CACEIS ROUNDTABLE SERIES

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INVESTOR SERVICES

Master Trusts What lies ahead?

It is twelve months since we last held our Master Trust roundtable to look into themes, challenges and opportunities in the sector. A good place to start was to discuss the main themes in the sector and how the market as a whole has progressed over the last twelve months.

The cost-of-living crisis and the inflationary environment was a starting point for discussions. It's creating some challenges and is changing the way we think. One factor cited by everyone related to concerns about members opting out because they cannot afford their contributions. And once members opt-out, it's usually very difficult to get them back in. One of the ideas that was discussed was the possibility of giving members an option to temporarily reduce their contributions – this would make members more connected to the scheme and make it easier to recommence payment when the time is right.

The cost-of-living crisis has impacted all cohorts, including the affluent. For example, it was highlighted that rising mortgage rates were taking their toll – and once members started to feel the effects of this, there is the potential they can opt out. The general consensus of the group is that opt-outs are still relatively low, but this could accelerate if the cost-of-living crisis continues for a longer period of time. Given these concerns, Master Trusts are beginning to track opt-out data.

Regarding the cost-of-living crisis, it was also commented on that Master Trusts demonstrating a focus on helping the financial well-being of their members through education and insight could create a level of differentiation in the market, though several are already well advanced in this area.

WORKING IN AN INFLATIONARY WORLD

Inflation is also a concern. Managing investment strategies in a higher inflationary world is seen as a challenge. There were differences of opinion, however, as to whether or not inflation was transitionary, and there was some debate on the future run-rate of inflation. This highlights the complexity of the environment we are currently operating in.

Furthermore, it was also agreed that delivering investment outcomes in a high inflationary environment is more challenging and may require increased use of more actively managed strategies. Additionally, it potentially opens the door to more communication with members about investment expectations.

We then pivoted the discussion to drawdown. It was generally agreed that in the Master Trust world, very few members are taking annuities, despite an improvement in annuity rates over the last few months. Drawdown is the de facto choice for Master Trust members and many take cash, but this does not provide long-term income. Annuities do. One potential alternative option is Collective DC Decumulation for retirees to give them a promise of a wage for life – an area that the DWP is looking to consult on at the end of this year. Indeed, how to achieve post retirement income will gain more visibility in a world of higher inflationary expectations.

CONSOLIDATION AND TRADE OFFS

Consolidation of master trusts remains a topic of discussion carried over from our last roundtable. It was generally agreed that there will be a little more consolidation in the UK, but to a lesser extent than we have seen previously.

"If you break down the market of 36 Master Trusts, you have multi-employer schemes, then mass-market schemes and other Master Trusts that are focusing on attracting bigger legacy schemes, which is where most of the competition is based. It's this latter space where we are likely to see a little more consolidation". There may also be some consolidation of the multi-employer schemes, where the ongoing governance requirements may prove too onerous for them.

However, it was also recognised that there is still a considerable amount of business in the sector - 'Lots of DC schemes, for example, still have to undergo their 'value for money' check to determine if they can do something better for their members'.

And there is growing recognition that Master Trusts now encompass a broad range of solutions and are different in terms of innovation, which is creating competition and choice for DC schemes seeking to move into a Master Trust.

But some barriers still exist. Although Master Trusts are investing more in technology and member experience, we discussed how barriers can be lowered for DC schemes transitioning to Master Trusts. One of the biggest potential barriers centres on trustees of DC schemes who rightly need confidence that a Master Trust is as responsible and committed to their members as they are.

> "As a DC trustee, we really care about the duty of care to our employees and recognise that this personalisation could fall away when moving to a Master Trust".

Education was also a key topic. In this context, it's important to highlight the benefits of moving to a Master Trust and the efficiencies it brings in the longer term, especially as default options are very well-designed. It was also recognised that the strength of the regulatory environment was a critical area – and a more common approach between the financial regulators in the UK could give trustees a lot more comfort.

WHERE ARE WE WITH TCFD (TASK FORCE FOR CLIMATE RELATED FINANCIAL DISCLOSURES)?

The roundtable was held in early November, shortly after Master Trusts began to publish their first iteration of TCFD reports. Under the 2021 Pensions Schemes Act, from October last year, all authorised Master Trusts have to report the financially material risks that are associated with climate change in accordance with the TCFD framework. We asked if there were lessons learned this year. The key observations included "Do members really care"? and "Is there a danger of losing the importance of why assessing climate risk is important"?

"We published member friendly versions of the TCFD reports and we tracked engagement, but very few members were reading them… and it does seem like a tick-box exercise". One of the big challenges being cited is that even with member friendly versions, the TCFD reports are compliance driven documents, making it difficult to really make them readable for members.

Will the TCFD reports lead to change on climate? The general consensus is that they will, but only over a period of time when trends can be identified and TCFD reports are published. The reports will also attract interest from action groups, who will read and challenge the reports, especially from the largest Master Trusts. This is likely to keep climate change on the agenda.

