ABI response to DWP Consultation Paper *Occupational Pension Schemes (Master Trusts) Regulations 2018*

12 January 2018

About the Association of British Insurers

The Association of British Insurers is the voice of the UK's world-leading insurance and long-term savings industry.

A productive, inclusive and thriving sector, we are an industry that provides peace of mind to households and businesses across the UK and powers the growth of local and regional economies by enabling trade, risk-taking, investment and innovation.

Executive Summary

1. This consultation response provides an overview of the Association of British Insurers position on the Department for Work and Pensions (DWP) draft Occupational Pension Schemes (Master Trusts) regulations 2018.

2. A number of insurers offer Master Trusts to members, alongside other business lines, either as well as, or instead of group personal pensions (GPPs). Insurers currently manage risks across a number of product lines, and all operate under stringent Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) regulation.

3. The ABI welcomes the opportunity to respond to this consultation, having previously called for tighter regulation of Master Trusts. We believe that providers of Master Trust schemes used for automatic enrolment should meet high solvency and reporting standards. However, we are concerned that some of the regulation requirements, as currently drafted, will introduce duplication of other regulatory regimes and, as such, additional cost and over reporting burdens for ABI members with little to no benefits to member protection. In particular, the Regulator's assessment of a scheme's financial sustainability should take account of the financial strength of insurers acting as scheme funders subject to the capital requirements of the Solvency II regime.

4. Another key concern that has not been directly addressed by the consultation questions is in regard to the proposed one-off authorisation fee. The ABI does not believe that a two fee system, or a smaller fee for new schemes, has been justified. Furthermore we believe that the level of the fee currently posed will have a detrimental impact on small legacy schemes, and that the likely impact will be disproportionate to the risks posed by these schemes.

5. We believe an appropriate solution would be to exempt Master Trusts run by insurers from the regime within the regulations, as enabled by section 40(1)(b) of the Pension Scheme Act 2017, if they meet the following criteria:

   - The scheme sponsor is authorised by the PRA to carry out regulated activities as a life insurer and:

- The relevant Master Trust is not used as a qualifying scheme for the purposes of automatic enrolment.

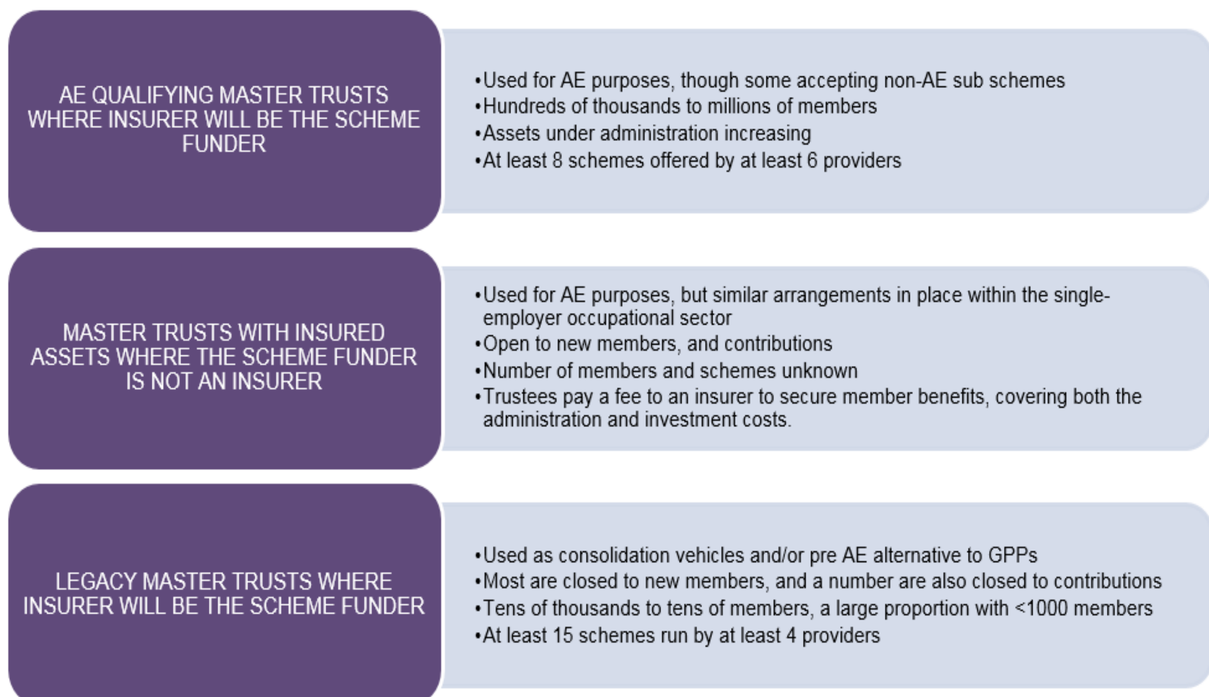
6. This response addresses issues by theme, as opposed to addressing the individual questions posed in the Consultation Paper, in order to provide the necessary context.

