Response to the master trust consultation document from the

Irish Association of Pension Funds

iapf

representing pension savers

IAPF Response to Pensions Authority Consultation on the regulation of defined contribution master trusts

Introduction

We welcome the consultation and the opportunity to contribute. We believe that Master Trusts have the ability to play an important part in pension provision in Ireland. The Authority has been clear that it favours the consolidation of smaller schemes into Master Trusts and that there is appropriate regulation and protection for members. However, in ensuring appropriate protection for members, there needs to be a balance that allows Master Trusts to set up and operate. We have some concerns that the proposals may not allow that.

It would appear that regulation is moving in a direction that will make it more difficult for smaller schemes to continue to operate on a stand-alone basis. It is important that schemes that cannot continue on that basis have an appropriate alternative in place. If Master Trusts are not available to them the alternatives are individual contracts which have tax disadvantages and, often, higher charges or waiting until auto-enrolment. Neither of these deliver the better outcomes for members that the Authority is trying to achieve.

Where appropriate Master Trusts do exist, and the intention is to consolidate smaller schemes into those, there should be a streamlined process that allows the transfer of members and benefits.

The particular issue is that currently there is no procedure under Irish law for either merging in a scheme to another scheme or transferring deferred members between schemes without winding up the transferor scheme.

It should also be recognised that Master Trusts don't automatically lead to better member outcomes. In stand-alone schemes, employers will often pick up administration and other costs and the only costs being paid by the members will be the investment management charge. In a Master Trust these will often be bundled together into one overall charge and the members will effectively pay all of the costs. Stand alone schemes also have the ability to develop investment and communication strategies that can be tailored to be appropriate to their particular cohort of members. This is more difficult in a Master Trust which is likely to have a much more diverse membership. Master Trusts should have the ability to cater for those employers who want a more favourable charging structure for their employees or tailored strategies.

We are aware that similar regulation has been implemented in the UK following specific issues that arose with the operation of some Master Trusts and a general acceptance that there were too many in operation to be feasible. We are not convinced that the same level of regulation is required at the outset and, with a much smaller market, we do not envisage a large number of Master Trusts applying for authorisation in Ireland.

Risks particular to Master Trusts

The consultation paper does not differentiate between those master trusts which are run for profit and those that aren't, despite this being used as the rationale for greater supervision and rules. We believe that the Authority should consider whether all of the requirements should apply to "not for profit" Master Trusts in the same way as "for profit" Master Trusts.

The paper refers to Master Trusts and single employer schemes, although the definition of a master trust refers to schemes involving unrelated employers. Many schemes will have more than one employer e.g. where subsidiaries or related companies are involved, so it is important to be clear on what is and isn't included. There may also be other schemes where the employers could be deemed to be related e.g. all in the same industry and it is unclear if these will be Master Trusts under the definitions proposed. In any case, it is important that schemes do not inadvertently become Master Trusts because of the wording of legislation or regulations.

Master Trust requirements - trustee

The paper states that the trustee must be incorporated as a designated activity company with the sole object of being a trustee of one, and only one named Master Trust. It is not clear why this is the case. Currently there are no restrictions under Irish law on trustees being involved in more than one pension scheme.

The consultation appears to assume that the trustee is the driving force behind the establishment of the Master Trust. This is unlikely, and it is more probable that the funding is going to be provided by a founder or sponsor entity which will be establishing the Master Trust on either a commercial or non-commercial basis. This entity would be the "settlor" in traditional trust law terms. The UK regulations have specific conditions applying to the scheme funder. This does not need to happen in Ireland, but any Irish regulations should be flexible enough to recognise that the founder may have a significant role.

There should also be scope for a different trustee structure where the master trust is not for profit. For example, industry wide schemes will often have representatives of the employers and trade unions or worker representatives for that industry as part of the trustee group.

Master Trust requirements - capitalisation

The costs of a wind-up can be significant and don't necessarily reduce pro rata because of greater scale. The trustees could have significant amounts of capital tied up in order to cover an event that might not happen. This might make the prospect of setting up a Master Trust uneconomic.

As indicated previously, it is unlikely to be the trustees that will have access to capital and therefore the capitalisation requirement may need to be met via one of the other parties. The requirement to have access to sufficient additional capital should be able to be satisfied by having an enforceable guarantee from a founder, a contingent asset or other instrument in place. We think the consultation document envisages this, but we are noting it for avoidance of doubt.

Master Trust requirements – conflict of interest

Greater clarification is required on the statement that "Any contractual conditions binding the Master Trust to particular service providers would be prohibited". We presume this to mean conditions that would absolutely and irrevocably bind parties. However, it is difficult to see how a Master Trust can be established if there cannot be some form of normal service level agreements in place between the various parties involved such as the trustees, administrator and investment manager. In order for such an arrangement to be developed, there would need to be some expectation that it would be in place for a defined time period. If this is not possible it is difficult to see how any party would be in a position to put the necessary capital together, particularly as it is likely to be some time before there is any return on that capital.

In a non-profit master trust scenario, the trustees may well want to negotiate preferential terms with the particular service provider in return for some form of minimum contractual term (with the usual overrides). For instance, the CPA in the proposed AE Strawman will need to balance the need to offer a minimum contract term to the chosen investment/administration providers, to incentivise them to offer the most preferential charging terms for their services, with the desire to have a retendering process at some point in the future.

Master trusts may have a similar trajectory, whereby the service provider will offer preferential terms which would be potentially loss making in early years, but move into profit in later years.

Master Trust requirements – member/employer communications

As Master Trusts will involve many employers, it is important that technology can be used to ensure the most effective communication means possible. This is particularly important as there is going to be a different relationship between the employer, trustees and members than in a stand-alone scheme.

It is difficult to see how an annual meeting can be practical in any way and will only lead to additional costs for little or no benefit.

Master Trust requirements – charges transparency

There should be an ability to have different charges for different employers where, for example, the employer wants to pick up the administration costs.

Master Trust requirements – new members

Presumably the requirement that the trustees must give consent to the enrolment of new members is at a participating employer level and not for each additional new member.

Summary

We believe that Master Trusts are likely to play a big part in the pensions landscape in the future and therefore agree it is important that they are regulated in a manner that provides security, fairness and simplicity for members. We would be happy to discuss any of the issues raised in the consultation and our response in greater detail.

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