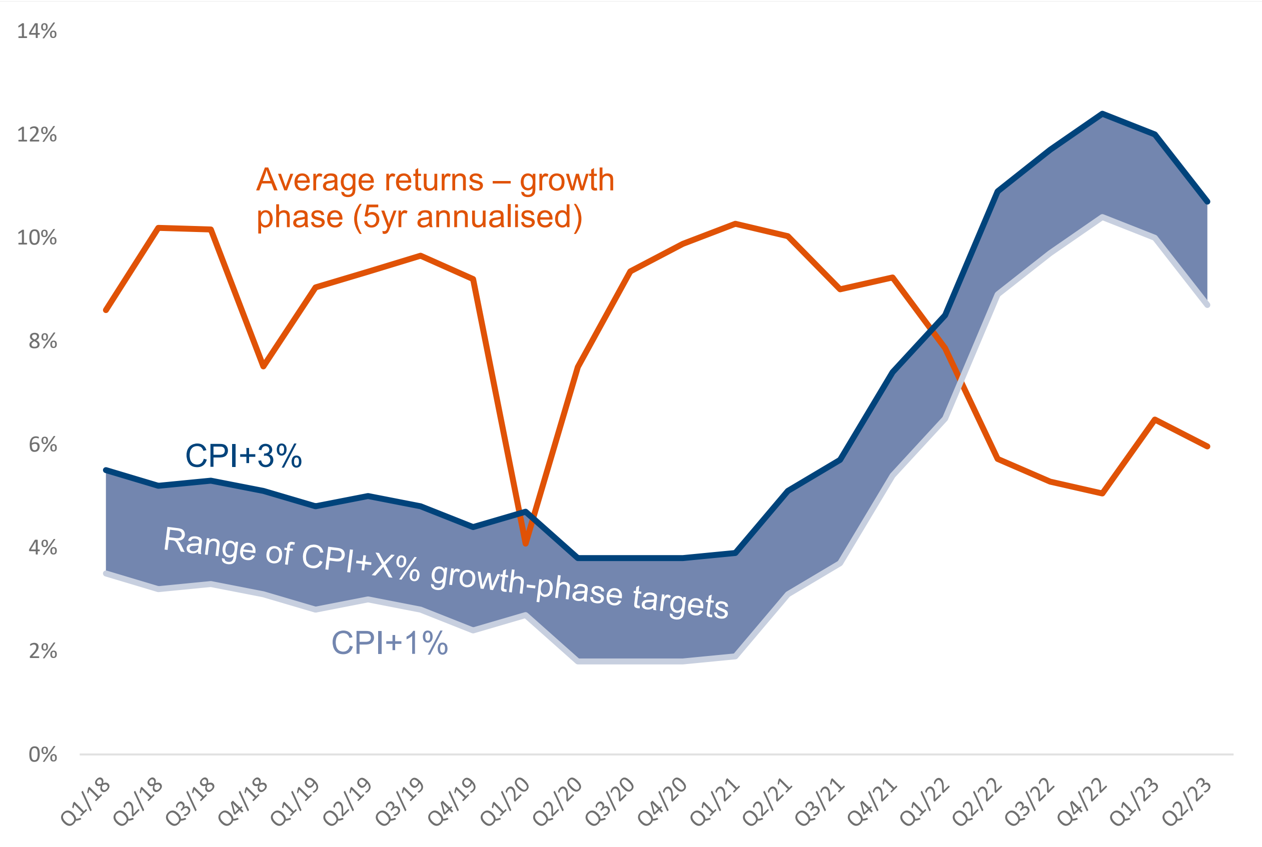
47. We wish to see growth in the market so that scheme members can benefit from efficiencies, but it would not be in savers' interests to see a market dominated by average performers who just happen to be large. The current Master Trust market shows no correlation between size and investment returns. This demonstrates the need for balance between scale and value. We wish for the

46 TPR aggregated Master Trust financial data submissions. October 2023.
47 TPR aggregated Master Trust financial data submissions. October 2023.

market to remain a competitive environment where smaller, more agile Master Trusts with unique offerings can challenge the largest providers by attracting clients through novel propositions. The proposed VFM framework will provide a cross-market mechanism to support this.

48. Generally, Master Trusts have performed well in the last 5 years, albeit the COVID-19 pandemic, above-target inflation, and Autumn 2022's bond market spike presenting challenging investment conditions. 5-year annualised returns show more consistent performance above commonly used benchmarks of CPI+1% (or 3%), especially from 2018-2022. Comparing against long-term inflation assumptions (around 2%), many schemes would still be outperforming despite challenging investment markets (see figure 10).

Figure 10: CAPA average annual investment returns in the growth phase, compared to a range of CPI+X% targets%[48].



Summary:

- The Master Trust market is achieving scale, with greater assets under management collectively than single-employer trusts, and this scale will continue to grow in the coming years. However there are still a number of large individual single-employer trusts.

[48] Using the Corporate Adviser Pensions Average (encompassing both MTs and GPPs) for a younger saver 30yrs from Spa. This is compared against a range of observed CPI+1% to CPI+3% levels as these are common industry growth phase return targets.

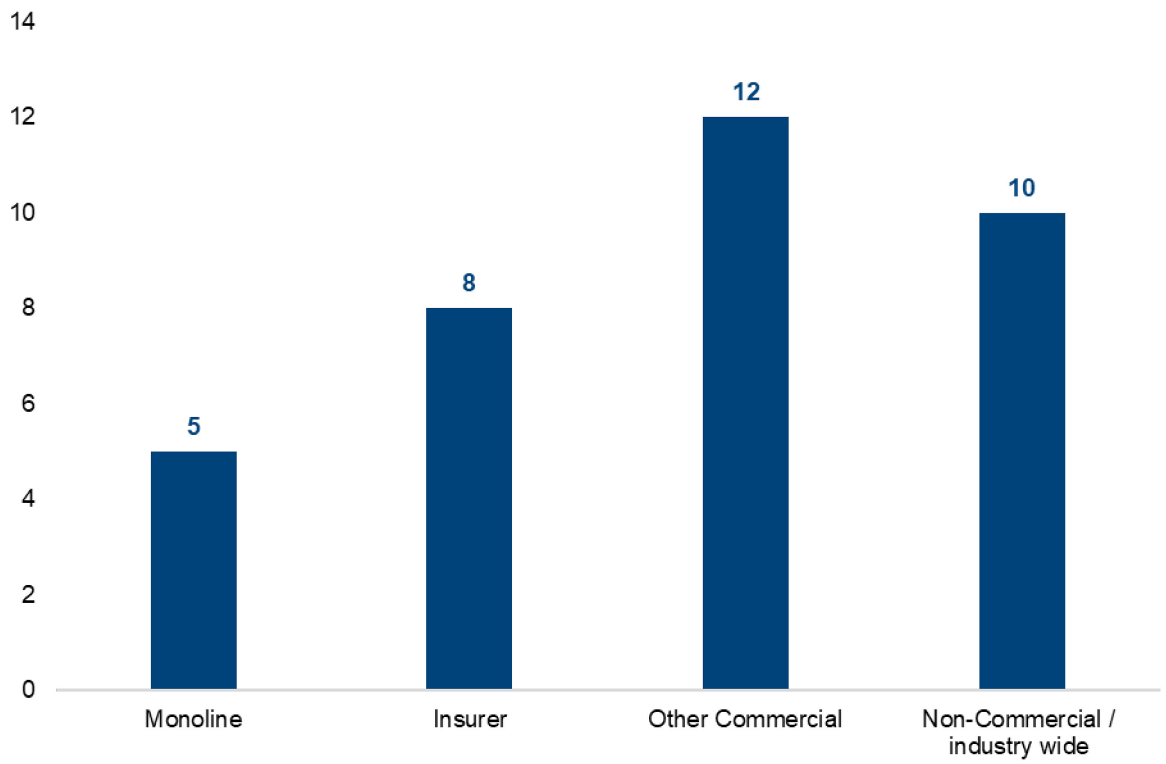
- Concentration of memberships and assets is high within a handful of schemes.
- Further consolidation is likely, as schemes without strong growth become targets for consolidation.
- Deferred members make up a significant proportion of overall memberships.

Market segments

49. Although there are 35 authorised Master Trusts, a few of these schemes are operated by the same sponsor: split into separate Master Trusts for administrative/historical reasons, or are in the process of merging with another Master Trust, the process of which takes some time to complete. As far as we understand, the intention is for these acquired schemes to be fully merged, leaving a more consolidated pool of under 30 Master Trusts.
50. The Master Trust Regulations 2018 have enabled different types of organisations to apply to become authorised, recognising that different organisations will cater for different demographics. As such, one way to categorise the market is along these organisational lines.
51. There are commercial Master Trusts:
    - Monolines – schemes set up to specifically cater for the mass AE market
    - Master Trusts sponsored by insurers –these insurers may also provide workplace group personal pensions (GPPs), individual personal pensions and life assurance products, as well as other products such as annuities.
    - 'Other commercial' – this group consists of employee benefit consultancies and other organisations.

    And non-commercial/industry wide Master Trusts, serving discrete communities.

Figure 11: Master Trusts by market segment[49]



52. Master Trusts are regulated by TPR. However some of the sponsors of Master Trusts are also regulated by the FCA for other parts of their business. This includes all of the insurers, as well as some other commercial Master Trusts. These organisations must meet the FCA's expectations, including in relation to the Consumer Duty, where relevant and where they have a material influence over these.

The role of the FCA

Master Trusts and single employer trusts are supervised by TPR. The contract-based DC market is regulated by the FCA and covers workplace and non-workplace pensions. The workplace segment of this market covers 12 million members with £260 billion in assets under administration (compared to 18.2 million members with £218 billion in the trust-based market)[50].

The FCA regulates around 100 firms[51] that provide individual personal pensions, stakeholder personal pensions, self-invested personal pensions

[49] Categorised by DWP and TPR

[50] Independent review of The Pensions Regulator (TPR) - GOV.UK (www.gov.uk)

[51] Based on the number of FCA-authorised firms (by firm group) that reported holding assets under administration in contract-based DC pension plans as of March 2022 as part of the FCA's 2021/22 Retirement Income Market Data

(SIPPs), GPPs and Group SIPPs, as well as retirement income products such as annuities.

The FCA's regulatory reach in the pensions and retirement income market also extends beyond firms that sponsor pension schemes. The FCA regulates firms and individuals that advise on investments including pensions, and that provide DB pension transfer advice, as well as asset managers and other investment services firms. This includes firms providing investment services to occupational schemes and Master Trusts, except where they provide advice on asset allocation or investment strategy.

The FCA has a range of supervisory tools to monitor and support ongoing compliance, and enforcement powers that can be exercised if a firm does not meet these expectations and requirements, including disciplinary sanctions, fines and de-authorisation, where appropriate.

