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Master Trust regulation

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Summary

A Master Trust is as an occupational pension scheme that provides money purchase benefits and is used (or intended to be used) by two or more employers that are not connected.

This note looks at the regulatory framework introduced under the *Pension Schemes Act 2017,* which generally applies only to money purchase benefits.

Whereas traditional trust-based schemes are set up a by a single employer with an interest in it, this may not be the case with Master Trusts as there will not be the same reputational risk. There are different models of Master Trust. Many are set up by a product provider, who installs a group of trustees to run it. In this model, the provider also supplies administration and investment services to the trustees. Employers can use Master Trusts to provide pensions for their workers, rather than setting up their own or using a Group Personal Pension (regulated by the Financial Conduct Authority).

The number of pension savers in Master Trusts has grown with the introduction of auto-enrolment and is expected to grow further. (Master Trust Impact Assessment, October 2017).

In May 2016, the Work and Pensions Select Committee described Master Trusts as a "good fit" with auto-enrolment because they provide ongoing oversight of investments by a trustee board at lower operating costs than single employer schemes." However, stronger regulation was needed. (HC Deb 579, March 2016).

A consensus developed that the regulatory framework for trust-based occupational pension schemes was inadequate for Master Trusts because:

- It had developed with single-employer schemes in mind and assumes an employer having an ongoing interest in the running of the scheme.
- Many Master Trusts were set up to make a profit, which gave rise to the need for a different type of regulation to ensure member benefits are protected.
- Master Trusts operate on a scale unprecedented in occupational pensions and the collapse of a large scheme has potential to create a greater shock than would be the case with a single employer scheme (Impact Assessment, para 15-19).

Under the regulatory framework put in place by the *Pension Schemes Act 2017,* the Pensions Regulator (TPR) is responsible for authorising and supervising master trusts against five criteria. These criteria are that: the people running the scheme must be fit and proper; the scheme must be financially sustainable; the funder of the scheme must meet certain requirements; the scheme must have adequate systems and processes; and the scheme has to prepare a continuity strategy. (HC Deb 30 Jan 2017 c756).

The details of the authorisation and supervision regime for Master Trusts are in the *Occupational Pension Schemes (Master Trusts) Regulations 2018 (SI 2018 No. 1030).* In debate in Parliament, Baroness Buscombe explained:

> From 1 October, both existing and new master trust pension schemes will be required to be authorised by the Pensions Regulator and will be subject to ongoing supervision by the regulator to ensure that they are maintaining the standards required at authorisation. Any scheme that opts out of applying for authorisation, or which fails to meet the required standards upon application, will be required to wind up and transfer its members to an authorised scheme (HL Deb 18 July 2018 c101GC)

She said the Government had always been clear that a significant number of schemes are unlikely to meet these standards and will need to leave the market. (Ibid c102).

The new regulatory regime came into force on 1 October 2018 (PN 18-52). TPR issued new figures showing that 30 Master Trusts had wound up or indicated an intention to do so, leaving 58 to apply for authorisation or trigger their exit from the market in coming months (TPR, The current master trust market – latest facts and figures, October 2018).

On 11 October, TPR said it had issued a fine of £5,000 to four trustees who had failed to invest £1.4 million of savings promptly (PN18-53).

1. Background

1.1 Definitions

There are two main types of pension scheme:

- **Defined benefit pension scheme** – a scheme in which the member builds entitlement to pension benefits based on fixed factors such as salary and length of service.
- **Defined contribution pension scheme** – a scheme in which an individual builds up a fund based on contributions and investment returns.

Workplace DC schemes can be either:

- **Contract-based** - where an employer appoints a pension provider, often an insurance company, to run the scheme. The scheme members will sign a contract with the provider who will make the majority of decisions about the way the scheme is run; or
- **Trust-based** – where they are sponsored by the employer but managed by a board of trustees (who have full responsibility for the management, administration and investment of the plan. The trustee's fiduciary duty is to act in the interests of members).

Master Trusts are multi-employer, trust-based DC schemes, which employers can use for auto-enrolment without having to set up their own scheme. The Pensions Regulator (TPR) explains:

> A master trust is defined as an occupational pension scheme that:
>
> - provides money purchase benefits
> - is used, or intended to be used, by two or more employers
> - is not used, or intended to be used, only by employers which are connected with each other
> - is not a public service pension scheme[1]

Section 1 of the Act would introduce a statutory definition (see section 4.1 below).

1.2 Auto-enrolment

In January 2018, there were 81 Master Trusts registered with the Pensions Regulator. They had 10 million members.[2] Their use has grown significantly with the introduction of auto-enrolment i.e; the duty on employers to automatically enrol workers into a workplace pension scheme, which is being introduced in stages between October 2012 and 2018. The Government expects it to increase the numbers saving or

1 TPR, check if your scheme is a Master Trust
2 TPR, DC trust: presentation of scheme return data 2017-2018, see also Bill 125 –EN, para 7; See also, DWP, Impact Assessment (IA), September 2016, p8-9

saving more in a workplace pension saving scheme by 10 million by 2018.[3]

To support auto-enrolment, the Government set up the National Employment Savings Trust (NEST). The rationale was that:

> For automatic enrolment to succeed, every employer and individual must be able to access pension saving. However, the Pensions Commission's analysis concluded that there will be a significant number of companies or individuals who are unprofitable for the pensions market to serve at a reasonable cost to members, typically small companies and lower earners. This being the case, automatic enrolment would be unworkable. The Pension Commission's solution to this was the National Pension Savings Scheme (now NEST).[4]

A review in 2010 found that the market had responded by establishing Master Trusts, although they were not widespread at that point. It concluded that it would be wrong to ask the existing pensions industry to cover the whole of the auto-enrolment population:

> Starting from a proposition of wanting to provide relatively low-cost pension provision for individuals without very significant reductions in the scope of coverage of automatic enrolment, our profitability analysis supports the Pensions Commission's argument that there is a supply gap in the existing pensions market. This gap persists despite the introduction of automatic enrolment; in fact, automatic enrolment counter-intuitively decreases overall profitability in the market, due to the inclusion of new savers with low salaries, low contribution levels and relatively high job churn.
>
> We conclude that it would be wrong to ask the existing pensions industry to cover the whole of the automatic enrolment population, either through higher charges or through some form of subsidised charges. A significant risk in asking the pensions industry to cover a new and, at current charge levels, unprofitable client group would be substantively higher charges. These would impact both on new savers and potentially lead to higher costs in the wider market place. This would undermine the hard won gains in terms of value for money that we have seen over the last ten years.[5]

It believed that NEST would "both offer good value to its target audience and provide a high benchmark for the rest of the pensions industry." It was a "necessary part of ensuring universal access to a pension scheme at an acceptable cost to the member."[6]

Growth in Master Trusts

In an impact assessment of September 2016, DWP showed how the market had developed since 2010:

> 10. Since the roll-out of automatic enrolment began in 2012, there has been a large growth of Master Trust schemes in the DC market place:

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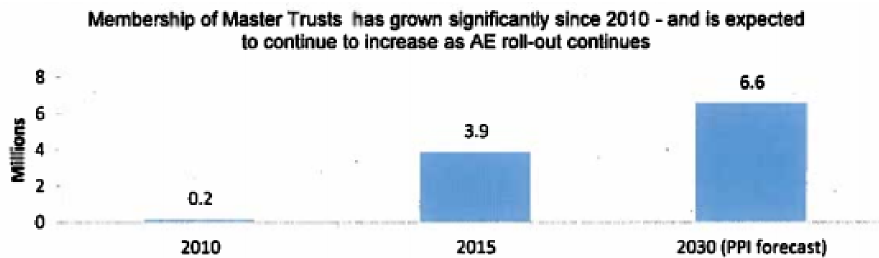
3 DWP, Automatic enrolment evaluation report 2016, December 2016; See Library Paper SN-06417 Pensions: automatic enrolment – 2020 onwards (December 2016).
4 Johnson et al, Making automatic enrolment work review, October 2010, p68
5 Ibid p92
6 Ibid p93



> 11. In 2010 there were around 0.2 million members in Master Trust schemes. By 2015, this had increased to around 4 million. Master Trusts now make up around 7 in ten memberships of DC trust-based schemes and in 2016 Master trusts being used for Automatic Enrolment were reported to be managing assets the value of around £7.6 billion. The latest (unpublished) estimate from TPR suggests there are now £4.3m members and around £8.1 bn in total assets managed by 84 Master Trusts.
>
> 12. The 2015 Employer Pension Provision Survey found that 5% of all UK employers offered access to a Master Trust scheme (3% using NEST, 2% with a Master Trust other than NEST), and the majority of these employers were using Master Trusts for automatic enrolment duties. Of those employers that had already implemented automatic enrolment, 37% were using Master Trust schemes (23% NEST, 14% other Master Trusts). Of those employers who were yet to 'stage' (implement automatic enrolment), although the majority (60 per cent) either already offered pension provision or had not decided which type of scheme to use, 21 per cent planned to use a Master Trust (including NEST).[7]

The Pensions Policy Institute states that 83% of employers have automatically enrolled employees into DC schemes.[8]

1.3 Regulation before the 2017 Act

As trust-based schemes, Master Trusts are regulated by the Pensions Regulator (TPR) rather than the Financial Conduct Authority (FCA) which regulates contract-based schemes.[9]

DWP explains that the regulatory framework for trust-based schemes was developed with single employer schemes in mind and that some of the fundamental dynamics and influences assumed to be in place do not apply to Master Trusts:

> 5. As a trust-based scheme, Master Trusts are subject to laws that have traditionally been designed for and applied to the single employer model (as this is how trust-based schemes have tended to be set up), and they are regulated by TPR. However, as multi-employer schemes for unconnected employers there are many ways in which Master Trusts share more in common with group personal pensions (a type of contracted-based scheme which is regulated by the FCA).
>
> 6. Contract law works in a different way to trust law and occupational pension law. The FCA regulate firms that offer personal pensions, including fit and proper person tests for key

[7] DWP, Impact Assessment - Master Trust Authorisation, September 2016
[8] Pensions Policy Institute, The DC Future Book – 2019 Edition, 11 October 2018
[9] MoU of Understanding between the Financial Conduct Authority and the pensions Regulator, April 2013

individuals delivering regulated activities. Also, the insolvency risk of insurance providers of personal pension schemes is regulated by the Prudential Regulatory Authority (PRA). Personal Pensions, along with other financial products and services, are covered by the Financial Services Compensation Scheme.