Background

The role of insurers in the Master Trust sector

7. Insurers currently undertake three key types of activity in the Master Trust sector, as summarised in the figure below.

Figure 1: *Summary of activities of insurers in the Master Trust sector*



8. Both the Pensions Schemes Act 2017 and the DWP's proposed regulations primarily focus on Master Trusts that are used as qualifying schemes for automatic enrolment, reflecting the significant growth in the number and assets under managements of these schemes since the roll-out of the Automatic Enrolment Programme commenced. Most of these Master Trusts do not have insurers acting as either scheme funders or service providers, and therefore are not currently actively regulated by the PRA or the FCA. We believe that providers of Master Trust schemes used for automatic enrolment should meet high solvency and reporting standards, and it was for this reason that we have previously called for tighter regulation of Master Trusts.

9. A number of insurers provide a Master Trust as an option for employers alongside GPPs, as an alternative for employers who prefer this legal structure. Where the scheme funder is an insurer, the trustees would typically use the same insurer's administration and investment services, although this is not mandatory.

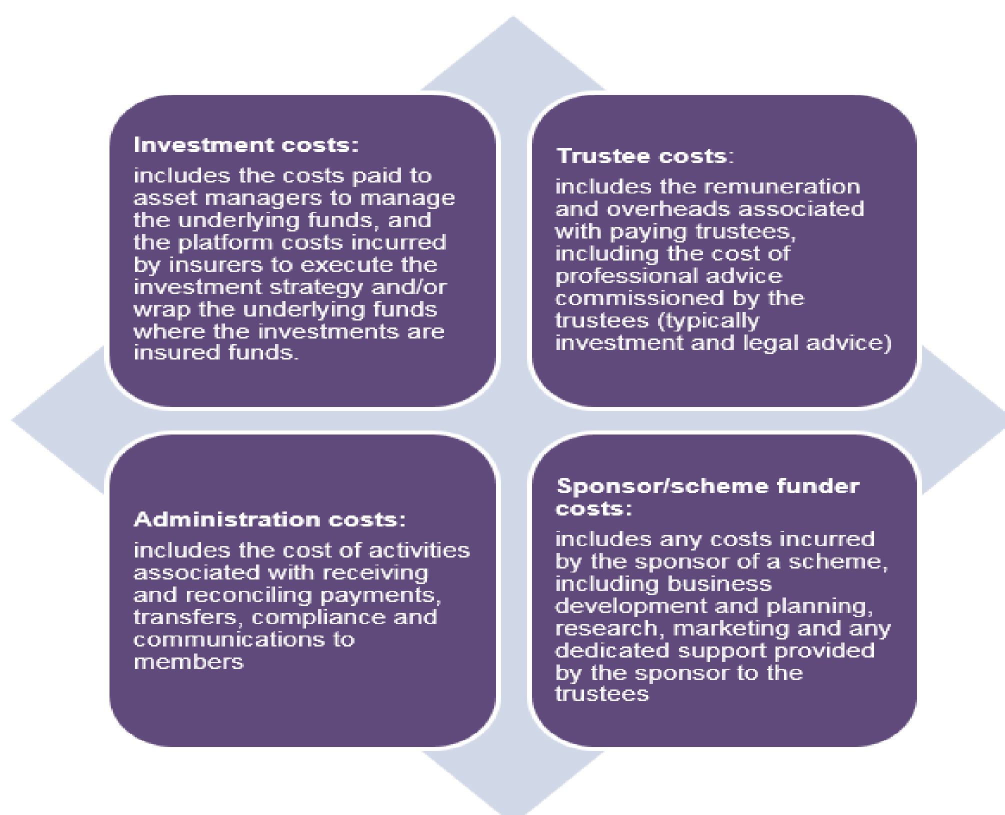
10. In some instances, insurers will also act as service providers, where another not-for-profit or commercial entity is the scheme funder. In this instance, the trustees will pay a fee to an insurer to secure member benefits, covering either the administration and investment costs, or both. This arrangement is also common for single-employer occupational schemes, of an occupational schemes.