53. The schemes which responded to the demand for pension provision created by the AE mass market, the 'monolines', cater for a wide range of employers, including those who may not be as attractive to other parts of the market. For example, many small businesses who have fewer employees and/or employees with lower average earnings and, therefore, smaller pension pots. There may also be a higher proportion of workers on short-term contracts who will not provide as regular an income stream for schemes than permanent employees. National Employment Savings Trust (Nest) was set up with a public service obligation to take on any employer who chooses to use the scheme, including those with lower-paid workers and/or those on short term contracts who may not be as individually profitable. Nest is the largest Master Trust with over 11 million members and £30bn in AUM.[52] Nest proved the trust-based, low-cost digital model could work at scale and other providers have entered to cater to the workplace pensions mass market. Other providers have seen the value in attracting a high volume of members to reach scale, looking at future profitability of their entire book, rather than how profitable each employer/member is to them.

54. As the monolines cater to the mass market, they generally have higher membership numbers and therefore higher volumes of contributions (depending on the proportion of active members) as a result and have realised some efficiencies which have led to the lowest operating costs per member across organisational types (see figure 12). These low costs are a key factor in helping the monolines to continue to attract new business, continue growth and secure external investment. This segment of schemes also has a greater proportion of deferred small pots, which are proportionally more expensive to administer, something which the Government aims to mitigate through the

[52] Benefits of our investment approach | Nest Pensions

automatic consolidation of eligible small pots into a small number of authorised default consolidators.[53]

55. For the insurers and other commercial Master Trusts, a Master Trust is typically part of the parent company's wider offering in the pensions space, which may include GPPs,[54] asset management, investment advice, saving vehicles, pensions consultancy and life assurance products, and the Master Trust can benefit from scale built across the business. For these providers, a Master Trust offered an opportunity to expand their business and leverage existing expertise and contacts in pensions, capitalising on the growing popularity of multi-employer schemes.

56. Employee Benefit Consultancies (EBCs), asset managers, and insurers sponsoring Master Trusts may be attractive to employers who are looking for more bespoke arrangements, as they are likely to offer a wide range of funds in addition to the default, through their wider business. The relationship between bespoke and default funds is discussed at paragraph 116.

57. There is a more disparate group of 'other' commercial providers who have a more unique offering, for example through their technology, investment strategy, or extended services such as financial advice.

58. Across these commercial market segments, different schemes are likely to be competing for different, though overlapping employers/industries, rather than the 'mass AE market' of the monolines. For example, these schemes may use their resources to seek out the largest employers, or large employers with high average earners within a certain sector, as these clients represent bigger wins than seeking out smaller businesses which take time and resource to onboard, for less immediate profitability. Where Master Trusts are seeking out the same clients, (often competing through an employer's use of a consultancy/intermediary), some schemes will be unsuccessful, and as a result may not reach scale via their chosen strategy, resulting in scheme consolidation.

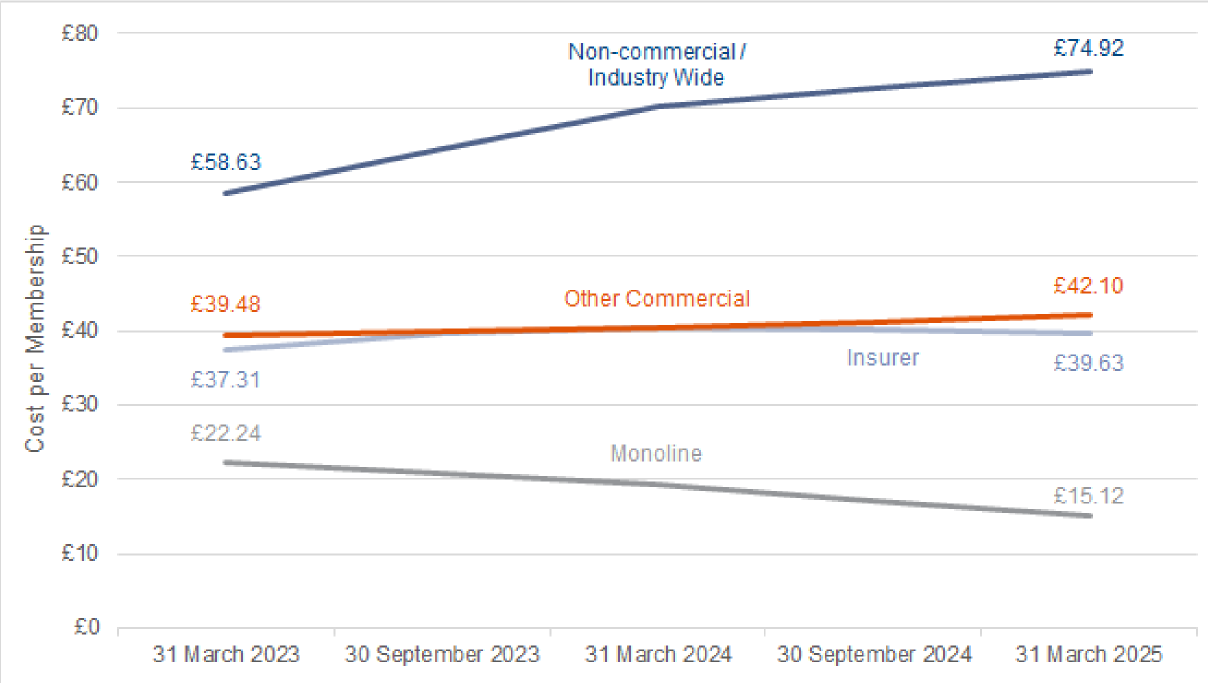
59. There are also the 'non-commercial', or 'independent' Master Trusts. These are generally related to a single industry but have been captured by the regime by virtue of their structure. For example, the Superannuation Arrangements of the University of London (SAUL), provides a pension for the employees of the University of London, but as this is made up of multiple employers, this scheme was required to apply for Master Trust authorisation. This group of schemes are not competing in the market in the same way as the other Master Trusts and have smaller memberships. The average cost per member in these schemes is also significantly higher than in other Master Trusts, but members do not necessarily feel this through their charges, as these more paternalistic employers may offset this. For these reasons, they may be thought of as more of an extension of the single employer trust market, bringing the de facto number of commercial Master Trusts down further, from under 30, to below 20 schemes.

[53] Ending the proliferation of deferred small pots - GOV.UK (www.gov.uk)

[54] Group Personal Pensions (GPPs), which are FCA-regulated and must be overseen by an Independent Governance Committee (IGC). While GPPs are not the focus of this paper, many employers use GPPs or Group SIPPs to provide workplace pensions for their employees.

60. These different market segments have varying operating costs (see figure 12), with average costs predicted to fall across insurers and monolines. Costs are predicted to fall the fastest in the monoline schemes, who are already operating at, on average, a lower cost per member than other segments. The insurers and other commercial schemes have higher operating costs per member. However, it is also important to note that operating costs within these segments vary, and therefore some schemes may have found greater operating efficiencies than others. It is unclear why costs are higher for these groups, it could be due to the clients they attract, associated costs within their supply chain or other reasons. For the non-commercial schemes, higher operating costs may not be passed onto the individual members, as they may be absorbed by paternalistic employers.

Figure 12: Average cost per member by organisational segment[55]



61. We have heard from various Master Trusts that the market is not yet mature; as well as seeking scale, many schemes are making large investments in technology, administration, and other areas. These project costs may be reflected in current overall costs, but you might expect these to reduce once these projects are complete and the benefits come on stream. A PPI report in 2020 highlighted the significant investment required to set up a Master Trust, including repayments of capital to fund their initial startup, which impacts costs, and flagged that it is harder for organisations without existing pension infrastructure to enter the market.[56] We predict that this will continue to be the case as schemes grow.

[55] TPR aggregated Master Trust financial data submissions. October 2023.
[56] 263175(1) PPI Report for Design Financial Sustainability.indb (pensionspolicyinstitute.org.uk)

Summary:

- Different market segments have different characteristics, competing for different employer types. Some of this competition overlaps, meaning there will be winners and losers in scaling.
- Non-commercial Master Trusts should be thought of as an extension of the single-employer trust space, subject to higher levels of regulatory oversight, but not seeking to increase scale to gain a higher market share.
- Operating costs vary across market segments, with monoline schemes benefitting from the lowest costs per member, which are set to decrease even further.

Chapter 2: Increasing scale, reducing costs, supporting diversification

62. Not all Master Trusts have reached breakeven (revenue greater or equal to costs). Before this point is reached, the scheme funder will see no direct return on their significant investment to set up the scheme. If this continued, or if it was predicted that it would take a long time to reach profitability, this would not be sustainable for the scheme funder, and they may take the decision to consolidate. If evidence cannot be provided to TPR that the scheme is commercially sustainable in the long term, TPR would consider withdrawing authorisation. An exception to this may be where the Master Trust exists to introduce clients to the sponsor's wider business. It may be more sustainable for these organisations to continue running the Master Trust at a loss, on the basis that this is sustainable when looking at the broader business. TPR review these strategies to ensure commercial sustainability.
63. The view that the Master Trust market will further consolidate is held by many in the pensions industry. LCP recently predicted that the market will contract to around 10 providers, and that larger single employer trusts will also move to Master Trusts in the coming years.[57]
64. Reaching scale can be achieved through organic or inorganic growth.

Organic growth involves the continuing contributions and investment returns of current scheme members, and attracting:

a) employers who have been running their own single employer trust,

b) employers seeking to fulfil their AE duties,

c) employers moving from Master Trust to Master Trust, the 'secondary market', and

d) employers moving from contract-based arrangements to a Master Trust,

[57] CA Summit 2023: Significant contraction of master trusts in next five years - Corporate Adviser (corporate-adviser.com)

There is limited movement from contract-based to Master Trusts, and as we will discuss, a secondary market is only just beginning to emerge.

Inorganic growth involves acquiring another Master Trust to achieve scale quickly. This is discussed in chapter 3.

65. As Automatic Enrolment has been fully rolled out with over 2 million employers having fulfilled their duties,[58] growth by attracting new employers is limited. Initially this was very fruitful due to the volume of employers required to fulfil their duties. Business could be attracted based on cost (including whether or not there is an employer connection fee), on the package of assistance provided for employers to ensure that they were correctly fulfilling their duties, or business could be attracted via an employer's supply chain, for example, payroll providers. The independent review of TPR found that "It was suggested to me that accountants, financial advisers and payroll providers play an important role in influencing outcomes for savers, on the basis that many small businesses look to these intermediaries to recommend a pension scheme, and payroll providers in particular are well-placed to ensure compliance by small businesses with AE obligations."[59]

66. New business from single employer trusts can be won through direct engagement with employers, or the use of intermediaries/consultancies, who consider the different offerings of schemes on behalf of their clients to aid in the selection process.

67. Scale itself is a boon to attracting business from single-employer trusts. TPR operational insight has found that larger single-employer trusts are unlikely to select a small Master Trust who cannot evidence managing a scheme of very large size, and whom these employers may be less confident in a smaller Master Trust's ability to stay in the market. Therefore, scale begets scale.

68. While the 'back book' of members is valuable through the charges that larger pension pots bring as they grow from investment returns, active membership is incredibly important for building scale. Active members will create a steady income stream for the Master Trust and will create greater organic growth through ongoing contributions. TPR analysis has shown that without healthy active membership, profitability and efficiencies are limited.