7. Some of the fundamental dynamics and influences that are assumed to be in place in occupational pensions – such as an employer having an ongoing interest in the running of the scheme and of the future of the scheme being aligned to the future of the employer – do not apply to Master Trusts. Also, many Master Trusts, unlike other occupational pension schemes are set up to create profit or to be self-sustaining. Alongside the transactional relationship with the employer, this gives rise to new risks which in turn gives rise to a need for a different type of regulation to ensure member benefits are protected.[10]

The Master Trust Assurance framework

As a way of mitigating risks, TPR and the Institute of Chartered Accountants in England and Wales (ICAEW) developed a Master Trust Assurance framework – which is voluntary and designed to help trustees assess whether their scheme meets equivalent standards of governance and administration to those set out in TPR's DC code.[11]

There is a list of the 22 Master Trusts that have been independently reviewed against the master trust assurance framework on the TPR website.

TPR explains that there are two types of report under the framework – one to check the design of the scheme's control procedures and the other to check the operating effectiveness of those procedures over the reporting year:

> Your Master Trust should have control procedures in place to ensure that governance and administration arrangements work properly.
>
> To obtain Master Trust assurance, you need to commission an independent reporting accountant to assess the design and operating effectiveness of the control procedures you have in place. The accountant will produce a report that explains whether your procedures meet the control objectives set out in the Master Trust supplement to AAF 02/07, produced by the ICAEW in partnership with us.
>
> In the unlikely event that certain control objectives don't apply to your Master Trust, you should ensure that their omission is explained in the report. It's the trustees' responsibility to ensure that sufficient control objectives are met to satisfy our DC code. We expect Master Trusts which obtain assurance to publish their reports on an annual basis.
>
> There are two types of report. Type 1 checks the design of the scheme's control procedures. Type 2 checks the operating effectiveness of those procedures over the reporting year. Trustees

10 DWP, Impact Assessment (IA), September 2016, p8-9
11 TPR website – Master Trust assurance

> are likely to obtain a type 1 report in the first year. We expect you to obtain type 2 reports in every subsequent year.[12]

In 2016, the Government estimated that 90% of savers in Master Trusts are in a scheme assured under this framework.[13]

1.4 What problem did the 2017 Act set out to address?

The Work and Pensions Select Committee found that Master Trusts were a "good fit" with auto-enrolment because:

> They can provide the ongoing oversight of investments provided by a trustee board at lower operating costs than single employer schemes, through economies of scale from pooling administrative functions. TPR encouraged employers to consider large multi-employer schemes for AE because they were "better placed to meet the standards […] necessary for good outcomes for retirement savers" and expected Master Trusts to dominate the market.[14]

However, it called for stronger regulation.[15]

In debate on the legislation, the then Work and Pensions Minister Lord Freud said there was much to recommend Master Trusts as the "scheme of choice for employers and members":

> They can drive value for money due to competition in the market and the economies of scale and offer a neat solution for smaller employers, for whom setting up an individual pension scheme for employees would be impracticable and burdensome.[16]

However, they gave rise to new risks, which the Government would address through the legislation. This was needed:

- To protect members from suffering financial detriment as a result of new and increased risks presented by Master Trusts which are not adequately covered by the existing regulatory framework, and to level the playing-field in what types of risk members are protected from both within the Master Trust market and between types of DC scheme.
- To promote quality based on a level playing-field in the Master Trust sector by ensuring that reputable Master Trust arrangements are not undercut by less reputable arrangements seeking to gain a competitive advantage by weakening member protections or by exploiting loopholes.
- To protect confidence in pension saving in the UK by reducing the risk of high profile failure or fraud in the Master Trust sector. Given the growing prevalence of Master Trusts in providing benefits it will also help protect the good reputation of the Automatic Enrolment programme, which is a key pillar of the Government's

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12 Ibid
13 House of Commons Deposited Paper DEP 2016-0535
14 Work and Pensions Committee, Automatic enrolment, HC 579, May 2016, para 14
15 Work and Pensions Committee, Automatic enrolment, HC 579, May 2016, para 23
16 HL Deb 21 November 2016 c1738

> approach to ensuring people make adequate provision for their financial needs in later life.[17]

A consensus had developed that that Master Trusts needed tougher regulation to address the risks of small, inadequately-resourced schemes collapsing and of scammers entering the market.[18] In fact, two Master Trusts had already failed. However, they were both relatively small schemes (with 7,500 members in total) which TPR indicated were straightforward to manage:

> […] the member assets were transferred into other pension schemes without any significant known member detriment, although this risk remains for other schemes.[19]

Another issue with Master Trusts was the quality of governance. Regulators had already identified a principal-agent problem in the auto-enrolment market, where:

> […] the employer selects the scheme on behalf of its employees but may not understand or act in the employees' best interests potentially automatically enrolling employees into poor value schemes.[20]

In debate on the Bill, Lord Freud explained that:

> In a single employer scheme, the employer is typically far more closely involved in the running of the scheme and tends to have a more active relationship with the trustees. With master trusts used for automatic enrolment, employer involvement is generally limited to paying over the employer contribution.[21]

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[17] DWP, Master Trust Authorisation – Impact Assessment, October 2016, p12

[18] See, for example, All hail the Pension Schemes Bill, TPR blog, 20 October 2016; A People's Pension One Pager. Master Trust Regulation, October 2016; ABI, Pension Schemes Bill – Master Trusts, October 2016

[19] DWP, Master Trust Authorisation – Impact Assessment, October 2016, p17-8

[20] FCA, CP 14/24, p22

[21] HL Deb 21 November 2016 c1728-9

1.5 Expected impact

In the impact assessment prepared for the Second Reading of the Bill in October 2016, DWP states that because some "substantive policy decisions" will not be taken until it has consulted on the regulations, there is too much uncertainty to provide a meaningful assessment of the costs to business at this stage.[22] The reason for proceeding with legislation without this detail was that there was a desire across industry to act as swiftly as possible to prevent poor quality Master Trusts undercutting those who had acted to address risks.[23]

The overall cost to business would depend on the number of Master Trusts choosing to enter or remain in the market. The Government expected that there would be some consolidation – with the number reducing from 84 to around 67 or (if schemes decided not to seek authorisation or failed to meet the standards) to around 54.

The key impact on members related to the level of risk/protection and the likelihood of any loss of pension savings. However, there was "considerable uncertainty" regarding the likelihood of scheme failure and the level of member benefits at risk.[24]

An updated impact assessment published alongside the draft regulations in October 2017 explained that the Government expected the number of Master Trusts to reduce to around 57:

> The costs to business will depend on the number of Master Trusts that choose to remain in or enter the market. Across the 87 Master Trusts known to the Regulator in 2017, it believes that there will be some consolidation in the counterfactual scenario and this may reduce the number of Master Trusts to around 70. The impact of authorisation on the number of Master Trusts is not known. It is anticipated that some schemes will not seek authorisation and some will fail to meet the criteria and exit the market. This is assumed to reduce the number of Master Trusts further to around 57, although this will be heavily dependent on individual schemes reaction to the authorisation regime.[25]

Introducing a debate on draft regulations in July 2018, Baroness Buscombe explained that TPR was working with 20 schemes had had already closed or signalled their intention to leave the market and that further consolidation was expected:

> During discussions on the Bill, noble Lords were clear that our expectation is that the market will respond to these changes. The emerging evidence shows that this is the case. The retrospective measures mean that the regulator is currently working closely and effectively with 20 schemes that have already either closed or signalled their intention to leave the market. This includes assisting them with finding appropriate destinations for their members. The introduction of new provisions earlier this year to ease and speed bulk transfers into and out of defined contribution

Costs to business

The Government is committed to producing an assessment of the Equivalent Annual Net Direct Costs to Business (EANDCB) of qualifying measures. The EANDCB is an estimate of the average annual net direct costs to business in each year that the measure is in force. It is calculated as the present value of the net direct cost to business divided by the sum of the discount factors appropriate for the length of time the measure is in force (HCWS574 3 March 2016)

[22] DWP, Master Trusts – Impact Assessment, October 2016, para 41
[23] Ibid p25
[24] Ibid p24
[25] DWP, Impact assessment: Occupational Pension Schemes (Master Trusts) Regulations 2018 consultation, October 2017

> schemes offers further support to members. In addition, where a scheme has started to wind up, the disclosure regulations ensure that members are made aware, allowing them to decide individually whether to accept the trustees' default destination or make their own arrangements.
>
> We expect that there will continue to be further consolidation of the market as we approach the October deadline.[26]

On 1 October TPR announced that:

> Three schemes have wound up and a further 27 have decided not to apply for authorisation and are winding up their scheme, transferring their members to an alternative master trust scheme or other appropriate vehicle. The remaining 58 master trust schemes expect to either apply for authorisation or trigger their exit from the market in the coming months. We anticipate more schemes will choose to leave the market before the authorisation window closes in April next year.[27]

[26] HL Deb 18 July 2018 c102GC
[27] TPR, The current master trust market – latest facts and figures, October 2018

2. The 2017 Act

Arrangements to regulate Master Trusts are in Part One of the Pension Schemes Act 2017

> An authorisation and supervision regime for Master Trusts will be introduced, so that Master Trusts would have to demonstrate to TPR that they meet certain key criteria on establishment, and then continue to do so.
>
> Existing Master Trusts will be brought into the regime and required to meet the new criteria.
>
> Requirements will be placed on trustees to act in certain ways in the event of wind up or closure of a Master Trust to protect members in those circumstances.
>
> TPR is provided with greater powers to take action where the key criteria are not met.[28]

The Act applies to Great Britain. Northern Ireland is expected to bring forward parallel legislation.[29]

2.1 Regulations

The Act contains a substantial number of regulation-making powers.[30]

In the legislation as originally presented to Parliament, most were subject to the negative procedure in Parliament.[31]

Statutory instruments

There are two types of SI:

- Affirmative: both Houses of Parliament must expressly approve them;
- Negative: become law without a debate or a vote but may be annulled by a resolution of either House.

