PENSIONS POLICY INSTITUTE

PPI

Executive Summary

Financial sustainability of master trust pension schemes

The Pensions Policy Institute (PPI)

The PPI is an educational, independent research organisation with a charitable objective to inform the policy debate on pensions and retirement income provision. The PPI's aim is to improve information and understanding about pensions and retirement provision through research and analysis, discussion and publication. It does not lobby for any particular issue or reform solution but works to make the pensions and retirement policy debate better informed.

The PPI is funded by donations, grants and benefits-in-kind from a range of organisations, as well as being commissioned for research projects.

Pensions affect everyone. But too few people understand them and what is needed for the provision of an adequate retirement income. The PPI wants to change that. We believe that better information and understanding will lead to a better policy framework and a better provision of retirement income for all. The PPI aims to be an authoritative voice on policy on pensions and the provision of retirement income in the UK.

The PPI has specific objectives to:

- Provide relevant and accessible information on the extent and nature of retirement provision
- Contribute fact-based analysis and commentary to the policy-making process
- Extend and encourage research and debate on policy on pensions and retirement provision
- Be a helpful sounding board for providers, policy makers and opinion formers
- Inform the public debate on policy on pensions and retirement provision.

We believe that the PPI is unique in the study of pensions and retirement provision, as it is:

- Independent, with no political bias or vested interest
- Led by experts focused on pensions and retirement provision
- Considering the whole pension framework: state, private, and the interaction between them
- Pursuing both academically rigorous analysis and practical policy commentary
- Taking a long-term perspective on policy outcomes on pensions and retirement income
- Encouraging dialogue and debate with multiple constituencies

This report has been authored by:

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John has been the PPI's Senior Policy Analyst since 2008. In his time at the PPI John has worked in a lead role in the modelling of a wide range of projects including looking at public sector pensions and pension related tax-relief.

At the PPI, John is responsible for the PPI's Pension Facts and has authored briefing notes and reports on subjects such as how housing wealth can support retirement, tax policy on pension schemes, harnessing pension savings for debt alleviation, public sector pension reforms.

John joined the PPI in 2008 from Hewitt Associates. At Hewitt he worked primarily on modelling of standard and non-standard Defined Benefit pension scheme calculations for the consultants to present to the clients.

Prior to joining Hewitt John worked for the Government Actuary's Department for 8 years in the Occupational Pensions directorate, during which time he calculated public sector pension scheme valuations, bulk transfer values, and designed models for the use of other Government departments.

Sponsorship has been given to help fund the research, and does not necessarily imply agreement with, or support for, the analysis or findings from the project.

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Automatic enrolment has led to a rapid increase in pension savers, with more than 10 million enrolled since its introduction in 2012. Master trusts have been created to meet this increased need for pension provision. Setting up a master trust is a capital-intensive venture, requiring professional advisors, systems for processing contributions, fund management, administration and marketing. In order to achieve financial sustainability, master trusts must ensure that they are able to cover both initial start-up costs, and loan repayments in cases where start-up capital has been borrowed, as well as ongoing costs associated with running the scheme. While a scheme's chosen charging structure impacts individual members, it also affects the financial sustainability of the scheme more broadly, so careful consideration must be given to ensure that this is appropriate for expenditure needs.

The greatest challenge to the financial sustainability of master trusts is the need to cover initial start-up and running costs until levels of membership and assets have grown sufficiently

There are significant costs associated with setting up a new pension scheme, as well as ongoing running costs, which can be more challenging to cover in the early years of the scheme while pot sizes are small. In order to meet costs during the period before the scheme income is sufficient, the master trusts will rely on financial support from other sources. If initial capital is provided as a loan, then servicing of that loan through regular payments is required as set out in the terms of the loan and is a cost to the scheme. These repayment cashflows also need to be met from future charges, alongside the ongoing costs of the scheme. Master trusts set up by an existing pension provider may benefit from existing administration and IT systems, while master trusts set up from scratch generally face higher initial start-up costs. As a result of concerns about the business models of some of the master trusts and the resulting impact on the schemes' financial sustainability, the Government introduced an authorisation regime.

Master trusts’ annual expenditure has been growing year on year, with cumulative expenditure around £1 billion by 2019 and costs expected to continue to grow

Chart Ex.1
Cumulative investment into the four largest master trusts may be at around £1bn by 2019

Annual costs of setting up and running the largest 4 master trust pension schemes (£millions)