69. Deferred memberships are growing across commercial Master Trusts (see figure 13), with around 60% of memberships in trust-based market being deferred pots.[60] As set out in the government response to the consultation on "Ending the proliferation of deferred small pots",[61] we have confirmed that we will implement the multiple default consolidator approach to automatically consolidate individuals eligible deferred small pots. This will reduce the number of deferred pots which schemes hold, which are mostly unprofitable.

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58 Automatic enrolment declaration of compliance report | The Pensions Regulator

59 Independent Review of The Pensions Regulator (publishing.service.gov.uk)

60 DC trust: scheme return data 2022 to 2023 annex | The Pensions Regulator

61 Ending the proliferation of deferred small pots - GOV.UK (www.gov.uk)

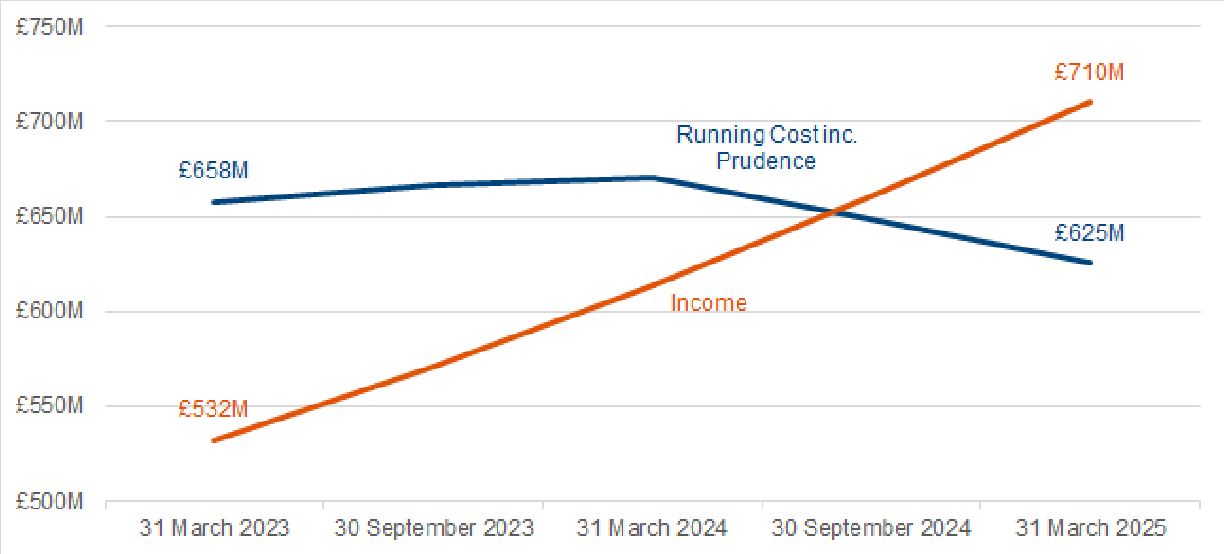
Figure 13: Deferred membership growth, historic and projected[62]

70. Active membership can be built by attracting new employers and/or single-employer trusts or acquiring other Master Trusts to generate growth. Schemes which can show that their assets/memberships will grow will be valuable clients and will be able to negotiate lower fees with the promise of future business. For asset management, scale increases the opportunities available to schemes and enables them to create sophisticated investment strategies within the default, as asset managers seek to win business. In addition to investment funds, schemes with very large scale can create discretionary portfolios, which allows greater breadth of investments, increased flexibility and innovation in how this fund is used.

71. Increased scale should generate operating efficiencies by reducing the average cost per product. Securing low costs is an effective business model as it helps schemes win business and create further scale through the offer of lower member charges, borne out of these supply-side negotiations. However, TPR have not yet seen evidence of a simple correlation between scale and cost reduction, rather, as income is increasing, there are signs that costs are beginning to level off at the aggregate level (see figure 14). Total running costs are likely to continue to rise as increased assets and membership are managed.

[62] TPR Aggregated Master Trust financial data submissions. October 2023. Years ending 31st March.

Figure 14: Master Trust running costs and income[63]



72. Though economies of scale may be being found at scheme level, we cannot confidently currently conclude that economies of scale are yet being realised across the Master Trust market. This may be due to the relative immaturity of the market, as schemes continue to make investments to improve their propositions. This may include reducing member charges, making for technological/system improvements, or decumulation offerings. Investments in these types of scheme improvements may temporarily increase operating costs and/or member costs, but are likely to be positive for scheme growth, governance and/or members' overall offering. Master Trusts operate in a competitive environment, and this can create a positive competition feedback loop, as schemes compete on their overall offering.

73. Some Master Trusts achieve efficiencies by limiting the number of available funds and operating a single or very few default funds, therefore reducing operating costs. Where schemes operate a wider pensions or insurance business, efficiencies may also be found. Schemes with existing experience in the wider pensions market also create efficiencies through effective models of governance which is also very important for competition, as trustees can challenge the decisions brought to them and seek improvements through their supply chain.

74. As schemes become even larger still, a range of investment skills and capability is likely to be brought in house. This will help to reduce costs once embedded, and would give these Master Trusts even greater freedom over their investments. Nest, the largest Master Trust, has an in house investment team which manages all important investment decisions and processes. This enables Nest tight control of their strategy, access to new markets and more efficient management of risk.

75. A report by the PPI looking at evidence from the Netherlands and US, found that £0.5bn in AUM was optimal for reducing member borne costs specifically,[64] after which point there are diminishing returns. Looking wider,

[63] TPR Aggregated Master trust Financial data submissions. October 2023.
[64] 20211118-value-for-money-final.pdf (pensionspolicyinstitute.org.uk)

sources from Australia have suggested A$30bn is needed to be competitive within that market,[65] and efficiency gains can still be achieved at $100bn.[66] Efficiencies from mergers of Australian schemes have been evidenced even at the largest size;[67] though this is largely driven by lowering costs (rather than via investment returns). Costs are unlikely to increase completely linearly with membership size, and likewise, governance processes may not need to undergo large changes due to increased membership, especially if the scheme is already a considerable size.

76. Likewise, the Department for Levelling Up, Housing and Communities, in the consultation "Local Government Pension Scheme (England and Wales): Next Steps on investments",[68] explored asset pooling within LGPS, and the scale benefits that this can bring. By pooling assets, significant savings have been made, and expertise and capacity has been developed in private markets. It is DLUHC's assessment that in pooling assets, the benefits of scale are present in the £50-75 billion range and may improve as far as £100 billion. As such, government also wishes to see further scale within the Master Trust market.

Diversification: The Mansion House Compact

77. Beyond the potential cost savings associated with greater scale, there is evidence that scale can support the diversification of pension schemes into less liquid assets such as private equity. Key channels through which this may occur include the ability to bring specialist investment capabilities in house, increased bargaining power with intermediaries and access to a wider range of investment opportunities.[69] The Pensions and Lifetime Savings Association has argued that larger schemes, for example those with more than £25-50bn of assets, have considerable governance capability and find it easier to invest directly, or alongside others, in productive finance.[70] The think tank New Financial has argued that a more concentrated market of super trusts with around £50bn of assets each would be enabled by economies of scale, wider investment horizons and increased professionalisation to invest in a broader range of assets in the long term interest of their members.[71]

78. At this stage, there is no clear evidence that the scale efficiencies being seen are being passed onto members either directly, through lower charges, or indirectly, through greater spending on investment and development of investment strategy. In 2022, Corporate Advisor, in their 'Master Trust and GPP Defaults report, found that "none of the master trusts and GPP providers included in this report say they expect to change the amount spent on asset management within the next two years. However, as they achieve greater scale, they may be able to embrace innovative charging structures within their

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[65] APRA Deputy Chair Helen Rowell - Speech to AIST Conference of Major Superannuation Funds | APRA
[66] Drivers of Performance: Insights from a Member Outcomes Perspective (apra.gov.au)
[67] Drivers of Performance: Insights from a Member Outcomes Perspective (apra.gov.au)
[68] Local Government Pension Scheme (England and Wales): Next steps on investments - GOV.UK (www.gov.uk)
[69] Local Government Pension Scheme (England and Wales): Next steps on investments - GOV.UK (www.gov.uk)
[70] PLSA policy position on pensions & growth – October 2023
[71] UK capital markets - a new sense of urgency (newfinancial.org)

existing overall price constraints."[72] We currently lack evidence on the breakdown of fee budgets, but as Government increases focus on value for scheme members, this is something we will seek to understand.

79. It is highly promising that 10 organisations are now signatories to the Mansion House compact, intending to achieve a minimum 5% allocation to unlisted equities, 9 of which sponsor a Master Trust. The signatories come from across the scheme types, including monolines, insurers, and an employee benefit consultancy (EBC).

80. It is also important to note that members of the Mansion House compact are not the only schemes investing, or considering investing in private assets. A few Master Trusts dedicate the same or an even greater proportion of their default to private assets and sit outside of the top 10 schemes by assets under management. This demonstrates that scale is not the only factor determining allocation to private assets, which may include investment expertise from the scheme funder (or might indicate that scale is achieved through the wider business).

81. Scale can increase access to private assets by increasing the probability that the scheme has the internal capabilities to deal with these investments and is likely to be able to negotiate lower investment fees. There are, however, risks relating to scale which have been studied in the Australian Superannuation system.[73] For very large schemes, whilst allocating assets to investments in private markets, schemes rightly consider liquidity management – their ability to transfer or sell those assets in the event of a merger or acquisition. Investment in different asset types may also be linked to scheme demographics, particularly regarding average proximity to retirement and knock-on liquidity considerations.

82. The Defined Benefit (DB) market holds over 7x the assets of the current trust-based DC market,[74] however this does not prove a good example of how scale can be used to diversify in high growth assets as most DB schemes are closed to new members and are maturing. They have therefore been gradually de-risking their investments, as they have less time to recover from the effects of volatility.

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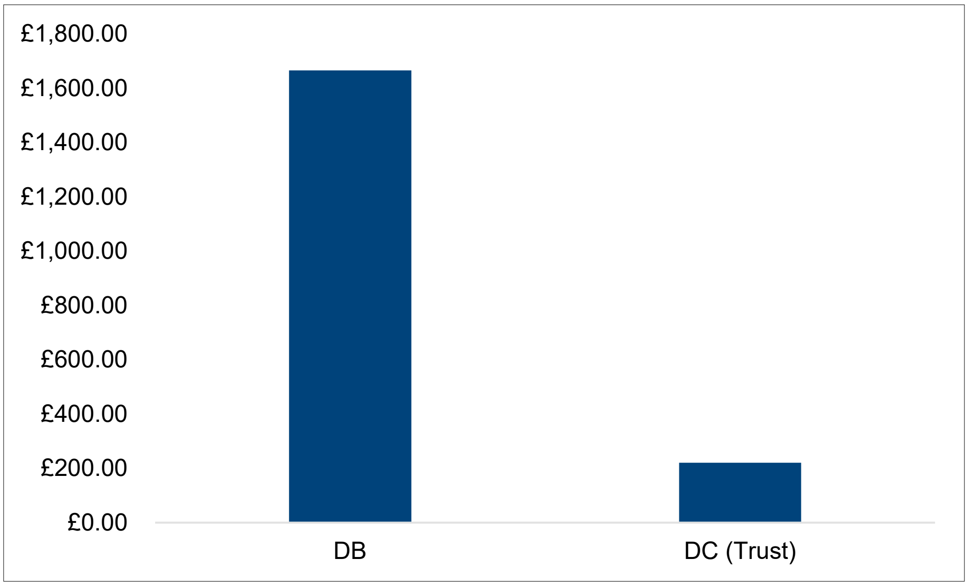
[72] Corporate Adviser, Master Trust and GPP Defaults Report, April 2022

[73] Microsoft Word - Does Size Benefit Super Fund Members - Lawrence and Warren (24 March 2023) (theconexusinstitute.org.au)

[74] Defined Benefit (Purple Book) and Defined Contribution (ONS, Funded Occupational Pensions Schemes)

Figure 15: Private Sector Defined Benefit assets v Defined Contribution assets (trust-based market) 2022[75]



83. This is in contrast to LGPS, an open scheme, which the report 'Investing in the Future: Boosting Savings and Prosperity for the UK' cites as a good example of schemes with scale and long-term horizons investing in productive assets.[76] However, it is important to note that LGPS are not subject to the same market pressures as commercial Master Trusts, with the associated impacts on charges and liquidity.
84. On balance we consider that there is persuasive evidence that schemes operating at a very large scale, with a healthy active membership, are likely to realise scale efficiencies in future, and can be better placed than smaller schemes to create diversified investment strategies, including investments in new asset classes with the associated potential benefits for saver outcomes.