For more information, see statutory instruments on the Parliament website and Library Briefing Paper SN-06509 (December 2012).

However, both the Delegated Powers and Constitution Committees expressed concern that this provided insufficient opportunity for parliamentary scrutiny.[32]

At Report Stage on 19 December, it amended the legislation to make more of the regulations subject to the affirmative procedure on the first occasion.[33] Lord Freud explained:

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28 Bill 125 –EN, para 9
29 Ibid para 23-5
30 Delegated Powers and Regulatory Reform Committee, Pension Schemes Bill [HL] 2016-17, November 2016, para 3; DWP, Pension Schemes Bill – Delegated Powers Memorandum, January 2017; DWP, Pension Schemes Bill. Delegated Powers Memorandum, October 2016
31 HL Deb 1 November 2016 c561; DWP, Pension Schemes Bill. Delegated Powers Memorandum, October 2016
32 Delegated Powers and Regulatory Reform Committee, Pension Schemes Bill [HL] 2016-17, November 2016; Letter from Chair of the Constitution Committee to Lord Freud, 11 November 2016
33 DEP 2016-0916

> The provisions that will be subject to affirmative resolution as a result of these amendments represent significant aspects of the authorisation regime, including the fit and proper person test, financial sustainability, systems and processes, continuity strategy and significant events.
>
> I owe the noble Lord, Lord Kirkwood, a proper exposition of the process of how we get to these regulations. Currently there is an engagement process with stakeholders to develop the detailed policy. We anticipate that that and an initial consultation to inform the regulations will take place in the autumn of 2017. That will be followed by formal consultation on the draft regulations. Our intention is to lay the regulations over the summer period and commence them during October 2018.
>
> I will now touch briefly on the actual provisions that are covered. Clause 7 relates to the need for individuals involved in the scheme to be fit and proper people. Subsection (4)(a) allows the Secretary of State to make regulations requiring the regulator to take into account certain matters when assessing whether a person is a fit and proper person to act in a particular capacity. Clauses 8 and 9 relate to the financial sustainability of a master trust. Clause 8 requires that the regulator must be satisfied that the business strategy relating to the scheme is sound and that the scheme has sufficient resources to meet certain costs. The power in Clause 8(4) is to enable regulations to set out matters that the regulator must take into account when deciding whether it is satisfied on these matters. Clause 9 relates to the requirement for a scheme strategist to produce a business plan, and the power in Clause 9(2) allows the Secretary of State to set out what information should be included.
>
> Clause 11 makes provision for systems and processes. It includes a regulation-making power to require the Pensions Regulator to take into account specified matters when deciding whether it is satisfied that the systems and processes adopted by schemes are sufficient to ensure that they are run effectively. Clause 12 sets out the requirement for the scheme strategist to prepare the continuity strategy. The powers in subsections (5) and (6) allow the Secretary of State to determine the format in which the level of charges should be set out. Clause 16 puts a duty on specified persons involved in running an authorised master trust scheme to notify the regulator when they become aware that a "significant event" has occurred.[34]

DWP consulted on draft regulations between 30 November 2017 and 12 January 2018. They were debated in the House of Commons on 10 July 2018 and in the Lords on 18 July 2018.[35] The *Occupational Pension Schemes (Master Trusts) Regulations 2018 (SI 2018/1030)* were made on 5 September 2018 and come into force from 1 October.

2.2 TPR's approach to regulation

Following consultation, TPR's Master Trust Code of Practice was laid before Parliament in July 2018. The purpose was to "provide master trusts with the clarity they need on how to apply for authorisation and the matters that will be taken into account in deciding whether a master trust should be authorised and remain so."

34 HL Deb 19 December 2016 c1489
35 DLC Deb 10 July 2018 c4; HL Deb 18 July 2018 c101GCff

Schemes were also offered a 'readiness review' before the window for applications for authorisation opens (between 1 October 2018 and 1 April 2019). TPR published key lessons learned from this in September 2018.

In July 2018, launched consultation on its proposed supervision and enforcement policy. It explained:

> The Master Trust Supervision and Enforcement Policy published for consultation today outlines how TPR will supervise all schemes as well as more intensively scrutinise higher risk master trusts.
>
> The document also details how TPR may use its powers to enforce against master trusts if problems arise or legislation is breached, and ultimately withdraw authorisation if a master trust no longer meets the authorisation criteria or other obligations.
>
> The supervision of master trusts aligns with TPR's new risk-based approach of proactively overseeing all types of pension schemes, which is being developed as part of the TPR Future change programme.[36]

[36] Future monitoring of the master trust market unveiled by TPR, TPR press release, 26 July 2018

3. The detailed provisions

Section 1 of the *Pension Schemes Act 2017* provides for a definition of Master Trusts as an occupational pension scheme which:

- Provides money purchase benefits (whether alone or in conjunction with other benefits);
- Is used, or intended to be used, by two or more employers;
- Is not used, or intended to be used, only by employers which are connected with other; and
- Is not a relevant public service pension scheme (section 2).

One employer is connected to another if:

- They are connected by reference to 'group undertakings' in the *Companies Act 2006;* or
- In circumstances specified in regulations.[37] The Government agreed that these regulations would be subject to the affirmative resolution procedure, because of the potential for "significant implications" in the event of some or all of the Master Trust provisions being disapplied as a result.[38]

Debate

At Committee Stage, Lord Flight raised concerns that certain industry-wide schemes (such as the Railways Pension Scheme, the Mineworkers' Pension Scheme and the Universities Superannuation Scheme) might be caught because, although they were essentially defined benefit schemes, they gave members the option of building up money purchase benefits through additional voluntary contributions (AVCs). He argued that the Master Trust should be targeted at "only those schemes that are currently subject to inadequate regulation."[39]

Lord Freud said he was "wary of creating a loophole.[40] However, at Commons Committee stage, the Government amended the legislation so that, for a scheme providing mixed benefits, the reference to the master trust would cover only the money purchase elements.[41]

In July 2018, Baroness Buscombe explained that the regulations provided further clarity on those schemes that were within scope:

> I can now confirm that the regulations will bring certain types of non-master trusts within scope—for example, what are often known as "cluster schemes" where schemes may have single employers but are run by the same people and are subject to the same rules. They also disapply the authorisation regime to some types of scheme which have specific characteristics that mean they meet the definition but do not face the same risks as master trusts—for example, certain small schemes where all the members

37 Section 1 (3)
38 Section 1 (5); DWP, Delegated Powers Memorandum, para 21
39 HL Deb 21 November 2016 c1730-1
40 Ibid, c1737; see also DEP 2016-0898
41 PBC Deb 7 February 2017 c14

> are trustees and the majority of the trustees are members of the scheme.[42]

3.1 Authorisation applications

Sections 3 to 6 provide for an authorisation framework.[43] This was needed because – although people running schemes regulated by the FCA had to satisfy various criteria before they can register for tax relief - there was currently no equivalent process for Master Trusts.[44]

Prohibition on unauthorised schemes

Section 3 provides that a person may not operate a Master Trust unless the scheme is authorised. To be authorised, TPR must be satisfied that the scheme meets criteria set out in section 5(3).[45] In the Commons, the then Pensions Minister Richard Harrington explained the Government's thinking:

> The requirement to become authorised creates a barrier to entry to the master trust market, so rather than us waiting for things to go wrong, the interests of scheme members will be protected in a proactive manner, because new master trust schemes will be prohibited from taking on members until they have satisfied the regulator that they meet essential quality standards. Existing schemes will have to become authorised to continue operating in the market. New schemes will have to be newly authorised.
>
> Introducing a requirement for authorisation is a proportionate response to the rapid development of master trusts, given the types of risks inherent in the structure of the schemes. Clause 3 prohibits a person—a "person" being an entity—from operating a master trust scheme, unless that scheme is authorised by the regulator, and so is the core and foundation of the whole authorisation regime.
>
> The clause also sets out the consequences of breaking the prohibition. It is important that those consequences are clear and firm. If the regulator becomes aware that a scheme is operating without authorisation, clause 3 requires it to issue a notice to the trustees of that scheme, explaining that the scheme is not authorised. Such a notification—I am sure we will discuss the effects of this later—is a triggering event that requires the scheme's trustees to transfer the scheme's members out and wind up the scheme. The risk of being shut down by the regulator is a strong deterrent that will ensure that the authorisation regime is taken seriously. The clause also gives the regulator the power to issue a civil penalty if the prohibition has been broken. This will act as an additional deterrent to anyone who may seek to operate a master trust scheme without authorisation.[46]

Applications and decisions

Section 4 provided for an application for authorisation to include:

- The scheme's latest accounts;

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[42] HL Deb 18 July 2018 c103GC
[43] Now sections 3 to 6 of the Act
[44] TPR welcomes proposed new powers to regulation Master Trusts, May 2016; HMRC, Pension Tax Manual, Registration: registering a pension scheme: applying to register
[45] Bill 125 EN, para 39
[46] PBC Deb 7 February 2017 c15-16

- The latest accounts of each scheme funder;
- The scheme's business plan; and
- The scheme's continuity strategy.

