



Master trust engagement programme findings report

Background

Between January and September 2020, the Pensions Authority undertook an engagement programme with a number of defined contribution (DC) master trusts and a number of firms that are considering establishing master trust arrangements. The engagement formed part of the Authority's ongoing move to a risk based and forward-looking approach to supervision.

The aim of the engagement was to assess how master trusts are meeting their governance and risk obligations, as well as their preparedness for the implementation of the IORP II Directive (the Directive) and the proposed requirements for master trusts, as published by the Authority, in June 2019 [[Pensions Authority response to consultation on obligations for trustees of defined contribution \(DC\) master trusts](#)].

The engagement programme consisted of:

- The completion of a detailed questionnaire by trustees,
- A meeting between the trustees and the Authority, based on the completed questionnaire; and
- A findings report issued to each of the master trusts which included observations and recommendations for improvement.

The purpose of this report is to provide feedback on the key findings identified during the engagement programme.

Overview

Details of the findings are set out later in this document. However, overall, the findings of our work are disappointing. The Authority found issues with every master trust, some of which were significant. Trustees must address these matters if their master trust is to meet the standards expected after the transposition of the Directive.

This engagement programme is especially significant given the important part that master trusts are likely to play in future Irish pensions provision. It is therefore important that there be no doubt about the minimum standards that the Authority expects.

Almost every master trust has been set up by a sponsoring organisation, usually (but not always) a financial institution or a consulting firm (referred to in the remainder of

this report as the founder). The Authority is not seeking to change this fact, and accepts founders have their own legitimate commercial objectives. However, these objectives must not limit the obligations of trustees to the members of these master trusts and there must be a clear and recognised separation of the roles of trustee and founder.

The main issues that emerged from our engagement programme are as follows:

- In many cases, trustees do not seem to understand the breadth of their responsibilities. Clearly, in some cases, trustees believe that their role is limited to a series of administrative and compliance tasks, and that they should follow the instruction of the founder in carrying out this work.

The two essentials of the trustees' responsibility are that they prioritise the interests of the members and that they should be proactive.

- Related to the previous point, many of these master trusts seem to be unaware of or unconcerned about the provisions of the Directive. The Directive sets out a European-wide standard for the proper management of a pension scheme. This information is important of itself, but it is especially relevant given that the Directive will shortly be transposed into Irish pensions law.

A well-run pension scheme should already meet the main requirements of the Directive. The least we might expect is that the trustees of a master trust, considering its scale and resources, would have made substantial progress towards that goal, given that the text of the Directive has been available for over three years. But in several of these master trusts, there is inadequate oversight and measurement of service provider performance, little or no risk management, and no internal audit function, formal or informal.

- In a number of cases, the rules of the master trust place unacceptable constraints on the trustees to act in the members' interests. In some instances, the rules do not allow the trustees to replace the administrator, irrespective of how inadequate or expensive the administration services might be. In another case, the investment of members' money is placed wholly under the control of the founder. This raises serious concerns for the Authority. The investment of scheme assets is one of the most fundamental objectives of a trust and it can never be appropriate that the trustees are so far removed from this activity.

We recognise that the trustees usually have no control over the master trust rules. Nonetheless, the Authority considers it utterly inappropriate that trustees' powers and responsibilities be constrained as described above. We will strongly advise any employer against participating in such a master trust and would have strong reservations about the action of any trustee of an existing scheme that facilitated a transfer into such an arrangement.

- Our examination uncovered a number of actual and potential conflicts of interest. It is clear in many cases that conflicts have not been given any significant consideration. There were some master trusts where we found no evidence that matters such as conflict inherent in trustees' employment and remuneration had been discussed.

A master trust can present significant potential conflicts. These can be overcome, but only by active engagement with them. Any failure in engaging with these serious matters is an indication that the trustees concerned do not understand the role they have undertaken.

There is no doubt that an examination of many existing single employer schemes would uncover issues similar to those identified in this document. But the objective of the implementation of the Directive is to raise the standards in Irish pension schemes, too many of which are not managed to a standard that the members and beneficiaries are entitled to expect. If master trusts are seeking to play an important role in future Irish pensions, their management and structure must be up to date.

The Authority will continue its engagement with current and future master trusts. An important part of our work in the period following transposition will be to publish guidance for the public, and especially for employers, about the minimum standards they should seek from master trusts before participating. Many of the master trusts we have examined would currently not meet such standards without addressing our findings.

The remainder of this report outlines our specific findings under the engagement programme.

1. Master trust governance structures

In most, but not all cases, there was a trustee company established with a board of directors. Typically, boards of trustees or boards of directors of trustee companies consisted of employees of the founder. Very few of the master trusts involved have appointed an independent trustee or chairperson. In some instances, it was evident that boards of trustees have little autonomy in decision making, as all major decisions required prior consultation or approval of the founder. This is unacceptable and we have significant concerns over legal provisions that fetter the fiduciary responsibilities of trustees. Some master trusts are considering their current governance structures with a view to establishing a more independent trustee board and the Authority intends to monitor these developments closely in the coming year.

All trustee boards hold regular meetings; however, agendas for meetings for some seemed standard and formulaic. In some instances, trustees appeared to receive information passively and there was little evidence of informed discussion on key issues. Good governance is not just about compliance; it involves demonstrating good behaviours and practices to ensure good member outcomes. Such behaviours and practices should be reflected in what is recorded in terms of minutes of trustee board meetings.

2. Business plan/continuity plan

The Authority's expectation is that master trusts must have a business or continuity plan which includes projections for income and expenditure and which demonstrates the viability of the master trust. In particular, the Authority finds it difficult to see how trustees can agree to the addition of members to a master trust unless they are satisfied that it is viable.