Again, education as a theme was threaded through the TCFD discussion – "Conversations on climate change don't seem to be happening on the member side", was one comment. Indeed, there is certainly scope to educate members on areas such as climate impacts and behavioural values towards climate change. This could create more engagement with what pension schemes are doing in this area.

It was recognised that the TCFD exercise holds value – "It pulled all the work we had done on climate and developed a narrative around it. What we probably needed was something like the TCFD reporting framework five years ago……it has allowed us to identify all the risks" and "We knew the risks were there, but it forced us to spell them out. It creates a good discipline, and it brings transparency into how we're managing the risks around climate change".

The TCFD has also provided Master Trusts with a good governance framework – "It's forcing us to all have the same conversations and going to the asset managers with similar questions". It was also nicely summed up with Master Trusts' position as asset owners – "we as investors have a policy, and as investors, we want to see change to reflect our value on climate".

The importance of straightforward member communication was also raised, and how we can learn from other markets?

> "In the Netherlands, for example, Dutch pension schemes have to report everything to the regulator – they also oversee pension schemes in helping them to do the right thing. And in this context, communications can then be at the member level, focusing on what the pension scheme is doing to manage climate risk and diversity – so something that is easy to understand".

IT'S ALL IN THE DATA

Data was cited as a challenge. Investment managers are providing the data in inconsistent ways, so it becomes difficult to create a single point of view once all the information is aggregated together. There is a lot of duplication in this process, and it was recognised that there needs to be more standardisation in reporting. This also creates challenges in benchmarking because like-for-like comparisons are difficult to make.

Pension scheme thinking on investing in higher emitting sectors is also changing – "A leading light is that some of the larger schemes such as USS, Nest and Railpen have developed strong frameworks to think about how they invest in higher emitting sectors" - this is beginning to influence and drive change across the broader market.

Furthermore, the story around the data is key. Active asset managers are prepared to invest in higher emitting sectors on the basis that they can engage with carbon-intensive companies on their transition plans to net-zero. This will have a more positive impact on driving down carbon emissions globally than investing squarely in lower emitting sectors. It means this could translate into higher carbon scores for pension schemes in the short term – so building a narrative around this is important.

Collecting data on private markets was a recognised challenge but there is progress – "There is a gap in TCFD analysis in private markets because the companies we invest in don't collect climate data. However, as we conducted our TCFD reporting, this has spurred us into action to ask those companies for more data and it has persuaded them to think about how they provide data". We'll see the benefits of this over the next two or three years.

"As companies start to produce data in a standard form, data will flow to the top in a more consistent way. At the moment, the data vendors have their own interpretation of ESG and climate risks. However, we have to start somewhere and work with what we have."

VALUE FOR MEMBERS

Value for members remains a focus in the regulatory environment. But challenges remain.

"We should not look to sacrifice so much on the investment side because of the drive to lower fees....and there is also a growing recognition in the market that good administration comes with a cost".

The FCA and The Pensions Regulator have published a joint discussion paper on developing a common framework for measuring value for members in defined contribution pension schemes. The aim of the two regulators is to drive a long-term focus on value for members across the pensions sector

So how can we correctly define value for members? There is still an element of subjectivity and it was agreed that broader factors, such as the quality of administration, must also be included.

Do we introduce an 'Ofsted' style rating system was one idea floated by the roundtable?

And how do we measure the member experience, in terms of engagement and communications? Regulators articulated in the summer that there might be a kitemark in relation to member services – 'we all live in a world where we have kite mark standards and it provides a good level of assurance...it will provide a lot more confidence to members'. It was agreed that this provides a good benchmark - a set of minimum criteria on member services.

Articulating value for members is also a really difficult challenge. People focus on very tangible things and in this context they look at costs and past performance. It becomes particularly challenging when active management has not demonstrated value for members – it has not delivered extra return or delivered those returns at lower risk. But it is delivering extra cost. However, the backdrop to this is key – "in the last few years, it has been relatively easy to get return through unsophisticated approaches, but we are now entering a new norm and we should see active managers demonstrating value, so there has to be some forward-looking thinking in terms of what value could look like".

And there was recognition that costs will go up as more Master Trusts seek to benefit from the more diversified return profiles of private assets, which becomes increasingly important in this environment. "We have to look at where illiquids have been successful - if we look at Australia, illiquids have demonstrated their returns in real value, especially over the longer term". And costs there are much higher, despite the much larger size of the "Supers".

Members understanding of value for money also came into view – "Do we need to do more work in what members perceive as value compared to what we think they perceive ...do members know"? Education was threaded through the discussion again – and in this context, insight to help members understand the concept of value for money.

The roundtable concluded that not many sectors across the financial services arena are really creating value for money, apart from Master Trusts. It was agreed that it becomes important to put value for money into context – instead of fixating on value for money between different Master Trusts, the focus should be on making comparisons against other pathways – for example Master Trusts versus SIPPS. We need to look at value for money with a different lens.

"We deliver amazing value across workplace savings – the value is astonishing"

MICHAEL CALLARI
Business Development Manager
CACEIS