Summary:

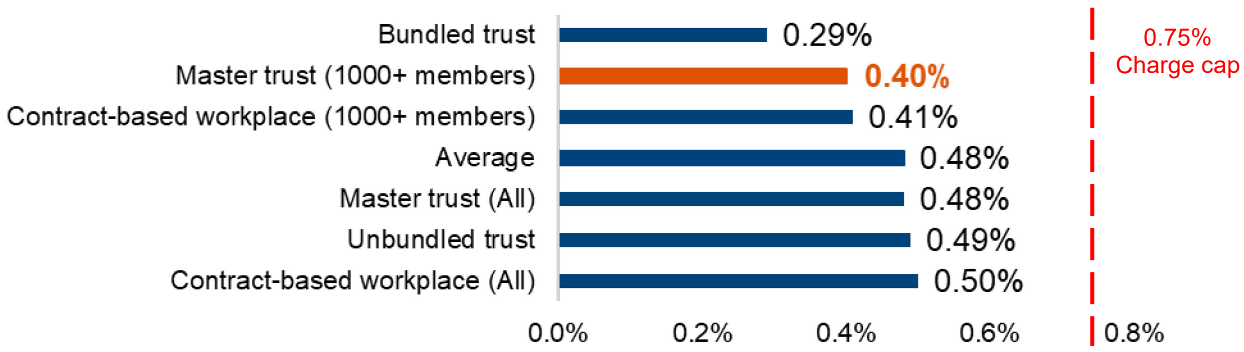
- Master Trusts have different growth strategies, and seek to reduce operating costs through building scale, refining their product offering, and by negotiating with their suppliers (asset managers, third party administrators etc.)
- Active membership is key for creating a steady income stream for Master Trusts.
- Scale can bring a range of benefits to savers and through these benefits can support the diversification by pension schemes into a wider range of investments.

[75] Defined Benefit (Purple Book) and Defined Contribution (ONS, Funded Occupational Pensions Schemes)
[76] Tony_Blair_Institute_-_Investing_in_the_Future_-_Future_of_Britain.pdf (ctfassets.net)

Charges

85. Members in default funds are subject to low charges as schemes are operating well below the 0.75% charge cap. 83% of members in default funds are subject to fees of 0.5% or less.[77]

Figure 16: Average ongoing charge (as a percentage of funds under management) paid by members, by detailed scheme type (2020)[78]



86. An average earner saving over their career could have £3,000 more in their pension pot as a result of moving into a large Master Trust from a scheme with market average charges.[79] While the average annual management charge within a Master Trust with over 1000 members is 0.4%, employers negotiate the charges for their own employees with their Master Trust. During the scaling up period that we have seen over the past 5 years, competition for clients which will help the scheme reach scale quickly, is being almost purely driven by shaving off basis points on charges. Multiple stakeholders from industry flagged this issue at a recent roundtable hosted by the House of Lords, highlighting that employer drivers are based around cost, which is filtering through employee benefit consultancies, who are asking schemes if they can reduce charges further as part of the selection exercise, and that this cost pressure is stifling innovation in investments.[80]

87. A few basis points can impact a members pot a great deal over the course of their savings journey and therefore in isolation, low member charges are positive for members. However, to deliver value, trustees, providers and their advisors should be considering a wide range of investment opportunities that can improve saver outcomes over the long term. A reduced investment budget both impacts on the amount a scheme can spend on investment decision making, and limits their ability to invest in assets with higher charges, which have the potential to produce greater returns. This ultimately impacts on member pots at retirement. As costs are knowable while returns are not, this is a difficult balancing act for trustees.

[77] Pension charges survey 2020: charges in defined contribution pension schemes - GOV.UK (www.gov.uk)
[78] Pension charges survey 2020: charges in defined contribution pension schemes - GOV.UK (www.gov.uk)
[79] Trends in the Defined Contribution trust-based pensions market (publishing.service.gov.uk)
[80] Master trust & GPP round table: The cost of a low-price DC mindset - Corporate Adviser (corporate-adviser.com)

88. Overall, scale can open up opportunities to make more diverse investments by attracting investment managers to create sophisticated investment strategies. However, aggressive price competition could put this at risk, if a high exposure to cheap index funds were the result. It could create a negative feedback loop if there is a knock-on impact on the supply of products and services. If small investment budgets make the UK DC market unattractive to asset managers, there could be more limited investment choices for schemes, potentially limiting performance and increasing investment risk. This risk is contrary to Government's ambition for the market, where greater scale will open a diverse range of investment opportunities for Master Trusts.

89. To address this risk, DWP has already taken steps to encourage more diversified investments by exempting performance-based fees which meet the criteria set out in regulations[81] from charge cap calculations, and through the same legislative vehicle, new requirements are placed on schemes to include their policy on investing in less liquid assets in the scheme's statement of investment principles, the first of which are beginning to be published. From October 2023, trust-based schemes are also disclosing the percentage of assets allocated in the default arrangement to specified assets via their Chair's Statements.

90. By achieving lower charges, it is much easier for trustees and their advisers to reason that it is overall to the benefit of members to move to a Master Trust. For employers too, it is easier to gain buy-in from their employees if they can explain that they will be moving to a new pension scheme, and as a result the employees will pay either the same or less than they are currently paying. Although it may be slightly harder to explain that they feel confident in their choice of scheme as they believe and have been advised that higher charges offer the potential of higher returns due, effective communication by employers to their employees on this point may help further move the dial away from cost and towards value. We would encourage employers to use 'Money Helper', delivered by the Money and Pension service, which offers useful guidance for individuals explaining member charges.[82]

91. We have heard from stakeholders that the decision to consider moving to a Master Trust is a business consideration undertaken by financial directors, and chief executive officers, often based on efforts to reduce the administrative costs of running the scheme. One of the roles of the trustee in these circumstances is to provide due diligence to ensure member interests are protected and as such trustees may not be involved in these strategic decisions at an early stage or be in a position to make a recommendation to the business, as these decisions are largely commercial. This distance has the potential to further remove member value as a consideration.

92. As part of their due diligence in scheme selection, we believe that trustees of single-employer trusts looking to move their scheme should be empowered to challenge Master Trusts on their pricing policies if they feel they could be detrimental to the long-term sustainability of the Master Trust.

[81] The Occupational Pension Schemes (Administration, Investment, Charges and Governance) and Pensions Dashboards (Amendment) Regulations 2023 (legislation.gov.uk)
[82] Pension scheme charges | MoneyHelper

93. The Office of Fair Trading, in its 2013 report on the DC pensions market, highlighted the principal-agent problem within the current system,[83] and though this report was, at that time, concerned with charges, the motivations of employers remain key for member outcomes. As employers look to discharge the burdens of governing and cost of running their own scheme, although the member is seemingly no worse off with the same or lower charges in a Master Trust, we must consider that those members can receive less overall investment in their pension by taking on the admin and investment fees themselves, so it is vital that they are receiving better value for what they are paying. A few employers use this cost saving to further contribute to their employees' pots or may continue to pay the admin charges in the new arrangement, however this is believed to be in the minority of cases and would only apply to current employees.

94. A DWP qualitative research study into employers' views and behaviours on AE and DC schemes in 2022,[84] found that employers who were choosing a pension for their employees considered issues including time and financial resource, the reputation and security of a scheme, value for members and advice or recommendations from outside bodies; and that when switching provider (an uncommon occurrence in those surveyed[85]), value was a priority. Likewise, the DWP Employer Survey 2022 asked what factors the 1,121 employers who offered defined contribution pensions considered, and found the following results:[86]

Table 1: DWP Pensions Employer Survey 2022: What factors did you take into consideration when you chose a pension provider and scheme for your employees? (Responses from employers providing a DC pension): – multiple responses.

	Employers considering this factor
Ease or convenience of the provider/scheme	64%
Advice from a professional body, or formal advice from colleagues/other employers	51%
The fees on the employer	49%
The value for members	49%
The value for money of the provider/scheme on the employer	45%
The fees or costs on your employees	42%
Scheme governance	44%
Investment outcomes	31%

[83] Office of Fair Trading: Defined contribution workplace pension market study, September 2013, OFT 1505. [ARCHIVED CONTENT] (nationalarchives.gov.uk)
[84] Workplace Pensions and Automatic Enrolment: employers' perspectives 2022 - GOV.UK (www.gov.uk))
[85] Over three in four employers (77%) said they hadn't switched pension provider or thought about switching, while almost one in ten (9%) had switched or thought about switching.
[86] Department for Work and Pensions Employer Survey 2022 - GOV.UK (www.gov.uk)

Previous relationship with the provider	15%
Informal advice from friends/family	10%
Other	2%
Don't know	7%

95. These results demonstrate that there are a wide range of issues that employers consider when choosing a pension for their employees, and that value for members, while commonly considered, is one of many considerations. The prominence of employer fees reflects the competitive behaviour we are observing in industry shows. There will also be variation in priorities across employers.

96. We expect that VFM framework assessment results will provide a basis upon which engaged employers can decide which scheme to enrol their employees into and in reviewing whether schemes continue to best fit the needs of their employees. Adoption of a VFM approach will further help move focus away from cost alone and drive improvement by encouraging underperforming schemes to either improve their performance, consolidate, or exit the market. We have jointly proposed, with TPR and the FCA, that there will be instances where mandatory communication of VFM framework assessment results to employers from schemes will be required. When a scheme arrangement is not providing value for money, we have proposed that the employer will be made aware within a reasonable timeframe and will understand what actions the scheme intends to take to either improve the VFM offering or transfer/wind-up in savers' best financial interest. Employers will use their discretion to act in the best interests of their workers and businesses.