To the surprise of the Authority, none of the master trusts engaged with had business plans/continuity plans in place or any form of document that could be referred to in order to demonstrate the future financial viability of the master trust. Trustees must be prepared for potential business threats and have a clear process to protect members in the event of a wind-up. Further, trustees must have a clear idea of how their master trust will grow and how this growth can be accommodated in a way that ensures that the best interests of members are protected.

In many instances, it was indicated that it was a matter for the founder of the master trust to develop the continuity/business plan. The Authority does not accept this: trustees must be centrally involved in the development and approval of the master trust's business plan. They cannot otherwise ensure that the operation of the master trust will not in any way compromise member interests. The Authority expects the trustees of all master trusts to engage with the founder on the development of the business/continuity plans as a matter of priority.

3. Appointment of service providers

Independence

In most cases, trustee boards were required to consult with or seek approval from the founder in relation to the appointment and removal of service providers and typically the founder provides some, if not all, services to the master trust. In addition, references were made by many trustee directors to the commercial realities of master trust structures and the difficulties that may be posed for the founder if the trustee opted to replace the founder as a service provider. It is of significant concern to the Authority that some trustee directors consider that their role includes some measure of responsibility for the interests of the founder.

It is not acceptable to the Authority that a master trust's governing documentation results in the trustee having no choice but to retain the founder for the provision of services to the master trust. Even if there is no such restriction within the governing documentation, we expect the potential for conflicts arising from the relationship between the founder and the trustee to be expressly called out and addressed in the conflicts of interest policy and in other areas, if relevant.

This is an area the Authority will continue to focus on in its ongoing supervisory engagement with master trusts and we will look for evidence that the trustee makes decisions in relation to the removal or appointment of service providers only on the basis of the interests of the members and beneficiaries and that the trustee is not inhibited by its relationship with the founder, in this respect.

Quality Control

The Authority saw little evidence of the criteria or scenarios trustees would consider before changing a service provider. Further, very few master trusts had established performance review metrics to assess the quality of the services provided.

We expect trustees to set out minimum standards for service providers and agree steps to be taken where standards fall short of what is required. We expect that the decisions in relation to the removal or appointment of service providers are made in

an objective manner and trustees are not inhibited in this regard by their relationship with the founder.

4. Conflicts of interest and remuneration

Master trusts are typically established by a pensions firm or financial institution which creates the potential for conflict of interest as the provider is funding the master trusts, at least in the early years. This can give rise to conflicts of interest not seen to the same degree in single employer schemes. All the master trusts we examined had a conflict of interest policy, but in almost all cases the policy was limited to an obligation on trustees to register interests. There was little information on how conflicts of interest may arise or the actions required to manage and mitigate them.

As noted, the potential for conflicts of interests arising from the relationship between the founder (and associated service providers) and the trustee board is significant in master trusts and needs to be addressed in a meaningful way. In many instances, the trustees were senior employees of the founder raising questions about the incentives for those trustees to ultimately act in the interests of the founder rather than the members. At a minimum, there should be clarity about the potential conflicts of interest for trustees in respect of their relationship with the founder, including in respect of how they are paid.

5. Investment

In many cases, the investment objectives set by trustees of master trusts were inadequate with no clear performance targets. Where objectives were set, trustees did not always sufficiently assess if objectives were being met and whether they remained appropriate. The primary job of trustees is to set the default strategy and the fund choice and to decide what the risk and return objective is for the master trust. Trustees will typically need professional help in this, but the overall task cannot and should not be delegated. We expect trustees to set clear investment objectives and have a suitable process in place that allows these to be regularly monitored and reviewed.

Some master trusts have incorporated Environmental, Social, and Governance (ESG) factors into investment decisions. However, the majority have given little consideration to this matter.

6. Charges for members and employers

It is particularly important that members and adhering employers can understand the master trust charges and are able to move to another provider if they are not satisfied that they are receiving value for money. The Authority was disappointed at the lack of transparency around master trust charges and especially found it difficult to identify all investment charges.

The Authority expects the trustees of master trusts to have a written policy specifying how charges are transparently disclosed. The Authority will need to be satisfied that charges are reasonably understandable for members. Increases in charges can only be made by giving six months' notice to members to allow an adhering employer to transfer, should they so wish, before the increase is implemented. In addition,

members or prospective members should be able to transfer assets in and out without charge.

7. Risk management, internal audit and internal controls

While the legislation implementing the provisions of the Directive is still awaited, the requirements in terms of risk management, internal audit and internal controls have been well known for some time. However, in most cases, there was little evidence of a robust system of risk management or effective internal audit functions. This is an area that requires immediate and significant attention by trustees of master trusts.

8. Member/employer communications

A master trust faces particular communication challenges given the potential size of the scheme, the number of members in unconnected workplaces and the different role of the employer in comparison with a traditional single employer scheme. For this reason, the Authority expects trustees of master trusts to have a written policy for engagement with members and employers. The policy must set out in detail the format and frequency of engagement with members and employers. The policy must also contain a commitment to active engagement with members and employers.

Most master trusts provided useful communications to members through a number of channels. However, there was little evidence that trustee boards had written policies for the engagement with members and employers.

Conclusion

The matters raised in this report should not be taken as exhaustive but rather as an overview of the main issues identified during the recent engagement programme. The Pensions Authority expects all trustee boards, and their advisers, to fully consider these findings and evaluate their own practices to establish if improvements are required.

The Authority will continue its engagement with current and future master trusts. An important part of our work in the period following transposition will be to publish guidance for the public, and especially for employers, about the minimum standards they should seek from master trusts before participating. Many of the master trusts we have examined would not meet such standards without addressing our findings.