11. However, a number of Master Trusts currently in existence pre-date the creation of the Automatic Enrolment Programme. We are aware of at least 15 such schemes, run by at least four insurers. Most of these schemes have a relatively small number of members, are largely closed to new members, and a number are also closed to new contributions. The impact of the regulations on these schemes is discussed further in the sections below.

Costs associated with running a Master Trust

12. The costs associated with running a Master Trust can be broadly split into four categories, as summarised in Figure 2, below.

Figure 2 *Costs associated with a Master Trust*



13. The extent to which these costs are covered by Solvency II, and the way in which they will need to be reflected in the business plan, will depend on whether an insurer is the sponsor of the scheme, or is acting as a service provider to a Master Trust where the scheme funder is not an insurer. It could also depend, to a lesser degree, on the legal structure of individual insurers. These issues are discussed further in the sections below.

Q1. ***The scope of the authorisation regime is intended to ensure that multiple employer, mixed benefit schemes are captured and that the members are protected by existing pension legislation in respect of any defined benefits and by the Master Trust authorisation regime in respect of any money purchase benefits. Do the disapplications undermine this intention?***

Q2. ***For all the regulations in this section is it clear to the schemes concerned whether they are required to be authorised or not?***

Scope

14. The ABI believes that it is generally clear in the regulations, as drafted, whether schemes are required to be authorised or not. We also consider that the disapplications set out in the regulations do not undermine the authorisation regime's intention as stated.

15. However, the broad definition of a Master Trust scheme could mean that the following schemes are unintentionally in scope:

- **Executive Pension Plans**. These are individually registered money purchase schemes with earmarked policies for members. A number of these schemes, which predate 2007, were set up with one Principal Employer, and allowed other employers who had a degree of association to participate in the scheme. It is unclear whether the definition of connected employers, as set out in the Act and draft regulations, is sufficiently narrow to explicitly exclude these schemes, or how providers would prove the degree of association on an ongoing basis, particularly as it could change at very short notice. Without meeting the exact definition of "connected employer", these Executive Pension Plans could be regarded as a Master Trust and unintentionally brought into the scope of these regulations. If these schemes fell within the Master Trust definition, they would then need to be wound-up as it would not be possible and or practical for them to meet the Master Trust requirements. These schemes usually only have a small number of members and are not currently classed as Master Trust schemes.
- **Cluster Schemes.** These are individually registered Executive Pension Schemes which share a common trust deed and rules and/or common trustees, used by smaller companies to provide benefits for key employees and directors. These can be historic schemes which have been closed to new members for several years and cannot be used for automatic enrolment purposes. These have not been classed as Master Trust schemes and the changes bring several thousand fully insured legacy schemes with 1-20 members into scope of the rules.

16. We believe further consideration is needed on whether these schemes should be within scope, and if not, how the regulations can be re-drafted to clearly exclude them.

17. We also believe that Master Trusts that meet the following criteria should be exempt from the regime by the regulations, under section 40(1)(b) of the Pension Scheme Act 2017:

- The scheme sponsor is authorised by the PRA to carry out regulated activities as a life insurer, and
- The relevant Master Trust is not used as a qualifying scheme for the purposes of automatic enrolment.

18. An alternative approach, should DWP deem the exemptions above too broad, would be to exempt Master Trusts from the regime using the following, narrower criteria:

    - The scheme sponsor is authorised by the PRA to carry out regulated activities as a life insurer, and
    - The relevant Master Trust scheme was set-up prior to 2007, the Master Trust scheme is closed to new members, and new single contributions, including transfers in.