The Secretary of State may make regulations setting out any other information to be included in the application and the application fee payable.[47]

These regulations would be subject to the negative resolution procedure.[48] The justification is that the provision allows for "additional operational detail, which may need to be changed from time to time."[49]

Under **section 5,** TPR must make a decision (within six months) as to whether the scheme meets the authorisation criteria in section 5 (3)). If authorisation is refused, the applicant must be notified of the reasons for this (section 5 (6)).[50]

A decision to refuse authorisation may be referred to the Tribunal under **section 6.**

Further detail is provided for in the regulations:

> To bring clarity to the application process, the regulations specify that the scheme must have a business plan approved by the trustees and the scheme funder. This will include detailed information about the ambition and financial strategy of the scheme, as well as providing details relating to the scheme funder, the systems and processes that are used and information on trustees and others in a position of influence over the running of the scheme. In addition, schemes and scheme funders will need to provide their audited accounts and the accounts of any third party funder.[51]

Debate – member engagement

Lord McKenzie proposed an amendment to require schemes to give details of their member engagement strategy in their applications for authorisation. He said:

> Understanding members' views and needs is essential to designing investment strategies and to the assessment of value for members. It is, or ought to be, an essential component of designing a pension scheme and something which is integral to its creation and continuance.[52]

Lord Young's initial response was that there were already minimum statutory standards for communication with members.[53] However, at Report Stage, he said the Government had decided to use regulations to ensure TPR took account of communications and engagement:

> I can confirm that the Bill as drafted allows the regulator to take into account the systems and processes relating to

[47] Section 4 (5)
[48] Section 4 (6)
[49] DWP, Delegated Powers Memorandum, January 2017, para 25
[50] For an overview its purpose, see PBC Deb 7 February 2017 c25
[51] HL Deb 18 July 2018 c104GC
[52] HL Deb 21 November 2016 c1753-4
[53] Ibid c1759

> communications and engagement when assessing the adequacy of a scheme's systems and processes more broadly. I can also confirm that the Government would intend—subject, of course, to consultation—to use the regulations under Clause 11 to ensure that the regulator specifically considers a scheme's systems and processes in relation to these important communication matters when deciding whether the scheme is run effectively.[54]

In the Commons, Alex Cunningham tabled an amendment to ensure that there was a requirement for an application to include a member engagement and communication strategy:

> Our amendments seek to ensure that as part of the defined-contribution—DC—code of practice, there is a requirement for the authorisation process principally to ensure that the application to the Pensions Regulator includes a member engagement strategy and a communication strategy. The Pensions Regulator's code of practice for DC pension schemes, published in July 2016, sets out the standards that pension trustees need to meet to comply with legislation. The code, which applies to all schemes offering money purchase benefits, is supported by a series of "how to" guides that provide more detail about how trustees can meet the standards in practice.
>
> The Pensions Regulator has also produced a tool to help trustees to assess their scheme against the standards in the code so that they can identify areas requiring improvement. The DC code sets out a number of areas in which an understanding of members is key, particularly those of gauging members' views to inform the design of investment strategies and the assessment of value for members. The regulator suggests:
>
> "Member nominated trustees in particular may be able to provide feedback, as might union representatives, other employee representatives or existing staff forums."
>
> It is because of the valuable role that scheme members can play that we have tabled the amendments on scheme member trustees. We need to improve the Bill to make it more scheme-member-friendly.[55]

He was supported in this by Ian Blackford who said it was "important to encourage as much member engagement as possible."[56]

Mr Harrington responded that it was not clear how this would increase protection for members. The Bill already required a scheme to satisfy the regulator that its "systems and processes are sufficient to ensure the effective running of the scheme." Regulations would "ensure that those matters are taken into account when considering a system's application for authorisation."[57]

Mr Cunningham said it was important to "communicate the full message to the people whose money we are dealing with." His amendment was defeated on division by 6 votes to 9.[58]

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54 HL Deb 19 December 2016 c1487
55 Ibid c18
56 Ibid c19
57 Ibid c20
58 Ibid 24

Notification requirements - triggering events

In broad terms, a "triggering event" is a type of "event that could put the scheme at risk."[59] The actual events that constitute triggering events were set out in section 21. Trustees are required to inform the employers if a triggering event occurs (section 22 (6)). In response to a proposal that members should also be informed, Lord Young said the Government "did not want to worry members unnecessarily and at a point when definitive information about the next steps may not be available."[60] The requirement on schemes was to pursue the continuity option set out in their implementation strategy, once approved by TPR, and to "make the strategy available to employers." Given the potential complexity of wind-ups, this struck the right balance.[61]

Funding

Lord Flight questioned whether an application fee would inevitably be payable by employers.[62] Lord Freud said the fee served two purposes:

> First, it ensures that TPR can recover the costs of processing applications from master trust authorisation without indirectly placing those costs on the wider pensions community it regulates. Without an authorisation fee it would have to recover these costs through the funding provided by the general levy, and this would not be fair given that a large number of the schemes which pay into this levy are not master trust schemes. Secondly, the fee ensures that schemes seeking to become authorised submit carefully considered applications by acting as a deterrent to submitting multiple applications.[63]

Consideration of the resources TPR would need would form part of the "annual business planning process in the normal way."[64]

3.2 Authorisation criteria

As stated above, section 5 (3) provides for TPR to decide whether a scheme met the authorisation criteria i.e:

- That the persons involved in the scheme are fit and proper;
- That the scheme is financially sustainable;
- The each scheme funder meets the requirements set out in section 11;
- That the systems and processes used in running the scheme are sufficient to ensure that it is run effectively; and
- That the scheme has an adequate continuity strategy.

The detail of the process and the standards applied will be set out in secondary legislation.[65]

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59 HL Deb 21 November 2016 c1815
60 HL Deb 21 November 2016 c1761
61 Ibid c1762
62 Ibid c1764
63 Ibid c1766
64 Ibid c1767
65 DWP, Master Trust Authorisation – Impact Assessment, September 2016

The authorisation criteria are now in s 7-12 of the 2017 Act.

TPR's Code of Practice No. 15 Authorisation and supervision of master trusts explains how to apply for authorisation and the matters that will be taken into account in deciding whether a Master Trust should be authorised and remain so.[66]

Fit and proper persons requirement

Section 7 set out "a requirement that TPR must decide if key individuals in the scheme are fit and proper to act in their roles." This would apply to individuals in key roles, including:

- The person establishing the scheme;
- Trustees of the scheme;
- Individuals who have the power to appoint and remove trustees;
- Individuals who have the power to amend the trust deed;
- The scheme funder; and
- The scheme strategist.[67]

There is provision for additional roles to be set out in regulations.[68] In response to a question from the Delegated Powers Committee, DWP explained that this regulation-making power was residual – to allow a response to new structures evolving in the market.[69]

Section 7 (4) provides that:

> In assessing whether a person is fit and proper to act in a particular capacity, the Pensions Regulator –
>
> (a) must take into account any matters specified in regulations made by the Secretary of State, and
>
> (b) may take into account such other matters as it considers appropriate (including, in particular, matters relating to a person connected with that person).

The first regulations under this section were subject to the affirmative procedure in Parliament.[70]

In its Delegated Powers Memorandum, DWP states that:

> The Government envisages these regulations will include matters in relation to competence and experience across the trustee board, as well as matters of propriety. It is important for schemes seeking authorisation that there is transparency over how the fitness & propriety will be assessed. In view of the wide range of considerations that may be relevant where different categories of person are acting in relation to a Master Trust, as well as the level of detail that might be required, the Government considers that these requirements cannot be appropriately set out on the face of

66 TPR, Master trust code of practice consultation, 27 March 2018
67 Section 7 (2)
68 Section 7 (2) (h)
69 DWP, Pension Schemes Bill – Delegated Powers Memorandum, January 2017, p8-9
70 Section 7(7)

> the primary legislation. Therefore clause 7(4)(a) provides a power for the Secretary of State to set this out in regulations.[71]

The Impact Assessment explained that:

> […] some Master Trusts may be able to demonstrate competence and integrity of their founders and trustees from existing processes they have already completed. Scheme return data held by TPR suggests that 41 schemes are part of a corporate group that has some existing FCA registration in other parts of its business. It is reasonable to assume that the founders of these Master Trusts may already have demonstrated their competence and integrity in relation to the financial history and integrity of the individual, although it is possible that requirements will differ from specific FCA criteria – depending on their function in the Master Trust. Others may incur costs to satisfy the criteria on competence and integrity. TPR intelligence based on preliminary assessment suggest that there may be a small number of schemes where there would be concerns about founder competence although these are not based on specific competence and integrity criteria that may be developed for Authorisation.[72]

