ABI Response to TPR Consultation on Supervision and Enforcement Policy for Master Trusts

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Introduction

The ABI 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. The UK insurance industry is the largest in Europe and the fourth largest in the world. It is an essential part of the UK's economic strength, managing investments of over £1.7 trillion and paying nearly £12bn in taxes to the Government. It employs around 325,000 individuals, of which around a third are employed directly by providers with the remainder in auxiliary services such as broking.

Executive Summary

1. The ABI welcomes the opportunity to respond to this consultation, having previously called for tighter regulation of master trusts. The supervisory and enforcement policy set out by the Pensions Regulator (TPR) is broadly suitable, but there are some areas that could benefit from further clarification. If implemented in an appropriate fashion, the policy should achieve its objectives and lead to an effective supervisory regime backed up by robust enforcement.

2. The decision to use a risk-based approach is an appropriate one. When assessing risk, TPR should reflect on how its own Code of Practice and other regulatory regimes reduce the possibility of a scheme being unable to fulfil its duties. In particular, the Regulator's assessment of a scheme's financial sustainability and control functions should take account of the financial strength under Solvency II of insurers acting as scheme funders. These insurers are regulated by the Prudential Regulation Authority using a risk-based approach set out by Solvency II, meaning they are subject to high capital requirements, robust risk management practices and internal controls, and substantive private reporting and public disclosure.

3. We would be concerned if schemes were deemed to be high risk due only to their size. Whilst this is rightly a consideration of any risk assessment, it should be properly weighed against the risk management and mitigation processes that are in place within such institutions. This would be consistent with the approach taken by other financial services regulators. Whilst some insurer-run schemes may be large in terms of the current master trust market, it is important to recognise that these schemes are part of a much larger group that is already required by regulation to have high quality governance and risk management processes, including both qualitative and quantitative risk assessments. Under Pillar 1 of the Solvency II regime, insurers' capital requirement provides 99.5% 1-year Value at Risk (VaR) protection, a capital buffer deemed sufficient to cope with a 1-in-200 year event. All such factors should be taken into account when

assessing the risk to scheme members of a master trust when determining the appropriate level of risk-based supervision.

4. Further clarity would be helpful regarding how the proposed ‘additional supervision’ approach will be implemented. Were size to be a significant factor in determining whether a master trust is high risk, and thus subject to ‘additional supervision’, this could lead to inappropriate and inefficient supervision. Additionally, it is unclear whether ‘additional supervision’ status would be disclosed publicly or could be following a Freedom of Information Act request. An unintended consequence of this could be a master trust becoming the subject of negative – and misleading – publicity purely for operating at scale. There are certain forms of Prudential Regulation Authority (PRA) intervention (e.g. The Proactive Intervention Framework) that are kept confidential. We would recommend that TPR should treat the ‘additional supervision’ designation in a similar manner.

5. It would also be helpful if TPR could publish the purpose behind the additional data items requested in the supervisory return for schemes subject to ‘additional supervision’ as this would help the schemes in question frame the information provided within the return in the most helpful way possible for the Regulator.

6. The proposals for routine supervision are appropriate in our view. To avoid unnecessary duplication, it would be helpful if the required data submissions could be aligned with those other regulators, notably the PRA and the Financial Conduct Authority (FCA).

7. The proposals for enforcement and de-authorisation are also appropriate. It is essential that poor practice in the market is subject to firm action, as the draft sets out. Were a master trust to make a disorderly exit from the market, this could damage public confidence in automatic enrolment and pensions more widely. We look forward to working with TPR to establish a proportionate and effective system to ensure this does not happen.

Consultation Questions

The draft policy sets out our risk based approach to supervision. Is this clear and proportionate and if not, why not?

8. The decision to use a risk-based approach is an appropriate one and should reflect the role that other regulatory regimes play in reducing the possibility of a scheme being unable to fulfil its duties. It is unclear from the draft policy what approach will be taken to master trusts that are administered by an entity regulated by the PRA, FCA and by TPR, such as insurance firms.