Summary:

- Competition to win business from employers is driving employer costs and member charges down (average 0.4% AMC in a Master Trust with over 1000 members).
- Employers should increase their consideration of value, something which the VFM framework will help to combat.
- Trustees should have meaningful involvement in the decision to move pension provider, to enable them to properly critique the offer.
- Competition on cost risks limiting the available budget to spend on making investment decisions and could rule out more expensive investments.
- However, the increasing scale of large Master Trust increases their ability to exert greater control over investments, and access more sophisticated strategies.

Chapter 3: Master Trust Consolidation

97. Significant consolidation occurred within the Master Trust market due to the introduction of the Master Trust authorisation and supervisory regime in 2018. Further consolidation in the market is beginning to happen again. The following acquisitions have all happened in recent years and are in varying stages of the process of being merged with another Master trust.

Table 2: Announcements of Master Trust consolidations post-2021

Receiving/acquiring scheme	Consolidating scheme	Date of announcement
Cushon Master Trust (purchased The Salvus Master Trust April 2020 and launched in January 2021)	Workers Pension Trust	June 2021[87]
	Creative Pension Trust	January 2022[88]
The SEI Master Trust	Atlas Master Trust	October 2021[89]
	National Pension Trust	July 2023[90]
Smart Pension Master Trust	The Ensign Master Trust	October 2022[91] (wound up September 2023)[92]
	The Crystal Trust	July 2023[93]

98. Mergers will occur in the commercial side of the market when schemes no longer feel that they will be able to attain sufficient scale to compete, and they become a target for consolidation from acquiring schemes seeking to increase their market share. In these cases, the scheme funder[94] or the funder's ownership looks to sell the business to see some return on their investment. Master Trust mergers are complex commercial negotiations. Decisions may take a long time to resolve and are likely to have commercial sensitivities. As

[87] Cushon acquires Workers Pension Trust after £26m funding raise (professionalpensions.com)
[88] Here we grow again – Cushon Acquires Creative | Cushon
[89] SEI Announces Acquisition of Atlas Master Trust from Capita | SEI (seic.com)
[90] IR Solutions, Q4 Europe
[91] Smart Pension acquires Ensign Master Trust
[92] Ensign - You're in control | Pension plans for the Maritime Industry (ensignpensions.com)
[93] Smart Pension acquires Evolve Pensions
[94] Then "scheme funder" as defined by the Pension Schemes Act 2017, in relation to a Master Trust scheme, means a person who—
(a) is liable to provide funds to or in respect of the scheme in circumstances where administration charges received from or in respect of members are not sufficient to cover the costs of establishing or running the scheme, or
(b) is entitled to receive the profits of the scheme in circumstances where those charges exceed those costs;

such, we expect consolidation to happen opportunistically, and it is not possible to forecast future consolidation rates.

99. For the independent or non-commercial Master Trusts, consolidation is likely to be for bespoke reasons; for example, schemes which are run by employers with a DB scheme might seek to exit the market if the DB section seeks insurance buyout, and they no longer have the large governance function and scale across the scheme to support the Master Trust. We may see specialist schemes continue to operate even without scale, as there may not be a Master Trust to suit their chosen investments in line with their principles.

100. If the schemes actively pursuing an inorganic growth strategy exhaust such opportunities due to a dwindling pool of commercially attractive Master Trusts, then we may see this consolidation activity slow/halt for a period.

101. For the acquiring scheme, inorganic growth via consolidation brings immediate scale, in some cases close to doubling the size of the scheme by assets in a single transaction. However, it is expected that scale efficiencies will not be fully realised until schemes are fully merged. This process takes some time, but this is not necessarily negative, as it allows changes to the scheme to be made gradually, and employer buy-in to be gained from within the merging scheme. The process of merging two Master Trusts is approached and implemented by schemes in different ways. This can be seen in table 2, where a full merger of the Ensign Master Trust has been completed in under 12 months, compared to other mergers which are still ongoing. Master Trusts may choose to take their time to merge schemes, as they integrate different systems, make new appointments and change the investment strategy of the ceding scheme. But it is in schemes' interest to merge schemes fully, to realise efficiencies and increase their scale.

102. Mergers are large projects and scheme capacity to manage these may be a factor in how often consolidation occurs. But undoubtedly, schemes who have been through this process before will learn from the experience and are more likely to be able to manage this better in future. Indeed, this experience might even form part of their bid.

103. These mergers have, so far occurred towards the smaller end of the market. Should a scheme with tens of billions in assets under management, (as is more likely to be the case as scale increases), with hundreds, or thousands of employers, look to exit the market, the size of this undertaking has the potential to cause disruption in the wider Master Trusts market. The Regime allows for this eventuality, as schemes can be wound up into multiple schemes. However, this is not to say that operationally an exit at that level would not be very challenging.

104. The total cash consideration payable to XPS (sponsor of National Pension Trust) upon completion following regulatory approval is up to £42.5 million, comprising of £35.0 million initial consideration and the potential for up to £7.5 million in addition based on business performance over two years[95]. For this, SEI have purchased a scheme of 60,000 members and £1.5bn in assets under management.[96] At a greater scale, Cushon, themselves an active

[95] IR Solutions, Q4 Europe
[96] Funder Change | National Pension Trust (NPT) (natpen.co.uk)

consolidator, was acquired by Natwest Group in June 2023 for £144m (for 85% of Cushon).[97] We can expect these sorts of prices to increase, as scale continues to grow within the market.

105. Natwest and HSBC both identified opportunities to enter the market, inorganically and organically respectively. Banks have the financial strength to acquire established Master Trusts, and the more recent Natwest/Cushon example highlights the potential appetite within the banking sector to enter the market in this way. Whereas HSBC entered organically, setting up their own Master Trust, and subsequently decided to exit.

106. Organic growth is achieved by winning business from employers (as discussed in chapter 2). Winning this business also has costs attached in using resources to attract new business, and project costs to onboard schemes. Schemes pursuing inorganic growth strategies must weigh up the costs of organic vs inorganic growth, to determine if a purchase is in their best interest, or whether they should pursue organic growth only. This is another reason why large employers represent high value for Master Trusts, as schemes can increase their membership without the full costs of purchasing a scheme.

107. Depending on the circumstances, some mergers may cause a triggering event.[98] The triggering event sets into train a series of actions which give TPR greater oversight and member protection, wherein the ceding scheme must set out an implementation strategy to be approved by TPR, following which, the scheme is required to report regularly to TPR until the triggering event is resolved. For the duration of the triggering event period, the ceding scheme must not take on any new employers, and employer/member communications must be sent out to explain this process.

108. The triggering event and continuity options were designed to manage exits where there was a failure of governance or where the scheme failed to meet other authorisation criteria. The dynamic of the market has now changed, where financially stable schemes are seeking to exit via mergers. To signal that mergers can be positive, there may be a need to investigate whether a new triggering event and/or an additional continuity option is required which more appropriately fits the circumstances of mergers we are seeing rather than the market exits we expected to see when the regime was designed.

109. Likewise, some mergers happen outside of the parameters of the triggering events as set out in the Act meaning there is no formal notification to TPR. For example, where a consolidator purchases the scheme funder of a ceding scheme (usually the entity controlling the scheme), the ownership of the scheme funder has changed but the scheme funder's relationship with the scheme has not changed. TPR remains engaged with ceding schemes to ensure that authorisation criteria continue to be met, but, unless the acquiring entity itself falls within the legal definition of scheme funder (i.e. it is contractually obliged to meet the costs or receive profits directly from the master trust), which brings the merger under a triggering event, TPR have no legislative grip over the acquiring entity in terms of financial sustainability,

[97] Majority acquisition of pensions fintech Cushon by NatWest Group completes | Cushon

[98] Section 21, Pension Schemes Act 2017. Identifying and notifying triggering events | The Pensions Regulator

fitness & propriety and systems & processes. Based on recent operational experience, TPR see this as a key risk which may increase if Master Trusts businesses, once consolidated at scale, are subsequently sold on to other investors – for example, you may have a Master Trust business acting a cross guarantor for significant acquisition debt but with TPR having very little grip over the ultimate owners. This risk, and the fact that regulatory oversight of a merger is almost randomly determined by this arbitrary way of distinguishing the motivation behind a transaction is another reason we may wish to revisit this legislation in due course.

110. As part of the broader regulatory framework relating to financial services sector, any decision to acquire or increase control of an FCA-authorised firm should be communicated to the FCA for the purpose of obtaining prior FCA approval. This means that FCA approval must be obtained prior to a proposed acquisition of an FCA-authorised firm sponsoring a Master Trust. Prior approval must also be obtained from the Prudential Regulation Authority (PRA) where the firm is also regulated by the PRA, who will consult with the FCA as part of their assessment. The assessments are of the suitability of the proposed controller against criteria set out in FSMA.[99]

Conflicts of interest

111. Some trustees have retained appointments to multiple Master Trusts. As the market becomes more concentrated, there is a risk that the influence from those trustees could lead to adverse outcomes. These could include homogeneity in scheme strategies, investments, and could be anti-competitive.

112. Multiple appointments can also occur in the process of a merger, where the ceding scheme's trustees are replaced with the board of the acquiring scheme. The benefits of this are to streamline decision making whilst the merger is underway. However, it could be argued that conflicts of interests could occur if the new trustees are not adequately considering the specific needs and demographics of the members of the ceding scheme.

113. We will work with TPR and others to understand the intricacies of these dynamics, and whether intervention is necessary. This could include TPR developing its guidance on conflict management to ensure these scenarios are appropriately managed, or the inclusion of such conflicts in the assessment of individual fitness and propriety.

Summary:

- Some Master Trusts have been active consolidators, achieving inorganic growth via acquisitions, particularly targeting low-growing schemes.
- It may be necessary to revisit the Regime, to ensure that it appropriately fits the circumstances of current consolidation, and that TPR has oversight of mergers in order to protect members.

[99] Requirements for a change in control | FCA

Consolidation of the single employer trust market

114. The single employer trust market is shrinking at a steady rate. We have progressed from over 3500 schemes in 2012, to 1220 non-micro schemes at the start of 2023.[100] The 'land grab' phase, where Master Trusts are competing for the remaining 1220 single-employer trusts to build scale, is still ongoing. Only 5 years on from the introduction of the Regime the market is not mature in this respect. Master Trusts, through good governance, the reassurance that the Regime brings, and employer cost savings, continue to make the case for moving from single-employer trusts to Master Trusts. This rate has been aided by requirements for more stringent reporting requirements, including reporting aligned to the Taskforce for Climate Related Disclosures (TCFD)[101] and value for member assessments,[102] encouraging schemes with under £100m in assets under management to consider wind up, if they cannot prove good value compared to schemes of over this size.