Debate

Lord McKenzie asked why the list of persons that would need to be assessed as 'fit and proper' referred to a person with power to vary a non-trust scheme.[73] Lord Freud responded that the Government wanted to ensure that it did not create an "avoidance loophole."[74] The intention was to cater for the very small number of occupational pension schemes which under existing legislation are not required to be set up under trust: public service schemes and certain small schemes.[75]

At Commons Committee Stage, Richard Harrington explained the importance of the requirement:

> The structure of the master trust scheme means that it is no longer the members' employers who set up the scheme or appoint the trustees. That changes the key relationship and the influences on the running of the scheme. Some master trusts are set up as a commercial enterprise and resemble something more akin to a conventional financial services product, but without being subject to the same regulatory requirements. It is therefore only right that we introduce the requirement of being fit and proper—fitness and propriety—in respect of those setting up and running master trusts.[76]

Financial sustainability requirement

Section 8 provides that:

> […] the Pensions Regulator must be satisfied that a Master Trust has sound business strategy and sufficient financial resources to meet the costs of setting up and running the scheme, and to comply with requirements to protect members where an event occurs that may lead to the scheme closing or winding up (see

71 DWP, Delegated Powers Memorandum, January 2017, para 32
72 DWP, Master Trust Impact Assessment, September 2016, para 50
73 HL Deb 21 November 2016 c1772
74 Ibid c1772
75 Dep 2016/0898
76 PBC Deb 7 February 2017 c26

> sections 20 to 33 in relation to triggering events and continuity options).[77]

The financial stability requirement is that the scheme has sufficient resources to meet the costs specified in section 8(3):

> (a) the costs of setting up and running the scheme, and
>
> (b) in the event of a triggering event occurring –
>
> (i) the costs of complying with the duties in sections 20 to 33, and
>
> (ii) the costs of continuing to run the scheme for such period (which must be at least six months and no more than two years) as the Regulator thinks appropriate for the scheme.

The Government expects that the requirement to hold a certain amount of capital in case of failure may impose the "most significant costs for schemes." The impact would depend on the extent that capital was already held by the founder (for example, to comply with FCA requirements) and the level of capital required under the new rules. The key factor would be to:

> […] hold sufficient assets or backing to cover the period in which the scheme is building to sustainability, to cover circa 12 months' operating costs, and to cover the costs of wind up/deliver their continuity of savings strategy, or other market exit.[78]

Section 8 (4) provided a power for the Secretary of State to make regulations on the matters that TPR must take into account in deciding if it is satisfied that a Master Trust meets the financial sustainability authorisation criteria.

In its Delegated Powers Memorandum, DWP explained:

> 36. The Government envisages using this regulation making power to, for example, require the Regulator to take into account the scale, nature and security of the sources of funding available to the scheme, as compared to its expected scale. In relation to the financial resources required to enable the scheme to meet its costs following a triggering event (key risk events, set out in clause 21), the Government anticipates that the Regulator will also be required to take into account the extent to which those resources are separated from or otherwise protected from the risk of the scheme funder's insolvency. The regulations are expected to also set out the factors that the Regulator will need to consider in assessing whether the business plan is 11 sound, such as the reasonableness of the calculation of the costs set out in subsection (3).[79]

The first regulations under this clause would be subject to the affirmative procedure.[80]

Comment

Providers took different views on the financial resource requirements. One was concerned that the Bill did not prescribe a minimum amount:

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[77] Explanatory Notes, para 47
[78] DWP, Impact Assessment – Master Trust Authorisation, September 2016, para 52
[79] DWP, Delegated Powers Memorandum, January 2017
[80] Section 8 (6)

> The Bill does talk about a scheme having six months' worth of operating costs but when you set up a master trust that doesn't amount to very much at all. We would like to see £2m being set as a rock bottom for capital adequacy.[81]

However, another disagreed, saying that Master Trusts operated in different ways and that deciding on the right amount of capital should be a matter for the trustees.[82]

The ABI said that as far as possible there should be a level playing field between Master Trusts and group personal pensions. It argued that insurers which operated under both the FCA and TPR's regulatory regimes were therefore already subject to prudential rules requiring them to hold capital for this purpose.[83]

In the Commons, Ian Blackford proposed that the financial sustainability of the scheme funder must be taken into account when accessing a Master Trust scheme's financial capability:

> A number of insurance companies have told us that they already hold a very significant amount of capital under the European regulatory framework for insurance insolvency. In this case, it seems unnecessary for insurers to be required to hold separate or additional capital on top of this in order to meet their new obligations as master trust providers under the Bill.[84]

Richard Harrington said the amendment was unnecessary:

> Clause 8 already sets out the two elements of the financial sustainability requirement: schemes must have a sound business strategy and sufficient financial resources to meet both their operating costs and costs following a triggering event, such as those of winding up in the event of scheme closure. The financial sustainability requirement is intended to mitigate the risk of a master trust being set up with inadequate planning and insufficient financial resources—that is its whole purpose. When the regulator assesses whether the scheme meets the requirement, it must take into account certain matters that will be specified in regulations, and our intention is that the regulations will include how the resources to cover the costs mentioned by the hon. Gentleman must be held. The scheme therefore includes a scheme funder.
>
> We are considering options for the regulations and will consult on them. Among those we will want to explore are holding the resources in escrow or as a guarantee, or other robust financial commitments. What the regulator will expect will differ greatly depending on the size of the company, varying from a massive multinational undertaking to a comparatively small one. It might involve a solicitor's client account or an escrow system. We want to consult on the options to get them absolutely right.
>
> Also, we can use the regulations to specify whether the resources could be held either by the scheme or elsewhere, such as with the funder. However, if they are held elsewhere, our intention is that there must be clear commitment and availability of the funds in a range of circumstances. We would not want the money to be

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81 Now Pensions: Master trust capital adequacy should be £2m minimum, Professional Pensions, 14 November 2016
82 Ibid
83 ABI, *Pension Schemes Bill – Master Trusts*, October 2016
84 PBC Deb 7 February 2017 c28

> held by the funder rather than by the scheme if there were not sufficient protections or commitments in the event of the funder's insolvency; the money must be readily available to do the job in whatever circumstances.
>
> It is absolute fair to say that the key risk for members is the financial sustainability of the scheme, so we have forcused on the requirement on the scheme, but the Bill and the regulation-making powers enable a variety of ways for the scheme to meet the requirements.[85]

The legislation would provide the Secretary of State power to prescribe matters that the regulator must take into account when assessing the scheme's financial sustainability. Such matters could include the scheme funder's solvency and whether it is subject to prudential capital requirements.[86]

Mr Blackford said he was relatively satisfied with the response, particularly given the ongoing consultation.[87]

Scheme funder of last resort

An Opposition amendment in the Lords – later removed at Commons Committee stage – would have provided for:

> […] the Secretary of State to make provision for a funder of last resort to manage any cases where the Master Trust has insufficient resources to meet the cost of complying with section 8 (3) (b) following a triggering event.[88]

The context is that there is a requirement for the Pensions Regulator to be satisfied that a Master Trust has sufficient financial resources to meet the costs of setting up and running the scheme and to comply with requirements to protect members in the event of wind up.[89]

Baroness Drake was concerned that much was left to regulations and she did not have the detail of the robustness of the capital adequacy or transfer-out regimes.[90] She said the Bill proposed "no contingency plan" for the situation where a Master Trust failed with insufficient resources:

> The Bill proposes no contingency plan for the failure of a master trust the records of which are in disarray, which has insufficient financial resources to comply with its duty when a triggering event occurs, and for which no master trust is willing to accept transfer of members' benefits. What will happen in those circumstances? How will all the members' funds be protected against increased charges? What liability for or immunity from the past provider's mistakes will a receiving scheme have?[91]

She was supported by Baroness Altmann, who asked:

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85 PBC Deb 7 February 2017 c28-9
86 Ibid c29
87 Ibid c30
88 Bill 125-EN, para 53; HL Deb 19 December 2016 c1511-13; PBC Deb 7 February 2017 c45
89 Section 8
90 HL Deb 21 November 2016 c1772
91 Ibid c1776

> […] how will any regulator know in advance what capital is actually adequate? The circumstances in which wind-up could take away people's pensions, even if the assets are ring-fenced and protected for the members, are those in which there is no other mechanism for covering the wind-up costs. That is where the members' pensions would be at risk.[92]

She said Ministers needed to explain why the Government did not think a compensation fund was necessary or how proper protection for members in extremis could be provided.[93]

Lord Freud responded that the Government believed the provisions were adequate:

> First, the main provisions in the Bill requiring schemes to hold certain funds are in Clause 8, which provides that for the scheme to be authorised it must satisfy the regulator that it has sufficient resources to meet certain costs. This includes the costs of complying with the requirements under the Bill once the scheme experiences a triggering event and those of running the scheme for a period of between six months to two years, in the event of a triggering event occurring.[94]

Members' benefits would be protected:

> The prohibition in relation to increasing members' charges applies during this period, so members are protected. If the funder should be in financial difficulty, the matter should be pursued via the normal court channels or insolvency processes. It is not the members' money which is at risk in these scenarios; it is the running costs of the scheme and payment for activities during the triggering event period.[95]

And the nature of the market meant there was less justification for Government intervention:

> We also know that other schemes may well rescue the failing scheme, as has happened before, to protect the reputation of the industry. This is a different dynamic from what would be the case in non-money purchase schemes, where the debt is about money needed to pay member benefits and where funding obligations to pay for the promised benefits would attach if another entity took over the scheme. The master trust industry can support the movement of members—some trusts are willing to do so—or take over failing master trusts, so government intervention is less warranted where an industry solution may be possible.[96]