9. In most cases of an insurer run master trust, administration of the master trust is wholly outsourced to the insurer; the insurer also pays the costs of the trustee board and indemnifies the trustees against any further costs they incur relating to the master trust. This means that systems and data, process and control functions, risk management and financial sustainability are already scrutinised and supervised by other regulators in the UK’s financial regulatory framework. Examples of overlapping regulatory regimes include:

- The TPR: Providers and the board of trustees of master trusts, which they fund, all fall under the compliance and governance requirements set out in TPR's Code of Practice 13. The Code details the legal duties of the board of trustees overseeing occupational pension schemes. Firms will demonstrate how they will meet the governance requirements set out in TPR's standards of conduct and practices in their authorisation submissions and on an ongoing basis.

- The FCA: Insurance firms are subject to an extensive conduct regime in the FCA's Handbook of Rules. As part of this, the Senior Managers and Certification Regime imposes fit and proper tests on senior staff in insurers. Such regulatory scrutiny is intended to create a culture of accountability to further improve policyholder/member protection.

- The PRA: Insurers are prudentially regulated by the PRA under the Solvency II regime, which requires insurers to hold a capital buffer sufficient to cope with a 1-in-200-year stress. This includes consideration of financial market stresses (e.g. bond default or equity shock), non-financial stresses such as longevity improvements, as well as combinations thereof.
  It is unlikely other, non-insurance, scheme funders will hold similarity stringent levels of risk-based regulatory capital. Thus all else being equal, insurer-run schemes will be lower risk than their counterparts run by non-insurers. Solvency II also requires insurers to have robust risk management and governance, including qualitative measures to complement the quantitative ones (known as Pillar 2) and extensive and frequent private reporting to the PRA and public disclosures (known as Pillar 3). These are additional factors that significantly decrease the overall risk posed by an insurer-run master trust.

- Financial Services Compensation scheme: In addition to the Solvency II regime covered in the section above, it is also worth noting that trustees of insured master trusts schemes receive protection under the Financial Services Compensation Scheme (FSCS). If PRA supervision were to fail, capital reserves were depleted, and the insurer became insolvent the trustees would be able to make a claim for 100% of the value of their members' assets. This additional level of protection is not available to non-insured schemes.

- If these factors – regarding both the prudential and conduct regimes that insurers are already subject to and experience operating within – are not taken into account, the risk posed by master trust schemes could be inaccurately assessed. It would be an inefficient policy outcome to have such schemes deemed high risk due solely to their size, when they are in fact low risk due to the scale and nature of other risk-based regulatory supervision that the scheme funder is already subject to. The TPR should seek to build on the work of the PRA and the FCA when making its own assessment of the risks these master trusts pose.

Does the draft policy clearly set out that how a master trust conducts its activities may influence the way we deal with them?

10. Yes, the policy appropriately outlined the need for master trusts to conduct their activities openly and honestly.

Are there any additional matters we should consider including in this policy or future guidance?

11. As suggested in paragraphs 7-10 overlapping supervision by other regulators should be taken into account when considering the TPR's oversight role of insurer run master trusts.

Do you have any comments regarding the proposed routine and additional supervisory approaches and activities set out in the policy?

12. The overall approach to supervision both routine and additional seems sensible. As highlighted our only concern is whether the risk assessment process will correctly identify the appropriate level of supervision, and whether the level of supervision they are subject to could be detrimental if made public.

Overall, is our approach to enforcing against master trusts clear and proportionate, and if not, why not?

13. Yes, the approach to enforcement is both clear and appropriate. Master trusts are a key pillar of the long-term savings system and should be regulated as such.

Is the draft policy clear about what we will take into account when deciding on enforcement action?

14. Yes.

Are there any additional matters we should consider when deciding on enforcement action in relation to master trusts?

15. No.

Does the draft policy provide sufficient clarity on the circumstances in which we may move to withdraw authorisation of a master trust?

16. Yes.

Is the policy clear on the steps we will take to initiate withdrawal of authorisation?

17. Yes.