19. We consider that the risks posed by these schemes to members are minimal for the following reasons:

    - The schemes are winding down, and the financial sustainability of the schemes are therefore not sensitive to assumptions about the number of customers that the scheme will attract over the lifecycle of the product line, or the level of ongoing contributions from members.
    - Where these are held under an insured arrangement, these funds are subject to linked long-term insurance business rules found in FCA Conduct of Business - COBS 21.[1]
    - The schemes are invested in unit-linked funds, which are covered by Financial Services Compensation Scheme, and they are covered by the FCA's requirements in relation to treating customers fairly.
    - The costs of the trustees are borne by the insurer, and thus are a liability of the insurer under Solvency II in the event of the insurer becoming insolvent.

20. In addition, whilst these costs will not be borne by the member the cost per member associated with either seeking authorisation for the schemes, or winding up the schemes, are prohibitive in the context of the existing financial reserves and protections applicable to insurance business.

21. An alternative approach, should DWP not accept that these should be out of scope, would be for DWP to allow insurers to seek authorisation for all Master Trusts that they run together under sections 40(2)(a) and 40(3)(c) of the Act. If this approach were also deemed unacceptable to DWP, then the DWP, FCA and TPR (The Pensions Regulator) should work with insurers to find a means to expedite the process of winding up the Master Trusts and assigning the policies to individual members (noting that members may no longer enjoy the protections described in the bullet points above).

22. Our following responses assume that the exemption for legacy schemes is accepted, and thus the following responses relate to those schemes which are not exempt.

Q3. Is it clear who will fulfil the roles subject to the fit and proper assessment in your scheme? Have we captured the important roles?

[1] https://www.handbook.fca.org.uk/handbook/COBS/21/?view=chapter

Q4. ***Are there any significant practical barriers to schemes meeting these requirements?***

Fit and Proper persons

23. The ABI believes that draft Regulation 5 is clear in setting out who, in our members' schemes, will fulfil the roles subject to the fit and proper assessment and are satisfied that the important roles have been captured. We are encouraged that the regulation has been drafted drawing extensively on similar existing requirements including the occupational pension scheme provisions around trustee knowledge and understanding (TKU) and FCA rules for financial institutions and financial advisers.

24. There are no significant practical barriers to insurer-run Master Trusts schemes meeting these requirements. We believe that the proposed requirements are permissive, relative to the existing screening processes, qualification and experience requirements commonly used by insurers.

25. Our members recognise that they will need to go through a separate (and possibly overlapping) authorisation process for confirming that those responsible for the scheme are fit and proper, but that level of effort is immaterial relative to the size of their schemes, and the benefit of introducing minimum standards across the market as a whole.

Q5. ***Are there any significant practical issues for Master Trust schemes in providing the information required for the business plan?***
Q6. ***How can we improve the clarity, coherence and comprehensibility of the list of information to be included in the Business Plan across the spectrum of scheme models?***
Q7. ***Should the detailed requirements in relation to the business plan be set out in code of practice rather than regulations?***

Financial sustainability

26. In assessing the financial sustainability of a scheme the Regulator must take account of the following as laid out in Regulation 6 (Schedule 2; 1):

    (i) Whether the scheme has a scheme funder which is not a participating employer in the scheme;
    (j) Where the scheme has a scheme funder which is engaged in activities which do not relate directly to the scheme, the scheme's position in any corporate group and any associated impact on the scheme's financial sustainability.[2]

27. Schemes must have the financial resources to cover (Schedule 2;2):
    - the costs of setting up and running the scheme
    - the cost incurred by solving a triggering event (including wind up costs)

[2] "Scheme funder", 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.

- and in the event of a triggering event occurring, the costs of continuing to run the scheme for at least six months and no more than two years.

28. ABI members, as PRA authorised firms, have to comply with Solvency II. Under the Solvency II Directive, insurers are required to hold risk capital to meet quantifiable new risks on their existing portfolio of business, plus one year's expected new business. This Solvency Capital Requirement (SCR) is calibrated such that a firm could survive a 1 in 200 year event and remain solvent.[3]

29. In addition, insurers are required to hold a Risk Margin on top of their best estimate liabilities. This is a margin equal to the amount a third party would require in order to take over and meet the insurance and reinsurance obligations of the insurer.