He argued that the addition of a compensation fund would introduce moral hazard and, if funded by a levy, would add to the costs on schemes.[97]

Baroness Drake returned to the issue at Report Stage, introducing an amendment that would require the Secretary of State to make provision for funder of last resort. She argued that without this, the Government

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92 Ibid c1778
93 Ibid
94 Ibid c1779
95 Ibid c1779
96 Ibid c1780
97 Ibid c1781

could not claim that the Bill would "protect scheme members and their pots from the costs of managing failure." Her reasons were that:

> The Bill places a prohibition on using members' pots to fund a wind-up, but that does not mean that it will all sort itself out. If providers go insolvent, who ultimately will ensure that the wind-up and transfer actually happens? Pots could be left in limbo for many months. Even if the trustees have a legal duty to make such a transfer, they will not be able to pay for advice and administrative services to enable it to happen […]
>
> The resolution regime when a trust fails provides for transferring members' pots to another master trust. The Government are relying on the industry to always step up to the plate, but they cannot be certain that it always will. I am sure that there are master trusts now that are already concerned about what that means and will not want to commit to being part of a panel or carousel of providers which will always guarantee to accept the transfer of members. They may consider the unknown future exposure to costs or the liability for the administrative errors or failures of a failed scheme too unpalatable. They may want to cherry pick, leaving a less-profitable section of the members stranded. It is not difficult to imagine the sorts of problems that could occur. The Government cannot assume that the increase in scale achieved from accepting a transfer of members from a failed trust is a sufficient incentive for another provider to always volunteer to rescue.[98]

Her amendment was supported by Baroness Bakewell of Hardington Mandeville.[99]

Lord Freud responded that requiring the Secretary of State to make provision for a funder of last resort would be a "costly and disproportionate response."[100] The Bill contained a raft of measures to address the risks the amendment was seeking to address. In particular, schemes would be required to satisfy TPR that they had sufficient financial resources to comply with their continuity strategy following a triggering event.[101] Government intervention would be inappropriate:

> First, such an intervention might undermine member protection by creating a moral hazard that disincentivised schemes from protecting their members. Secondly, if the Secretary of State were required to make provision for a scheme funder of last resort, this could disrupt the normal operation of the market by deterring other master trusts, or scheme funders, from retaining public confidence in master trusts and rescuing a failing scheme. We already know of some master trusts that have been consolidated by being taken over by others. In the extreme, the taxpayer could end up having to pick up the tab for failed schemes. However, the essential argument is that Clause 33 protects members' savings from being used to pay for the costs of winding up or transferring.[102]

Baroness Drake responded that she was not seeking to tie the Government down to a particular provision but to answer the question

[98] HL Deb 19 December 2016 c1504
[99] Ibid c1506
[100] Ibid c1506
[101] Ibid c1506
[102] Ibid c1507

that "no Government or regulator can guarantee that they can remove all risk of regulatory failure." In the event of regulatory failure and a trust not having the means to finance wind-up, there was "nothing in the Bill to show how a member is protected" and "no answer to the question of who will bear the costs."[103] The House of Lords voted to accept her amendment by 209 votes to 204.[104]

Debate in the Commons

Opening a debate on whether the clause should stand part of the Bill, Richard Harrington said he had concluded that requirement for a scheme funder of last resort was unnecessary – the risk of scheme members being left stranded was "absolutely minimal." Were a scheme to fail, it was very attractive for existing successful master trusts to take the members on as it allowed them to "add members without adding very much to their costs." The Government was working with the Pensions and Lifetime Savings Association, which was exploring establishing a panel of white knights." Furthermore, the clause was imprecise in nature and he was concerned that it could lead to "perverse behaviour, with schemes shifting funds about, knowing that the taxpayer will pick up the bill."[105]

Alex Cunningham disagreed:

> It is not enough for the Government to argue that a failing scheme will always be successfully transferred. They instead must ensure that a funder of last resort is identified in the Bill. The Government argue that there is no need for a funder of last resort because the procedures laid out in the Bill will prevent it from reaching that far. Industry experts across the board insist that a funder of last resort or equivalent is needed.[106]

There were a number of options in regard to who or what the funder of last resort could be – it was the duty of the Secretary of State to ensure there was one. It was better to decide sooner rather than later, who would pay in the event of something going wrong. He asked the Minister to provide the Committee with "100% assurance that the Bill without this clause is enough to protect members" and said:

> In the absence of greater clarity about the Government's insistence that the Bill already addresses areas raised in this debate, it is vital that clause 9 is not removed. We should be covering every base in order to say confidently that we have taken every possible measure to protect members' money 100%.[107]

Ian Blackford said that in the absence of another solution, the Government should think about this clause remaining part of the Bill for now.[108]

Responding, Richard Harrington said that under the regime provided for in the Bill, after a 'triggering event' the regulator would be closely involved with how the scheme proceeded to resolve its difficulty or

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103 Ibid c1509
104 Ibid c1511-13
105 [PBC Deb 7 February 2017 c30-1]
106 [PBC 7 February 2017 c32]
107 Ibid c34-6
108 Ibid c36

close. It had powers to support a scheme – for example, by appointing a trustee. Overall, the Bill struck:

> […] a delicate balance between prevention and self-regulation and Government intervention – something that is very hard to do. The clause would disrupt that balance and confuse the regulatory approach... It is not possible to give absolute guarantees, but we can reduce risk to the lowest possible level and that is what the Bill aims to do [...]. We are against creating a Government-backed scheme because we think it would create moral hazard.[109]

The Committee voted by nine votes to four to remove the provision.[110]

Alex Cunningham returned to the issue in the Report Stage debate on 22 March arguing that:

> We need a funder of last resort because we must be able to predict what could happen, even if there is only the slightest chance of it happening, and ensure that we have a plan of protection in place. I ask again: why will the Minister not provide people all over this country with a 100% assurance that the Bill without this provision is enough to protect members. If he is to ignore our sensible new clause, he must guarantee that no master trust will be in a situation in which it has failed and has insufficient resources to meet costs. In the absence of greater clarity, it is essential that this new clause remains in the Bill.[111]

Pensions Minister Richard Harrington responded that:

> The whole purpose of the regime introduced by the Bill is to mitigate the very risk about which the hon. Member for Stockton North is concerned. He is right to be concerned about it. Various clichés have been used at various points in proceedings on the Bill, usually involving nuts, sledgehammers and other such matters. I would prefer to say that it is a question of being proportionate, or not being disproportionate. I think that that sums it up.[112]

He said the market was currently responding well to dealing with existing Master Trusts wishing to exit before authorisation. The Government was:

> […] working with the regulator on non-legislative measures to address concerns about potential liabilities of trustees and receiving schemes that might arise if the record of a Master Trust in wind-up is poor.[113]

Mr Cunningham's amendment was defeated on division by 289 votes to 230.[114]

During the Lords consideration of Common's amendments, Baroness Drake described this as disappointing and asked for an update on what further action the Government had taken to address "the protection of scheme member benefits in the event of a master trust winding up with insufficient resources to meet the cost of complying with and obligations

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[109] PBC Deb 7 February 2017 c40
[110] Ibid c42
[111] PBC Deb 22 March 2017 c885
[112] Ibid c898
[113] HC Deb 22 March 2017 c898
[114] HC Deb 29 March 2017 c 337

under the Bill."[115] The Minister responded that representatives of certain pension funds were "contemplating a system for allocation among themselves of any master trust that was going to wind up if the market did not provide a proper destination."[116]

In debate on the draft regulations in July 2018, Baroness Buscombe provided a further explanation of how TPR would support members of schemes that exit the market:

> I have previously described "triggering events", which are those likely to risk the scheme being closed and wound up. When this occurs, the scheme is required to convert its continuity strategy into an implementation strategy, including setting a clear timetable for either resolving the issue or closing the scheme. The regulator will work with the scheme to ensure that appropriate action is taken at each stage, including notifying employers and members about what has happened and what their options are if the scheme is going to wind up. The financial sustainability requirements will mean that there are sufficient funds to see the scheme through the transition period. Restrictions on charges in the Act mean that additional costs cannot be passed on to members.[117]

Business plan

Section 9 provided that a Master Trust must have a **business plan** prepared by the scheme strategist and approved by the scheme funder and the Trustees. The strategy must be reviewed at least annually and revised if appropriate. It must be provided to TPR on application for authorisation, within three months of any revision or on request by TPR.