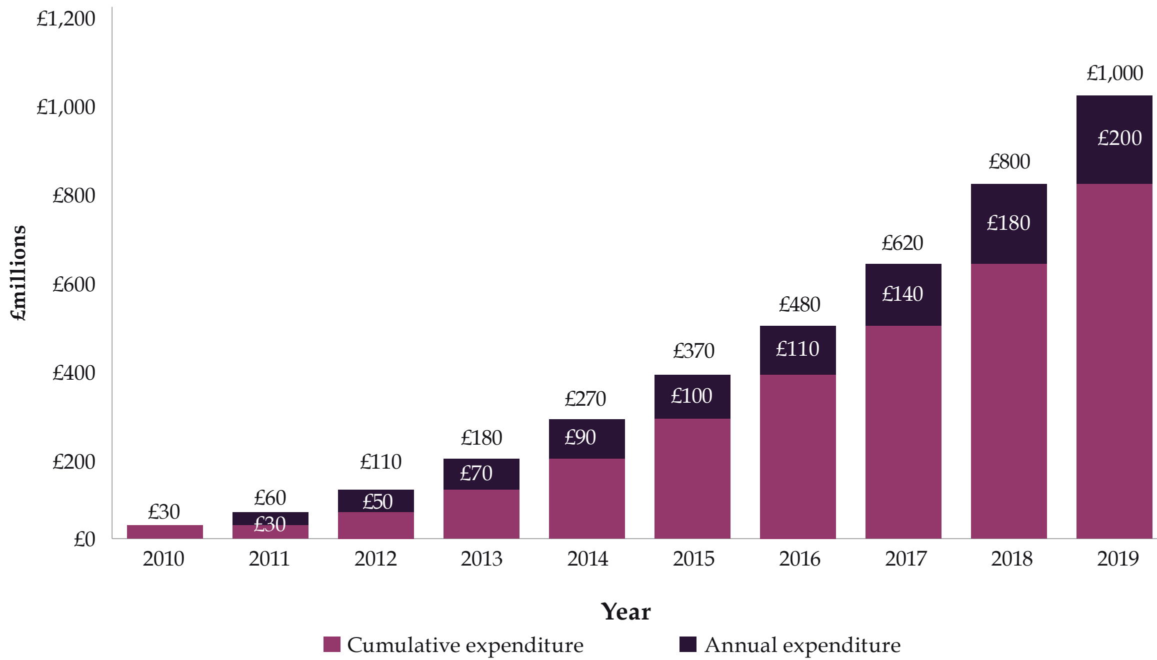
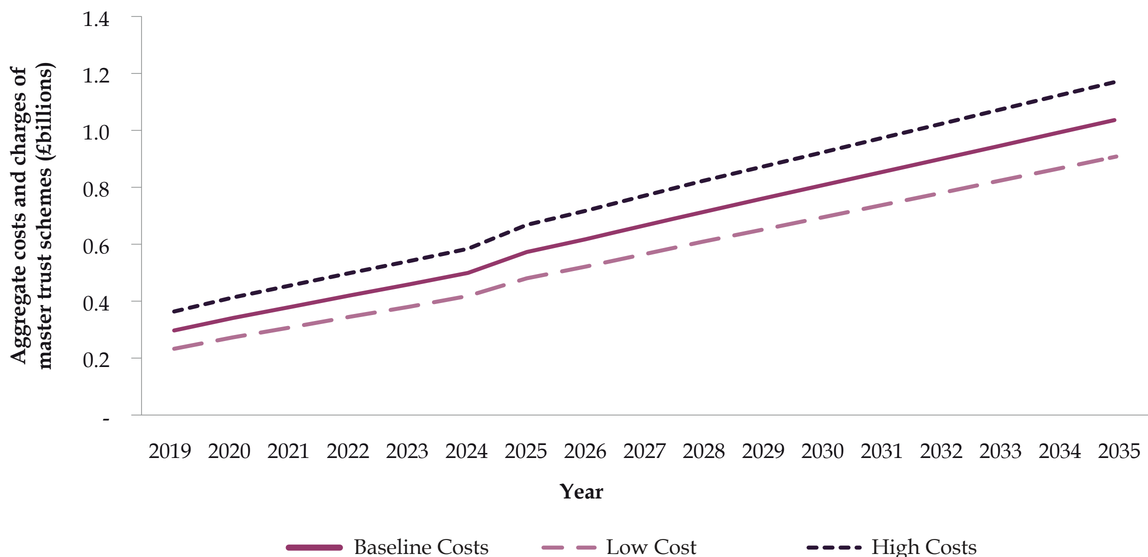


Chart Ex.2
Costs of master trust schemes are increasing in earnings terms

Projection of costs of master trust schemes (£billions in 2020 earnings terms) under high, baseline and low cost scenarios



The master trust industry is unlikely to achieve breakeven on costs until around 2025. Thereafter, the industry may generate annual profits which will accelerate as the funds under management grow. However, in reality there may be some reduction in the profits as providers seek to achieve a competitive advantage by reducing their charges, while still having a large enough pool of assets under management to achieve a profit from the charges.

There are a number of known future challenges which are likely to impact master trust costs moving forward

- **Pensions dashboards:** Data cleansing exercises necessary for the implementation of pensions dashboards are likely to present additional costs for master trusts, both on an immediate and ongoing basis. While the cost of dashboards to the master trust industry is difficult to accurately predict, the Department for Work and Pensions' estimates in the Pensions Bill 2020 Impact Assessment suggest large schemes would face implementation costs of around £200,000 each. For medium size schemes, implementation costs are calculated to be around £75,000 each, along with having to share the cost of £100,000 per administrator. Over the longer-term, this may be offset by lower costs in other administrative areas as a result of higher quality data.
- **Deferred members:** Small pots belonging to deferred members are likely to become an increasingly important issue as job mobility continues to grow. While active pots are more continuously administered as new contributions are regularly received and allocated, deferred pots present their own administration issues as a result of inefficiencies in administering multiple pots for the same person or maintaining contact with an individual without having a current employer to provide contact information. Schemes with a greater proportion of pots belonging to deferred members may experience costs that are particularly high relative to their assets under management, as these pots tend to be small and do not grow with ongoing contributions. Without policy change, the number of deferred pots in master trust schemes could grow from 8 million to 27 million by 2035.
- **COVID-19:** While the full impact of COVID-19 on pensions is not yet certain, reductions in overall contribution levels as a result of increased unemployment and volatility in the stock market are likely to impact master trusts' income from charges, at least in the short-term.

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