115. If last year's rate of consolidation of 11% continued, then we would be left with only around 500 trust-based DC schemes by 2030. With Government intending to introduce new regulatory measures, including the VFM framework, we may reasonably expect this rate to increase. TPR's proactive regulatory initiatives on emerging risks[103] may also result in consolidation if trustees are not able to adequately address identified risks.[104]

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[100] DC trust: scheme return data 2022 to 2023 | The Pensions Regulator, see figure 1, and table 1

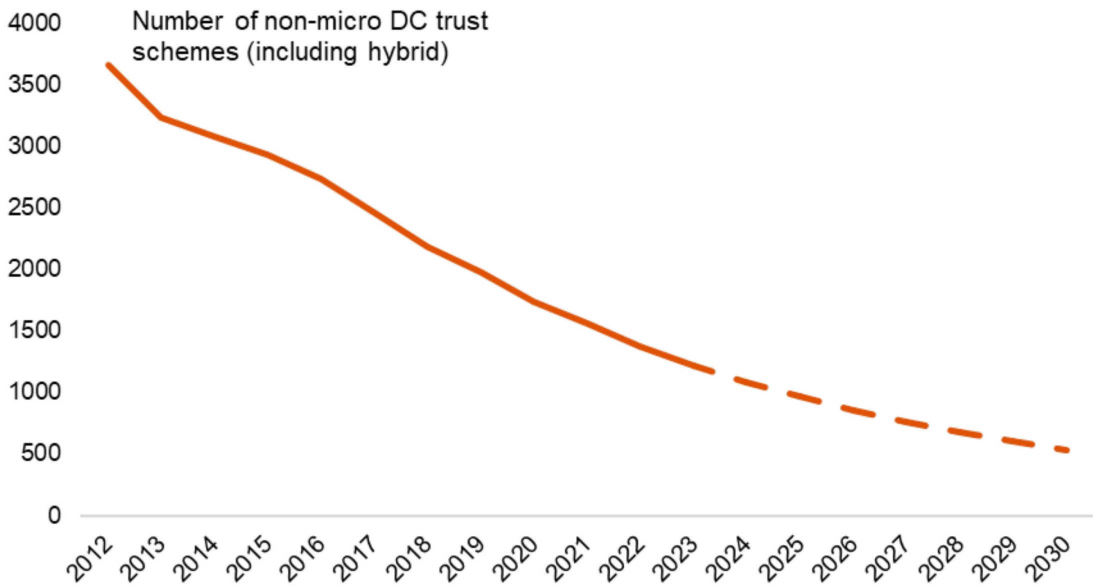
[101] The Occupational Pension Schemes (Climate Change Governance and Reporting) Regulations 2021 (legislation.gov.uk)

[102] The Occupational Pension Schemes (Administration, Investment, Charges and Governance) (Amendment) Regulations 2021 (legislation.gov.uk)

[103] New initiative under way to check savers are getting value from their pensions | The Pensions Regulator

[104] Supervision | The Pensions Regulator

Figure 17: Consolidation of the trust market at the current rate[105]

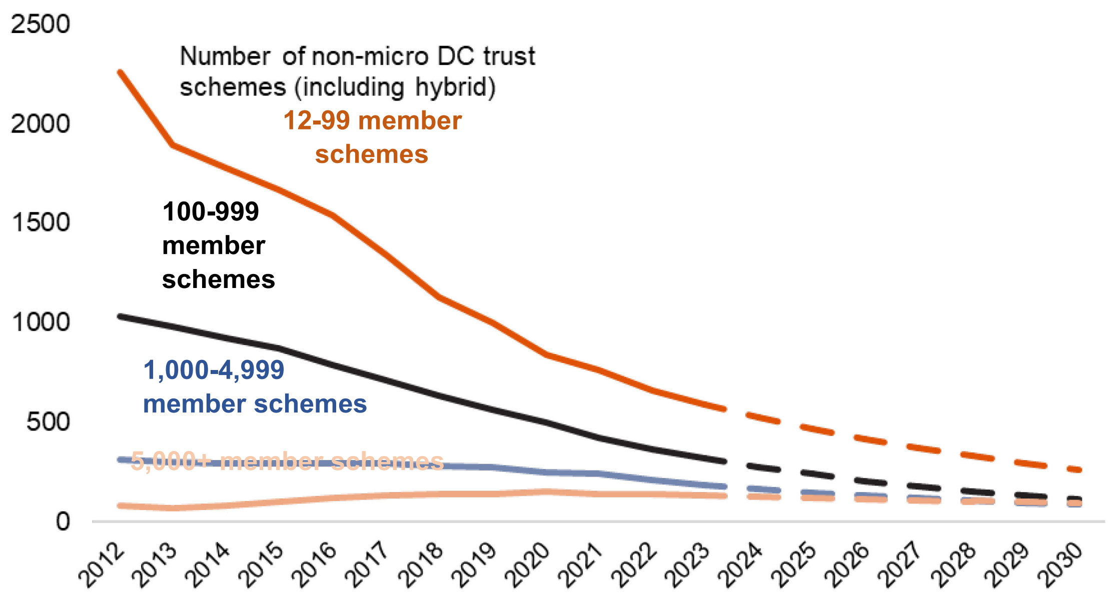


116. The smallest schemes have been decreasing at the fastest rate (see figure 18), in line with the impact of the regulatory measures mentioned. Larger schemes are reducing in number at a slower rate, however they are beginning from a lower base. We might have expected the medium and large sized single employer trusts to move towards Master Trusts at a faster rate proportionally, as competition for these valuable clients is fierce. This would increase assets within Master Trusts at a greater rate. However, these medium and larger schemes are already likely to be much better governed than smaller schemes and more able to cope with regulatory changes and prove better value for money.

117. Conversely, smaller schemes, particularly those with a large, deferred membership, are much less appealing a proposition for Master Trusts, as they are likely to represent less income for schemes, compared to the efforts required to onboard them, and therefore we expect Master Trusts to focus their efforts on larger employers. This may be less of an issue for those Master Trusts who are adept at onboarding schemes and can cope with the capacity. This need to cater for the smaller end of the single-employer trust market continues to demonstrate the structural importance of the 'monoline' schemes.

[105] DWP analysis based on DC trust: scheme return data 2022 to 2023 | The Pensions Regulator. Dotted line shows what could happen if the average consolidation rate over the past three years (of 11% per year) continued.

Figure 18: Decrease in scheme numbers by size of scheme membership[106]



118. The combination of increased regulatory requirements versus the value and potential costs savings to the employer offered by Master Trusts tip the balance further towards wind up. However, there can be barriers to the potential transferring scheme, including project costs. DWP will continue to look at ways of incentivising and removing barriers to consolidation for single-employer schemes who could be better served by Master Trusts.

119. In a single-employer trust, the in-house pensions managers have control over how the scheme is run, something which, upon joining the default arrangement of a scheme, they cede to a large extent. Such single-employer schemes are likely to also be clients of various professional service firms who may also encourage schemes not to wind up in order to retain the business. It may be difficult for employers to give up their control if they feel that their strategy is effective, and therefore may seek a Master Trust which offers more bespoke arrangements. Bespoke arrangements are likely to be found in a Master Trust backed by an insurer (which may also offer bespoke GPP arrangements), an Employee Benefit Consultancy or others, rather than a monoline scheme. But for many employers, the scale, efficiency, and sophistication of strategy of a large default arrangement, especially as these develop over coming years, may be far greater than is possible in their own arrangement.

120. While bespoke arrangements are within a large employer's reach, smaller employers may be less likely to achieve a bespoke arrangement for their own employees with a Master Trust, as they do not have the scale to make them as attractive a proposition and may be faced with higher charges

[106] DWP analysis based on DC trust: scheme return data 2022 to 2023 | The Pensions Regulator. Dotted line shows what could happen if the average consolidation rate over the past three years for each membership size continued.

as a result. In their attempts to win business, Master Trusts will be making the case that default funds with scale, excellent investment governance, and sophisticated investment strategies, can outperform a single-employer's bespoke funds, but we do not understand how far this message is reaching the smaller end of the market. The point has been made by stakeholders that an employer seeking a bespoke arrangement must be confident that it can outperform the default, as they may invite liability should it fail to perform, making the default fund more attractive. It is the job of the intermediary to facilitate discussion on these considerations, and we would welcome their further insight, as well as insight from trustees of single-employer trusts.

121. Whichever Master Trusts are most successful in winning business from single-employer trusts during the continued scaling up period, appetite for consolidation is high, and competition for employers will continue to shape the market. This is not to say that single-employer trusts will cease to exist. The case for larger paternalistic employers providing excellent contributions and other benefits, understanding the needs / priorities and views of their members, managing schemes well, with good returns, can continue to be made for as long as these criteria are fulfilled.

Summary:

- DWP continues to support consolidation of single-employer trusts, where this is in the best interests of members.
- DWP and TPR actions are already helping to facilitate consolidation at the smaller end of the trust market, and competition for business and the benefits of Master Trusts are attracting larger employers too.
- Default strategies within Master Trusts will offer a level of sophistication and efficiency that will be hard to match, and bespoke offerings will have to prove themselves to keep up with large default funds.

Becoming systemically large

122. As scale and the concentration of assets/members increases, TPR and Government must consider the risks arising from schemes becoming systemically large. The larger schemes become the more likely they are to have good governance and continuity plans in place to prevent a scheme failure, but there becomes a risk that schemes are too large to be effectively dealt with within the current framework if an issue arises (it's possible this could be the case because of a large consolidation).

123. The current Regime can cater for the exit of large schemes. Continuity option one[107] allows for members to be transferred to more than one scheme, if it were found that there was not another scheme which could take on the entire membership of a systemically large scheme in wind up.

[107] Section 24, Pension Schemes Act 2017

124. The Regime was established at a time when there were many emergent Master Trusts and it was considered that there would always be another scheme able to take on the business of a failing scheme. Against this background, the threat of deauthorisation was a credible one. However, as schemes get larger the more disruptive deauthorisation would be to the market. TPR will be alert to any schemes attempting to push the boundaries of acceptable behaviour, knowing that deauthorisation would provide massive inconvenience to participating employers and scheme members. With this in mind, it is prudent to consider the tools that TPR has to drive compliance where necessary.

125. In recognising the systemic importance of certain organisations within their sphere of influence, other UK and international regulators place additional scrutiny or expectation on those organisations. We will consider whether such measures are merited for schemes reaching a systemically important scale, and how that should be assessed.

126. We can take learnings from the Australian pension system in terms of scale, where it has been studied that scale must be managed effectively, or coordination issues, diseconomies of scale, reduced flexibility, and reduced competition could be caused.[108] A strong, influential regulator is needed to help manage these risks at a market level, challenging schemes to make sure that members benefit from added scale.

127. With the growth of systemically large schemes, there could be barriers to entry. The HSBC Master Trust entered the market in 2019, later than others, and decided to wind up in 2023.[109] This provides a useful case study for future entrants. The Financial Times, reported that timing, fees and the perception of a bank's experience in pensions had been cited as reasons for its withdrawal from the market. In a market where scale is key, for smaller/new entrants wanting to make impact, differentiating the offering from others will be essential. This is where advances in technology and additional offerings by Master Trusts must keep pace, to prevent losing clients.

Summary:

- Continued consolidation and organic growth may produce schemes of systemically important size. TPR will consider how to define schemes reaching this size, and what additional measures may be needed to protect members best interests.

Interactions with DWP policy

128. DWP current policy, alongside the expansion of automatic enrolment and announcements made at Mansion House in July 2023 and policies

[108] Microsoft Word - Does Size Benefit Super Fund Members - Lawrence and Warren (24 March 2023) (theconexusinstitute.org.au)
[109] HSBC abandons plans for UK pensions business | Financial Times (ft.com)

confirmed at Autumn Statement today, intersect with Government's ambition to see a smaller number of very well run, larger schemes[110], providing consistent returns and value for money.