30. Reporting requirements under Solvency II call for insurers to provide the PRA with the following information:

    - Under Solvency II, UK insurers have to provide the PRA with a private Regular Supervisory Report (RSR) every three years, and an annual update. The RSR has to include a wealth of information on the firm's business and performance, as set out in Article 307 of Commission Delegated Regulation (EU) 2015/35.
    - Insurers also need to publish a public, annual Solvency and Financial Condition Report (SFCR), which can usually be found on their websites. Again this contains details of business and performance as set out in Article 293.

31. We do not believe that it is the DWP's intention to introduce an additional layer of capital requirements for those insurers that run Master Trust schemes, particularly given that the costs associated with running a Master Trust are relatively small in comparison.

32. Solvency II rules do not explicitly refer to Master Trusts; no distinction is made between them and any other occupational (or workplace) pension schemes. Instead, Solvency II rules are based on the features of a policy. However, where an insurer is the sponsor of the scheme, or is acting as a service provider to a Master Trust where the scheme funder is not an insurer, we believe that the investment costs and administration costs (as set out in Figure 2) are accounted for under Solvency II.

33. Under Solvency II, insurers do not have to reserve for the Master Trust or for winding it up, meaning that the trustee costs and sponsor/scheme funder costs (as set out in Figure 2) are not explicitly covered, as they are not classified as insurance obligations.

34. The overall Risk Margin for insurers' corporate savings businesses (including the Master Trust) reserve for:

    - the assumed cost of transferring liabilities to another provider,
    - expense increases and
    - mass lapses of 70% of members.

35. The ABI believes that under Solvency II, the existence of the Risk Margin and the SCR removes the need for any additional reserving to cover the operation or the winding up of

[3] http://ec.europa.eu/internal_market/insurance/docs/solvency/solvency2/faq_en.pdf

a Master Trust and that Solvency II risk capital would be more than sufficient to cover the wind-up costs in the two years following a shock to a Master Trust.

36. The ABI suggests that a mechanism could be developed whereby insurers could enter into a contractual relationship or provide a letter of comfort (with the members and/or trustees of the scheme as appropriate) such that all Master Trust wind-up costs may be effectively labelled as insurance obligations, giving regulators comfort that they are covered by the existing Solvency II capital regime. We consider that this approach would be simpler, more practical and more transparent than a duplicate, additional capital buffer imposed by TPR.

37. Where insurers are acting as scheme funders, we would expect the Regulator's assessment of a schemes financial sustainability to take account of the financial strength of these scheme funders subject to the capital requirements of the Solvency II regime.

Business plans

38. The ABI believes that the detailed requirements in relation to the business plan should be set out in code of practice rather than regulations.

39. Typically, ABI members do not account for their Master Trusts separately from their other pension business. As such, they do not currently attribute costs, ring fence income from charges, or report profits separately for their general business from the Master Trust. Whilst members are open to providing this documentation to TPR, in the interest of transparency and enabling TPR to have a complete picture of the automatic enrolment market, we would welcome further detailed guidance about how this should be done in practice. The text below highlights some of the conceptual challenges posed when considering the business plans of Master Trusts, which will also be relevant for other Master Trusts which take out insurance policies where the scheme funder is not an insurer. We believe that the detailed requirements in relation to the business plan should be set out in the code of practice rather than the regulations.

40. Most insurers that operate their own Master Trusts act as both the scheme funder of the Master Trust and the provider of the insurance policy the Trustees use to secure member benefits (covering both the administration and investment costs set out above).

41. It is not always easy to separate both the costs and income that relate to the insurers' role as product provider to the trustees, and the costs and income that relate to their role as scheme funder.

42. We assume that the business plan for the Master Trusts would not cover all the itemised costs associated with running the insurance policy (including the platform, compliance, legal, administration), as these would be covered by the fee paid to the insurer as a product provider. This would enable consistency between Master Trusts invested in insured policies, where the sponsor is not an insurer, and Master Trust invested in insured policies where the scheme funder is an insurer.

43. However, if such an approach were taken, any income would also need to be apportioned between the income generated in respect of the insurance policy and the income

generated to cover the cost of the Master Trust, otherwise, losses or profits made on the insurance policy would be included in the Master Trust accounts.