In the Commons, Richard Harrington said that through the business plan, the regulator would be able to monitor the adequacy of the financial resources available to the scheme. The detailed requirements will be in secondary legislation. The business plan would support risk-focused financial supervision.[118]

Scheme funder requirements

Section 10 requires that the scheme funder of a Master Trust must be a separate legal entity. This means that it must be a legal person which only carries out activities that relate directly to the Master Trust for which it is the scheme funder.[119]

The Government made an amendment at Third Reading in the Lords to make it clear that the regulator could require that the scheme funders' accounts were audited. This was important given that they would provide key information for TPR's assessment of the Master Trust's financial sustainability. The Government had always intended that this should be the case but had been advised that "specific provision about audit in existing legislation might cast doubt on the breadth of the power."[120]

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115 HL Deb 5 April 2017 c1081
116 Ibid c1085
117 HL Deb 18 July 2018 c104-5GC
118 PBC Deb 7 February 2017 c42-3
119 Sections10 (2) and (3); Explanatory Notes, para 54-44
120 HL Deb 16 January 2017 c12 [Lord Henley]

Debate in the Lords

Lord McKenzie questioned the rationale for requiring the scheme funder to be a separate legal entity:

> In particular, the requirement for a scheme funder to operate only a single master trust would require a number of existing schemes to move from being supported by an FCA-regulated entity with significant financial resources to being supported by a single-purpose vehicle set up just to run the master trust. The policy rationale for this is unclear, and perhaps the Minister would clarify whether that really is the intention.[121]

The ABI had suggested that this should not apply when the scheme funder was an FCA-authorised insurer:

> As suggested under Solvency II, firms must hold capital against pension scheme risks. These capital requirements are onerous and it does not seem reasonable to require the holding of additional capital on top of them.[122]

However, Lord Young argued that the requirement was essential to enabling the regulator to assess the financial position of the scheme:

> To enable the regulator to assess the financial position of the scheme with certainty when deciding whether the master trust should be authorised or remain authorised, the scheme funder must be set up as a separate legal entity. This is defined in the Bill as meaning, in effect, a legal person whose only business activities are in relation to the master trust. Requiring scheme funders to be separate legal entities will make their financial position, and the financial arrangements between them and the master trust, more transparent to the regulator and provide greater clarity regarding the assets, liabilities, costs and income in relation to the master trust business. This will greatly assist the regulator in carrying out its assessment of schemes' financial sustainability.[123]

It would not prevent the Master Trust benefiting from support of the scheme funder's wider group:

> Support can be offered from the scheme funder's wider group explicitly through the provision of a legally enforceable guarantee or other formal arrangement from another group company of sufficient financial strength. Where the scheme funder currently conducts other businesses, a degree of cross-subsidy may already take place, and there is no intention to prevent this.[124]

Neither was it intended to "require the unpicking" of any shared service arrangements:

> Many financial services companies – indeed, many other companies – will use staff, systems and premises for multiple business lines, and usually allocate those costs as accurately as possible across the relevant activities.[125]

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[121] HL Deb 21 November 2016 c1786
[122] Ibid
[123] Ibid c1787-8
[124] Ibid c1789
[125] Ibid c1789

Groups of companies were used to restructuring their statutory account arrangements to reflect changes in focus and existing schemes would be allowed a transitional period to comply.[126]

Lord McKenzie returned to the issue at Report Stage, with a revised amendment that would require the scheme funder to be:

> […] constituted and carry out its activities in a manner that enables its financial position and the financial arrangements between it and the master trust to be transparent to the regulator.[127]

He questioned claims by the Minister made at Committee Stage that the requirements in the Bill were "not designed to require the unpicking of any shared service agreements"[128] He was concerned that the Government was at risk of "throwing the baby out with the bathwater" in circumstances where a "scheme is funded by an FCA-regulated entity with the robust capital requirements that this entails."[129]

Lord Flight said the fundamental issue for the insurance industry was that "the funder being a separate entity does not really work":

> The Bill will introduce additional cost on master trusts offered by insurers, potentially to the detriment of existing scheme members as these schemes already operate under stringent FCA and PRA regulation.[…] A key benefit of a master trust being part of a wider and well-capitalised entity is that the scheme can, if necessary, draw upon this capital. Members of master trust schemes offered by insurers currently benefit from this additional security.[130]

He asked the Government to continue negotiations on this point, arguing that it was "not entirely satisfactory if the key provider industry is not comfortable with this issue."[131]

Lord Young repeated that the requirement was essential to TPR's assessment of the financial sustainability of the scheme. He went on to discuss possible underlying concerns, such as regards the cost of corporate restructuring:

> The practical and legal requirements for setting up a business entity should not of themselves be burdensome. It is quick and easy to incorporate a company in the UK, and the Government make a company's ongoing filing requirements as simple as possible to comply with. However, we recognise that to meet this requirement, some companies offering master trusts among other lines of business would have to undergo corporate restructuring. To address this, we are working with key stakeholders to develop a proportionate approach to regulation that minimises the burden on business without undermining the Pension Regulator's ability financially to supervise schemes through transparent financial structures and reporting.[132]

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[126] Ibid c1789
[127] HL Deb 19 December 2016 c1514
[128] Ibid
[129] Ibid c1515
[130] Ibid c1515-6
[131] Ibid c1515-6
[132] Ibid c1517

Regarding the potential for overlapping regulatory requirements:

> […] if we identify an overlap between our requirements and those of other regulatory regimes, the Secretary of State has a regulation-making power in Clause 8 that can require the regulator to take those regulatory requirements into account when assessing whether a scheme is financially sustainable. We believe that power to be sufficiently flexible to prescribe, for instance, that if the scheme funder has an enforceable guarantee from a financially sound parent company, such as one that the meets the PRA's capital requirements, the regulator must take that into account when assessing whether the scheme has sufficient resources to meet the specified costs.[133]

Lord McKenzie said the issue was "completely unresolved."[134]

Government amendment in the Commons

At Commons Committee stage, the Government made amendments to address the concerns raised in the Lords:

> The first would allow an entity to be a scheme funder and, therefore, carry out activities in relation to more than one master trust, and also carry out activities, such as due diligence, where it is considering becoming the scheme funder of a new master trust scheme. The second would provide a power for the Secretary of State to create exceptions to the requirement for the scheme funder's activities to be limited to the master trust. Scheme funders who meet the requirements that are to be prescribed in regulations will be able to carry out activities unrelated to master trusts—for example, providing shared services to other schemes.
>
> We hope that this easement will minimise disruption to existing corporate structures and shared service arrangements. In addition, enabling scheme funders to carry out activities in relation to more than one master trust may facilitate consolidation in the market by making it easier for a scheme funder to rescue a failing master trust.[135]

Alex Cunningham welcomed this but asked for an assurance on whether "insurance companies that are already under strict regulation by" the FCA would be exempt from the separate legal entity clause.[136]

Ian Blackford asked for clarity on when and how the regulatory powers outlined in the amendment would apply and in what circumstances they might be used.[137]

Richard Harrington explained why the Government did not want exclude FCA-regulated insurance companies from the provisions.[138] They would be exempt if they met prescribed requirements in the regulations. In terms of the factors that would be considered when consulting on the regulations:

[133] Ibid c1518
[134] Ibid c1519
[135] PBC Deb 7 February 2017 c44
[136] Ibid c46
[137] Ibid c47
[138] Ibid c47

> They are the solvency of the entity, what regimes it falls under, transparency of arrangements and what connections there are between the funder and provider of the schemes.[139]

Alex Cunningham said it was important to send clear signals to the industry regarding the requirements.[140]

Report stage

At Report Stage, Ian Blackford proposed an amendment that the scheme funder should be able to carry out any activities apart from those that defined as "restricted":

> Amendment 7 makes provision for the Secretary of State to define "restricted activities" by regulation, including a list of specific activities restricted to minimise the risk of loss by master trust scheme funders. Through these amendments, we acknowledge that there may be circumstances in which the scheme funder requirements in the bill should not apply. The amendments state that the requirements need not apply to firms whose activities are already restricted by virtue of existing regulation.
>
> The ABI have said that, in particular, the Prudential Regulation Authority rules mean that insurance activities of the scheme funder that are not directly related to the master trust scheme are transparent and do not threaten the solvency or sustainability of the Master Trust. The ABI have said: "This is a sensible and pragmatic approach".[141]

Richard Harrington responded that Government amendments tabled in Committee meant that the scheme funder was "no longer restricted solely to activities relating to the Master Trust."[142]

Delegated Powers Committee

The Delegated Powers Committee did not think the Government had given an adequate explanation for allowing the regulations under the proposed new clause 11 (3A) to be subject to the affirmative procedure in the first instance only:

> 6. Amendments 3 and 4 will have the effect of allowing the Secretary of State by regulations to provide for exceptions from the requirement that the scheme funder may only carry out activities that relate directly to the Master Schemes in relation to which it is a scheme funder. The Department explains in the supplementary memorandum (see paragraph 6) that during consideration of the Bill in the House of Lords concerns were raised that this requirement would give rise to significant costs and disruption for certain existing Master Trusts. The regulation making power has been inserted in response to these concerns.
>
> 7. This appears to be a significant power in that it will enable the Secretary of State to provide for exceptions from a requirement which currently appears on the face of the Bill.
>
> 8. The regulations are subject to the affirmative procedure in respect of their first exercise and thereafter subject to the negative procedure. In our view the first time affirmative procedure is only

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[139] Ibid c48
[140] Ibid c48
[141] HC Deb 22 March 2017 c865
[142] Ibid c900

> appropriate if there are good reasons why subsequent exercises of power do not require the same level of Parliamentary scrutiny.
>
> 9. There is only one sentence in the supplementary memorandum (see paragraph 10) to explain why the first time affirmative procedure has been chosen:
>
> "The first regulations made under the powers in clause 11(3A) will be subject to the affirmative procedure on first use of the power because they will introduce alternative additional requirements that scheme funders have to meet".
>
> 10. **In our view the Department's explanation is inadequate. It does not explain why the Department takes the view that the considerations affecting the first exercise of the powers are different from those affecting subsequent exercises so as to justify a different level of Parliamentary scrutiny.**
>
> 11. **In the circumstances the House may wish to ask the Minister to provide a fuller and more convincing explanation for the use of the first time affirmative procedure in this case.**[143]

On 5 April 2017 Lord Henley explained that the Government expected subsequent amendments to be relatively minor and therefore thought that the affirmative resolution procedure would be disproportionate for them further regulations.[144]

Systems and processes

Section 11 would provide for the Secretary of State to make regulations in relation to the **adequacy of a Master Trust's systems and processes** (which is one of the five authorisation criterion which a Master Trust must meet to be and remain authorised). In deciding whether these are satisfactory, TPR must take into account any matters specified in regulations by the Secretary of State.