Value for Member Assessments

129. From 1 October 2021, trustees of all relevant pension schemes, regardless of asset size, are required to calculate and state the return on investments from their default and self-select funds, net of transaction costs and charges. This information must be recorded in the annual chair's statement and published on a publicly accessible website. Where relevant schemes manage under £100 million of total assets and have been in operation for 3 or more years (specified schemes) trustees must carry out a more detailed assessment of how their scheme delivers value for members. The assessment must include a comparison of reported costs and charges and fund investment (performance) net returns against 3 other schemes, and a self-assessment of scheme governance and administration criteria, which are prescribed in the Occupational Pension Schemes (Scheme Administration) Regulations 1996. The outcome of the value for member assessment must be reported in the annual chair's statement and published on a publicly accessible website. The outcome must also be reported to the Pension Regulator (TPR) via the annual scheme return. The value for member requirements reflect the government's expectation that if a specified scheme does not demonstrate good value for members when assessed against the comparator schemes then trustees of the specified scheme should consider winding up the scheme and transferring their members rights to another scheme that does offer good value. TPR are currently running a regulatory initiative to improve adherence with these requirements.[111] In cases where this results in wind up, it is likely that these employers will be considering a move to a Master Trust, which would further increase scale in Master Trusts, as well as having a positive impact for members of these poorly performing schemes.

Pensions Dashboards

130. Pensions Dashboards will enable users to see all their pensions in a single place, and this may lead to increased pot consolidation. However, this relies on very active engagement, and we will take a close interest in consumer behaviour following dashboard use. There may be a commercial incentive for pension providers and schemes to grow their scale by capturing some of this activity. Initial dashboards will not include value for money assessments, but this may be considered in future, as both policies are embedded. Pot consolidation will not be facilitated directly on dashboards, but if dashboards were to include modelling tools which illustrate scheme performance based on value for money assessments in future, this may further drive pot consolidation. If schemes are very successful in capturing assets through pot consolidation, this could have a material impact on their scale.

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[110] Alongside several smaller Master Trusts which will likely be more bespoke offerings in the non-commercial market segment, or smaller commercial Master Trusts with a unique offering and ambition to scale quickly.

[111] New initiative under way to check savers are getting value from their pensions | The Pensions Regulator

Value for Money

131. Working in collaboration with TPR and the FCA, we published the Government-Regulator response to the proposed Value for Money (VFM) framework and regulatory regime consultation in July 2023.[112] The VFM framework is designed to increase comparability, transparency, and competition across DC pension schemes and is part of our strategy to shift the focus from purely costs to a holistic assessment of value for savers. The framework will require default workplace DC schemes to provide standard metrics and follow a consistent VFM assessment approach that will help improve performance and saver outcomes. Underperforming schemes will be required to take immediate action to improve the value they provide to scheme members, or consolidate where this is in the best interests of members.

132. This proposed approach is anticipated to help drive consolidation of the market – both due to schemes winding up following results that they are not value for money, but also due to the competitive pressure that the regime will exert. We expect consultancy services to take reports on value for money into account during the tendering process when schemes are looking for a scheme or provider to move to (some consultancies already have their own models for determining appropriate schemes).

133. Initially, the proposed VFM framework is aimed at the professional audience who oversee workplace default arrangements, such as trustees, managers, providers, and Independent Governance Committees (IGCs). Over time we anticipate the framework will evolve and become more member focused.

134. Trustees, managers, providers and IGCs will be required to report framework metrics and assessment outcomes. This should help to focus attention of areas in which they can improve their value offering. We expect employers to use VFM assessment outcomes when deciding which schemes to enrol their employees into or when reviewing whether schemes continue to provide value for money to their employees.

Deferred small pension pots

135. The consolidation of deferred small pots could also have the potential to impact on the consolidation of schemes. The combining of these pots, which are unprofitable for schemes of all sizes, will improve efficiency across the board, and may make the schemes 'losing' these pots more profitable. The proposed default consolidator model, where a small number of pension schemes/providers will act as consolidators, will see these schemes taking on these deferred small pots, which will grow as other small pots are combined with them, turning the tables on their profitability in time. Although the stock of these pots is relatively low at around £4bn, especially when split across a number of approved consolidators, the flow of small pots is estimated to grow at £400m annually,[113] adding collectively to their scale. A number of the largest Master trusts operating in the AE market already have a significant proportion of deferred pots, and the scale to deal with them. This proposal may also increase profitability for non-consolidators as the current stock of small

[112] Value for Money: A framework on metrics, standards, and disclosures - GOV.UK (www.gov.uk)
[113] Ending the proliferation of deferred small pots - GOV.UK (www.gov.uk)

deferred pots results in annual industry-wide losses of up to £225m,[114] while external estimates suggest that this could rise to a third of a billion pounds per year by 2030.[115]

Trustee knowledge and capability

136. Master Trust trustees are already subject to much greater scrutiny than other trustees. The Regime requires authorised Master Trusts to have at least 3 trustees on their board. Master Trusts need to satisfy TPR that their trustees are fit and proper persons, as defined in legislation, and TPR keeps this under regular review. TPR hold a register of Master Trust trustees so they are easily reachable and can be held accountable. TPR understand that Master Trusts have at least one professional trustee on their board, though this is not a legislative requirement. The further consolidation of the Master Trust market is likely to increase standards of Master Trust trusteeship, as boards seek out the highest levels of professionalism and accreditation to make up their board and continue to improve the diversity on boards.

Decumulation

137. In response to the consultation "Helping savers understand their pension choices", all trustees will be required to offer decumulation services with products to members and develop default solutions, based on the general profile of their members either directly, or in partnership with another organisation.[116] This will include trustees of Master Trusts. We will consider if the Regime needs to be adapted to take into account need to discharge these duties and the criteria to assess a Master Trusts decumulation offer.

Expansion of Automatic Enrolment

138. By removing the lower earnings limit and reducing the age at which eligible employees will be automatically enrolled, more savers will be brought into saving, earlier in their life. When implemented, we estimate over 500,000 new savers will be brought into pension saving through the proposed expansion and increases to workplace pensions of more than £2 billion per year. This will further increase the scale of Master Trusts, as these investments will grow for longer, potentially producing greater returns at retirement. The impact of these measures is most likely to be felt in the monoline Master Trusts, who are most likely to provide pensions for individuals in this cohort.

Reviewing the General Pensions Levy

139. A consultation on proposals for changes to the structure and rates of the General Levy on occupational and personal pension schemes from April 2024, 2025, and 2026 closed on 13th November.[117] Government is committed to reducing the current deficit in the levy, and a remediation plan was put in place in 2020. Master Trusts currently benefit from a reduction in levy rate compared to other scheme types, owing to their relative immaturity and

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[114] Ending the proliferation of deferred small pots - GOV.UK (www.gov.uk)

[115] Small-pots-co-ordination-group-spring-2022-report.pdf (plsa.co.uk)

[116] Helping savers understand their pension choices: supporting individuals at the point of access: consultation response - GOV.UK (www.gov.uk)

[117] The Occupational and Personal Pension Schemes (General Levy) Regulations review 2023 (publishing.service.gov.uk)

structural importance in the success of automatic enrolment. The preferred consultation option (option 3), would see an increase in rates for all schemes by 4% per year, and add an additional premium rate payment for small schemes (with memberships under 10,000), with the rationale that this would allow TPR to focus on regulating fewer, larger schemes, as this may result in market consolidation. It is likely that some of these small schemes may decide to consolidate into a Master Trust, while others may choose GPPs, and individual scheme members may choose SIPPs. We will respond to the consultation in due course.

Lifetime Provider Model

140. DWP has opened a call for evidence to explore whether a lifetime provider model, built to give savers one pot for life, while consolidating past deferred pots, could drive better outcomes for savers and prompt more targeted engagement. This call for evidence also considers what role CDC provision could play under such a model. This is a model with promising attractions, that would also have an impact on the existing AE framework and the employer role, and there are steps that we think would need to be in place before this could be delivered. We will need to carefully understand how this interacts with the Master Trust market, including questions around scale and consolidation, and how member or employer choice might drive or change competition.

Chapter 4: Competition

141. As the long tail of smaller schemes truncates via consolidation into larger schemes, facilitated by the VFM framework, we might expect market dynamics to shift. As we approach this point, Master Trust to Master Trust consolidation activity is likely to increase as schemes which have not reached scale withdraw from the market. Some would argue that the board is already set as active membership is already highly concentrated, and we forecast that this concentration will continue, particularly in larger schemes. But as we have discussed, membership can be increased quickly via inorganic growth.

142. At this point, it is vital that the market does not stagnate, and remains competitive in the interest of members. The Value for Money framework will continue to provide a structure to drive competition across the market. The framework will further the current trajectory of consolidation with Master Trusts likely continuing to focus on winning business from the remaining single employer trusts (which could be around 500 non-micro schemes by 2030), particularly the larger of these trusts as already described. We would also expect to see a larger number of moves between Master Trusts as employers consider the outcomes of the framework.

Moving pension provider

143. Competition will still exist in winning business from new employers, and there is emerging a small ‘secondary market’, where employers move from one Master Trust to another. According to survey data collected by WTW with some of the largest employers, 14% of employers using Master Trusts were

considering moving to a new provider.[118] The motivations for switching may be due to investment returns, employer costs, member charges, better technology, decumulation offerings. Or it could be due to the wider offering of the Master Trust, for example, member apps, financial wellbeing tools and advice, and other savings vehicles.

144. Moving from scheme to scheme is a large project undertaking and comes with associated costs, for legal advice, consultancy services as well as project management. As this is the case it also seems unlikely that employers will move based on very similar costs – we predict that better value, or a more unique offering, will be a larger driver. A DWP qualitative research study into employers' views and behaviours on AE and DC schemes in 2022, found that employers rarely switched their pension provider as they felt it was too difficult a process. The few who had, cited dissatisfaction with their provider's customer service as the main reason, and most employers considered value for members to be a priority when considering switching schemes.[119]

145. The cost of movement between Master Trusts, and level of satisfaction from employers/employees, means that we do not expect that there will be a great deal of movement in the secondary market each year without intervention even when it could be of benefit to savers themselves. A lively secondary market may also impact on liquidity considerations – as schemes try to avoid investing in less saleable assets – which may have a negative impact on investment in productive finance.

146. The strength of a secondary market is also affected by the level of active employer engagement. Larger employers with greater HR functions are likely to be more engaged and keep the performance of their Master Trust under review. As these large employers are the most valuable clients for Master Trusts, competition for retention of these clients may be enough to ensure healthy competition in a much smaller market, something which increased transparency of competition via the VFM framework will help.

Interaction with the supply chain

147. We hope that as consolidation occurs and trusteeship continues to become more professionalised, trustees will expect the best from their investment teams, and actively challenge them to bring them new strategies to remain competitive and improve member outcomes.

148. The increase in scale in the Master Trust market can have downstream effects on service providers. Operational insight from TPR is witnessing that the existence of fewer single-employer DC schemes is leading to some service providers freezing or withdrawing their service offerings. Ultimately this may result in consolidation as single-employer schemes are unable to get sufficient support at a reasonable price. But at the same time, we may see service providers creating partnerships with Master Trusts where each is the preferred provider for the other. Such arrangements may need further investigation to

[118] 2023 Defined Contribution Pension and Savings Report - WTW (wtwco.com)
[119] Workplace Pensions and Automatic Enrolment: employers' perspectives 2022 - GOV.UK (www.gov.uk))

determine their potential effects and whether they need to be considered within the authorisation of the master trust.