44. The charges apportioned to cover the cost of the Master Trust, (rather than the insurance policy) could then also be shown in scheme accounts along with the costs incurred by the scheme i.e. trustee governance, professional advice and dedicated support provided by the sponsor. All of these can be identified and evidenced without too much difficulty and would produce a genuine profit and loss position.

45. The alternative would be to include all income generated by the Master Trust and the insurance policy, and attempt to apportion all costs to the scheme. This will be difficult to achieve given that it would require an apportionment of all relevant overheads and not just direct costs. i.e. percentage of platform costs, IT costs, compliance, distribution, marketing, change management etc. Even where there are direct costs such as administrative staff costs, it is likely that not all staff are dealing with the Master Trust all of the time. Apportionment is unlikely to lead to an accurate picture with regard to costs and would be likely to lead to additional costs within providers.

46. Where the insurer provides an insurance policy to a Master Trust that is not owned by the scheme sponsor, we would expect that all charges taken in respect of the scheme and all costs payable would be attributed to the Master Trust, and that accounts could be provided. For example, where an insurer provides administration services to a Master Trust that is not its own Master Trust, it pays part of the total member charge to the Master Trust scheme. It is relatively simple for that Master Trust to then account for income and outgoings and report a profit or loss as a result. The insurer, as the provider of the insurance policy, would cover all administration and investment costs within the member charge it retains. The profit or loss that the insurer makes on that policy would therefore not be included in the Master Trust's accounts.

47. It is worth noting that some insurers may be comfortable continuing to provide a Master Trust as part of its wider business strategy despite its low value or membership, when this enables the protection of member benefits, or maintaining positive commercial relationships with participating employers.

48. Some providers have also raised concerns about the commercial sensitivities of information set out in the business plan, and would like reassurance that this information would not be shared beyond the trustees and TPR staff.

Q8. What, if any, other lines of business do scheme funders carry out that do not undermine the transparency of their financial arrangement with the scheme?

Q9. What, if any, disclosures of the matters in regulation 8, scheme funder requirements would be disproportionate to provide and why?

Q10. What, if any, alternatives could we consider to make the scheme funder's financial arrangements with the Master Trust sufficiently transparent to the regulator for its financial assessment?

Q11. Are there any circumstances where scheme funders would not be able to comply with the requirement to submit their accounts no later than nine months after the end of the financial year to which they relate and if so why?

Scheme funder

49. The Pensions Scheme Act 2017 requires a scheme funder to be 1) a legal person who 2) only carries out activities that relate directly to the Master Trust scheme(s) of which it is the funder. However, the draft Regulations will exempt scheme funders from the second requirement if they meet the prescribed requirements relating to financial transparency and disclosure.

50. A number of the documents requested to meet the financial transparency and disclosure requirements as set out in draft regulation 8(1) are documents that insurers already generate for annual reporting purposes.[4] The ABI believe that early clarity on acceptable evidence will be required from TPR as well as a proportionate approach based on both size of a scheme and the risk presented.

51. The ABI understands the call for transparency to allow the TPR to do their job, however, the Regulator's assessment of a schemes financial sustainability should take account of the financial strength of insurers acting as scheme funders subject to the capital requirements of the Solvency II regime.

52. In recognition of this, if the scheme funders provide the following information and is a PRA authorised firm, then we cannot understand a need for the additional detail set out in 8(1):

    (i) latest full audited accounts are provided along with;
    (ii) the scheme return (which will detail the size etc.) and;
    (iii) an explicit letter of financial support to meet all the obligations placed on the trust company and those of the scheme funder with a statement that mentions that in meeting this commitment, the scheme funder is not compromising or significantly impacting their Solvency II position.

53. If the scheme funder is able to provide a positive response to the question that all members are invested in a fully insured and earmarked pension scheme and they provide the documentation set out in the points above, we feel that should be sufficient. Any additional requirements would not improve member protection (for an insurance company run pension scheme) but would add further cost and complexity.

Authorisation fee

54. Another key concern that has not been directly addressed by the consultation questions is the proposed one-off authorisation fee. The ABI does not believe that the two fee system has been justified. Furthermore, we believe that the level of the fee currently posed will have a detrimental impact on small legacy schemes, and that the likely impact will be disproportionate to the risks posed by these schemes.

[4] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/663437/occupational-pension-schemes-master-trusts-regulations-2018-consultation.pdf