149. Currently across commercial Master Trusts, there exists a broad spread of investment managers, administrators, platform providers, trustees, and investment strategies etc. but if the market was to consolidate into a handful of larger schemes then market concentration in these areas has the potential to introduce systemic risk and homogeneity.

Summary:

- In a more consolidated market, it is possible that competition issues could arise. However the VFM framework will mitigate this risk, and competition concerns in the wider market are likely to be alleviated by the strong ongoing competition for single employer trusts, as well as, the emergence of a wider 'secondary market', creating further competition.
- A small secondary market may emerge, creating further competition.
- Large schemes will drive competition in their supply chain, though there are downstream risks if the supply chain becomes too concentrated, or agreements between suppliers cause market distortion.
- New entrants into the market may be unlikely, and entrants would have to provide a unique offering to be successful. It is more likely that new entrants would seek to purchase an existing Master Trust.

Chapter 5: Future regulation and supervision of Master Trusts

150. The Master Trust Authorisation and Supervisory Regime was created to deal with emerging risks, particularly the risks of scheme failure. The Regime sets out a clearly defined pathway for schemes to follow in wind up, and TPR have reported that no scheme has exited in an uncontrolled fashion. There are also a number of processes within the Regime to identify anything which may be cause for concern. For example, significant event reporting and the annual supervisory returns offer a defined pathway for schemes to flag changes within the business which TPR will wish to investigate and consider intervention with emerging risks relating to scheme structure.

151. As we have discussed, although the Master Trust market could not currently be described as mature, TPR are already looking forward and preparing for a more concentrated market with a few very large schemes. The risk of scheme failure in a more mature market will be lower, and, therefore, TPR's approach can manoeuvre from primarily seeking to prevent and mitigate against failure (although this work will of course continue), to a collaborative supervisory approach, challenging schemes to be in a mindset of continuous improvement.

Enhanced Investment Governance

152. In this, TPR will be taking a particular focus on value. We expect that most Master Trusts, given their scale, governance structures, and their additional authorisation and oversight, will be proactive in ensuring their scheme meets 'value for money' metrics. However, the range of investment returns within this market is large, therefore there will be a role for TPR to focus on VFM *within* the Master Trust market, even before the VFM framework is legislated for. Indeed, within their 2021 corporate strategy, covering a 15-year period, TPR set out 5 priority areas, one of which was value for money, and another of which was scrutiny of decision making.[120]

TPR will enhance the existing supervision of investment governance in Master Trusts.

- As part of an enhanced focus on investment governance TPR will build on the current provision of investment data, seeking an increased flow of more timely investment information. This will enable TPR to closely review the changes to strategies understand trends in investment, building a market-wide picture and allow TPR to intervene to warn members at timely moments.
- This information will be used (alongside information already gathered) to drive better performance by challenging schemes at key moments, including: how decisions are made and the expertise on trustee boards, and prompt schemes to consider their strategy if they are underperforming relative to others in the market, and focus on continuous improvement.
- TPR will evaluate this strategy and explore further with DWP whether any legislative changes may be necessary in future to support this enhanced level of scrutiny.

153. TPR as an independent regulator will make a further statement on implementation of this approach, in due course.

154. The framework for collective defined contribution (CDC) schemes, spelled out directly that TPR would provide greater scrutiny over investment governance in those schemes.[121] In shifting to a greater focus on value, TPR intend to adopt a similar approach in their supervision of Master Trusts through existing regulatory powers, and ensure it gathers up to date insightful information, allowing more meaningful, and regular conversations to take place. This information will give TPR a market-wide picture enabling them to probe how decisions are made, and prompt schemes to consider their strategy if they are underperforming relative to others in the market.

155. This information will also give TPR insight into market-wide emerging risks. The spike in the bond markets in autumn 2022 demonstrated that exposure to bonds in pre-retirement strategies were arguably not being given

[120] Corporate Strategy Pensions Future | The Pensions Regulator
[121] TPR Code of practice: Authorisation and supervision of collective defined contribution schemes. August 2022. Investment | The Pensions Regulator

full and proper consideration by DC schemes. While the rise in Gilt yields was rapid, had TPR had access to timely investment information and been able to assess how Master Trusts were managing duration, it may have been in a better position to sound warning bells of approaching danger to members, and to question schemes on their strategy at a timely moment.

156. We do not wish TPR to cause herding towards the mean or to encourage short-termism, so this scrutiny of investment strategies is likely to ask schemes to describe how their investment strategies are beneficial for their unique membership, acknowledging that multiple schemes exist to cater for different demographics. This may also include questioning the relationships between trustees and their investment teams, asking how trustees provide effective challenge to drive better outcomes.

157. We expect trustees to be active decision makers, and to challenge investment teams to produce value-based investment options for them to choose from, not simply to approve the strategy that is presented to them. As such, TPR will also expect to see suitable levels of knowledge on trustee boards regarding investments and will expect Master Trusts to put in place investment committees, if these are not already present.

158. Given the importance of the role of the Chief Investment Officer at a Master Trust, it may also be necessary to extend the fit and proper test to the person holding this role, and to ensure that person is appropriately experienced.

Additional measures

159. Also contained within the legislation for CDC schemes is the inclusion of risk notices,[122] where TPR are able to issue a notice to trustees about matters of concern which, if left to deteriorate, are likely to lead to the breaching of authorisation criteria. This pre-emptive step requires a resolution plan to be submitted and implemented, allowing time for issues to be rectified, and thus mitigating the risk of TPR having to withdraw a scheme's authorisation, which may not be in the best interests of scheme members. The inclusion of this mechanism within the Regime may be even more important as schemes reach systemically important size, as de-authorising them becomes a more complex task.

160. Given the increasing income streams and projected future growth of Master Trusts, it may be appropriate to address whether the current level and application of penalties within the Regime, and the wider powers available to TPR, remain an appropriate deterrent, to ensure that members are adequately protected.

161. Against these proposals of tightening regulatory grip, we will also consider whether the Regime should be made less onerous where consolidation is taking place. The existing provisions regulating the wind-up of a Master Trust may not work effectively, leading to attempts to work around regulation, rather than in the spirit of it. Any proposals would ensure that

[122] Section 29, Pension Schemes Act 2021.

members remained protected but provided Master Trusts with a more efficient consolidation process.

162. As the market further consolidates, we will bear in mind whether it is appropriate to lift the ban on pre-agreements to allow new market entrants the best opportunity to build scale with unique new offerings, setting a challenge for established Master Trusts to retain employers through excellent performance and service.

163. In the movement from traditional single-employer trusts to Master Trusts, the market has become more commercial and Regulators must be able to act where the incentives of a commercial Master Trust are not aligned with the interests of members.

164. Where Master Trusts are sponsored by an FCA-authorised firm, such as an insurer, the firm must meet minimum standards of conduct under FCA rules including, where relevant, the Consumer Duty. Where it applies, the Consumer Duty requires firms to act to deliver good outcomes for retail customers, including members, even where the firm does not have a direct client relationship with them but can determine or materially influence their outcomes. We will continue to work with the FCA as the Master Trust Regime evolves.

165. Proposals requiring legislation would be taken forward when Parliamentary time allows, subject to any statutory consultation requirements.

Conclusion

Recommendations:

TPR:

- Will adopt a collaborative supervisory approach, which will focus on value and continuous improvement.
- As part of an enhanced focus on investment governance TPR will build on the current provision of investment data, seeking an increased flow of more timely investment information. This will enable TPR to closely review the changes to strategies and to understand trends in investment, building a market-wide picture and allow TPR to intervene to warn members at timely moments.
- This information will be used (alongside information already gathered) to drive better performance by challenging schemes at key moments and will include challenging how decisions are made and the expertise on trustee boards, and prompting schemes to consider their strategy if they are underperforming relative to others in the market, focussing on continuous improvement.
- Will evaluate this strategy and explore further with DWP whether any legislative changes may be necessary in future to support this enhanced level of scrutiny.

- Will expect that trustee boards have appropriate levels of expertise in investments.
- Will work to define and identify schemes reaching systemically important size and consider what additional oversight these schemes may require.
- Will consider how to mitigate against potential conflicts of interest arising from multiple trustee appointments.

DWP:

- Will support TPR in its focus on value, enhanced investment governance and forward-looking strategy, and will consider legislative changes if necessary.
- Will keep under consideration and may further explore changes to the Regime which have been highlighted through this work. This may include:
    - Amending the Regime to consider market withdrawal in the cases of mergers and acquisitions, ensuring that the Regime is appropriate for these circumstances, and that TPR have proper oversight.
    - The addition of the Chief Investment Officer to the list of persons who are required to undergo a 'fit and proper' persons check.
    - The addition of risk notices as part of the Master Trusts Regime.
    - The removal of pre-agreements in tightly prescribed circumstances, to promote further market competition, if necessary.

As scale in the market is built and the VFM framework is embedded, we intend to work with TPR to understand competition in the market and any further emerging risks resulting from scheme size.

166. Government and the regulators, both the FCA and TPR are aligned in their commitment to ensuring that the pensions market works in the best interests of savers. We will continue to strive for competition within the market to protect members through effective regulation and supervision, to champion good practice and encourage new ideas which will drive better member outcomes. TPR and the Government are in unison in envisaging a more interventionist, influential, involved approach from TPR in relation to Master Trusts in order to see these objectives achieved.

167. Scale is, and will continue to be achieved within the Master Trust market - through continuing contributions, more employers choosing Master Trusts, and through further consolidations. Market dynamics are at work and there is already a high concentration of membership and assets within the largest schemes. DWP analysis showing that the size of the market could reach £420bn by 20230 in real terms and that approaching 80% of all DC members could be in schemes of over £30bn (subject to market volatility and policy changes)[123]. All these signs point toward a positive picture for members as schemes members realise efficiencies and take advantage of economies of

[123] Trends in the Defined Contribution trust-based pensions market (publishing.service.gov.uk)

scale. But this is not to say that improvements cannot be made, or that new risks relating to scale will not emerge.

168. The market could increase at an even steeper incline with the right focus on value. Cost is important, it is why Government introduced the charge cap - a few basis points on the charge cap have a significant effect. But members are paying for their funds to be invested and a reduction in the amount which is able to be spent on investments introduces the risk of poor value. If better returns can be found by increasing the diversity of investments, eclipsing an increase in cost, then it should be easier for trustees to pursue that strategy.

169. This obstacle is not easy to overcome and is in part built into the employer-choice model of our system. The value for money framework, combined with enhanced investment governance by TPR has the potential to continue to improve this issue. But nobody could argue that using defaults and therefore creating this tension has not been superior for member outcomes than member choice, when it has achieved so much in getting millions more saving. 94% of Master Trust members are in the default fund,[124] now the task is to maximise those savings for the retirements of those millions of members.

[124] 20230926-the-dc-future-book-9-2023.pdf (pensionspolicyinstitute.org.uk)