In response to questions from the Delegated Powers Committee, the Government said that it anticipated "considerable market consolidation" in the early years of the new regime and that it would need to be able to respond. For example, it might need to set out the "standards of features that must be met by a scheme" or to "cover matters of principle or objectives."[145]

Baroness Bakewell asked whether there would be a specific requirement to assess so-called 'ESG risks' [ethical, social and governance]. She also asked whether there would be an obligation to manage conflicts of interest:

> Master trusts develop new types of business structures which alter the relationships between members, employers, trustees and providers, on which occupational pension law and regulation is largely based. There is no requirement to include member or employer representatives on the board, and providers have a significant influence over who they appoint.

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[143] Delegated Powers etc Committee, Pension Schemes Bill 2016-17 [HL] Commons Amendments, 26th Report of Session 2016-17, 4 April 2017

[144] HL Deb 5 April 2017 c1078

[145] DWP, Pension Schemes Bill – Supplementary Memorandum concerning the Delegated Powers in the Pension Schemes Bill p6

> Many master trusts have been set up with a profit motive – something that existing occupational pensions' regulation does not cater for. As the OFT observed, this is a concern and a complex area as these companies have obligations to their shareholders and other stakeholders and, as with any company, seek to make a profit. IFAs and fund managers may be part of the provider group that set up that master trust.
>
> The trust deed in a master trust can inhibit the trustees from acting in the best interests of members if the rules fetter their powers. The master trust multiemployer characteristic can increase complexity and, with it, the potential for conflicts of interest.[146]

She referred to concerns expressed by TPR, to the effect that it was hard to understand when Master Trusts were acting as agents of the provider and when they were acting in the best interests of the member.[147]

Lord Young said ESG risks were already broadly taken care of through existing regulatory arrangements.[148] The issue of conflicts of interests was being addressed through additional governance requirements applying to occupational pension schemes generally.[149]

In the Commons, Alex Cunningham moved an amendment that would introduce annual reporting requirements for Master Trusts. The aim was to ensure that members had access to:

> […] an annual report of administration, fund management costs and transaction costs, so that they can see exactly how the fees are broken down and what they are actually paying for. It would also help satisfy the Financial Conduct Authority's desire to reveal all costs, which it believes will result in competition and potentially better performance for members.[150]

He suggested adopting the Local Government Pension Scheme cost template and its transparency code, although this was currently voluntary and measurable outcomes were still some way ahead.[151] On transaction costs, he referred to the FCA's report on the asset management industry, which highlighted concern about the information on transaction costs given to investors.[152]

Richard Harrington responded that he was committed to transparency but that the Government already had the powers it needed:

> The objective of the clause is to ensure that schemes are run effectively. It contains powers to make regulations that will specify what aspects of the scheme's systems and processes the regulator must take into account in deciding whether they are sufficient to ensure that the scheme is run effectively. Examples of what such regulations may cover are listed in the Bill. The list already includes processes relating to transactions and investment decisions. We

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146 HL Deb 21 November 2016 c1791-2
147 HL Deb 21 November 2016 c1791-2; Master trust conflicts of interest not unmanageable for independent trustees, 20 November 2012
148 TPR, Code of Practice 13, Governance and administration of occupational trust-based schemes providing money purchase benefits, July 2016; *Occupational Pension Schemes (Investment) Regulations 2005 (SI 2005 No. 3378)*
149 *Occupational Pension Schemes (Charges and Governance) Regulations 2015 (SI 2015/879)*
150 PBC Deb 7 February 2017 c49
151 Ibid c50
152 Ibid c53

> have been clear that the examples given are not exhaustive and that regulations may include other matters relevant to systems and processes. A guiding principle in setting the scope for the authorisation regime has been ensuring that master trust regulation is proportionate.
>
> I should point out that existing legislative requirements already require trustees of occupational pension schemes offering money purchase benefits, including master trust schemes, to make an annual statement. The hon. Gentleman did not mention that: they are already required to make an annual statement regarding governance, which is known as the chair's statement. It is appended to the scheme's annual report and accounts.
>
> The Government have an obligation under section 113 of the *Pension Schemes Act 1993*, as amended, to make regulations requiring transaction costs and administration charges of money purchase schemes to be published. We intend to consult, because the subject is very complex, and we are not, as the hon. Gentleman asserted, kicking it down the line. It is not that the Department for Work and Pensions does not want to do it. We intend to consult this year about how this information is published and proactively reported to pension scheme members.[153]

Continuity strategy

The purpose of section 12 is to provide that a scheme strategist must prepare a continuity strategy which sets out how members will be protected if a Master Trust has a 'triggering event.'[154] The strategy must include a section setting out the levels of administration charges that apply in relation to scheme members. It must contain such other information to be specified in regulations and must be submitted to TPR (on authorisation, within three months of revision, or on request by TPR) to determine whether it is adequate.

The available evidence indicates that some existing Master Trusts already have some form of exit strategy or discontinuance plan in place. However, there is a wide variation in the level of detailed planning.[155]

Debate

Noting that continuity strategy must include "a section setting out the levels of administration charges" applying to members of the scheme, Baroness Drake proposed a cap on charges during a triggering event period. She said that although there was provision to protect members from the imposition of additional charges following a triggering event, it was "not at all clear what that baseline is, how it is set or, indeed, if it is fair value."[156] Lord Freud responded that the charge cap would apply in the same way as to other occupational pension schemes. There was also a specific prohibition on increasing charges following a triggering event.[157]

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[153] PBC Deb 7 February 2017 c56

[154] Under section 21, these are events likely to lead to a scheme failing or being de-authorised

[155] DWP, Impact Assessment – Master Trust Authorisation, September 2016, para 55

[156] HL Deb 21 November 2016 c1813; Clause 34

[157] Ibid c1816-8

In the Commons, Richard Harrington explained that the aim of the clause was:

> […] to ensure continuity of pension saving for the members of the scheme when that scheme experiences an event that could put its future at risk. That also benefits employers using the scheme, particularly those using it to meet their automatic enrolment legal obligations. An adequate continuity strategy would demonstrate that careful consideration had been given to what the scheme would do if it were at risk of failing. That should make the closure of master trusts more orderly and managed, which is good for members and employers. We all agree that chaotic and unplanned closures would likely be detrimental to them.[158]

Nigel Mills asked why the schemes were allowed three months to send its continuity strategy to TPR following a revision. The Minister responded that this had come out of discussions with TPR.[159]

3.3 Ongoing supervision

Sections **13 to 19** enabled ongoing supervision by TPR.

Under section 13 TPR is required to publish and maintain a list of authorised Master Trusts.

Under section 14 provides for annual accounts of both the scheme funder and the Master Trust to be submitted to TPR annually.

Section 15 provides a requirement for a new supervisory return to be submitted to TPR on request. The details of what this needs to include would be in regulations.

Section 16 creates a requirement for specified persons to notify TPR of 'significant events' (to be set out in regulations) as soon as is reasonably practicable.

Section 17 gives TPR power to impose a fixed penalty on any person who failed to provide information requested for the purpose of TPR's authorisation functions. The amount of the penalty (not more than £50,000) would be set in regulations. The provisions mirror those in the *Pensions Act 2008* for a failure to provide information in relation to auto-enrolment.

Section 18 gives TPR power to impose an escalating penalty on any person who failed to provide information requested in a notice issued under section 72 of the *Pensions Act 2004* (which allows TPR to issue a notice requiring specified persons to provide information to it). The daily rate (not more than £10,000) would be specified in regulations.

Section 19 provides that where TPR was no longer satisfied that a scheme met the authorisation criteria, it could withdraw the scheme's authorisation.

Richard Harrington gave an overview of the provisions in these clauses at Committee Stage in the Commons.[160]

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158 PBC Deb 7 February 2017 c57
159 Ibid
160 PBC Deb 7 February 2017 c58-9

The provisions are now in s 13-19 of the 2017 Act.

Debate on section 16 – significant events

As stated above, there is a duty to notify the Regulator of 'significant events' – to be defined in regulations.[161] The Delegated Powers Committee said the Government had not justified the scope of this regulation-making power:

> It appears to be needed because the Government have not yet decided on the policy or the purposes for which the power is to be used. In our view this does not provide a satisfactory basis for drafting such a wide power, particularly as deciding what constitutes a significant event is fundamental to determining the scope of the duty imposed by clause 16. Accordingly, we consider the power to be inappropriate in the absence of any convincing reasons to justify its scope.[162]

In its response, the Government said the intention was that 'significant events' would be of a lower order than 'triggering events'. It wanted to retain flexibility to respond to future developments:

> The Government's intention is that a significant event in a Master Trust scheme should be sufficiently important to merit the attention of the Pensions Regulator, justify the costs of the scheme of providing information and be relevant to the ability of the scheme to meet the authorisation criteria. However a significant event will not necessarily be one which results in the scheme failing to meet the authorisation criteria.
>
> For example, schemes will periodically change trustees. The fitness and propriety of a trustee is linked to the scheme's authorisation, so the Pensions Regulator must be informed and the new trustee will be assessed against the relevant standard. Other significant events might be a change to the continuity strategy, changes to business plans, a change to the scheme administrator or capital adequacy falling within a certain percentage of the threshold. The Government wishes to hold further consultation with industry prior to making the regulations setting out what constitutes a significant event. While the list of significant events will not be subject to frequent change, it is appropriate for the future for there to be sufficient flexibility for the list to be adjusted to reflect market developments and potentially new Master Trust structures and processes.
>
> The power is akin to an existing power in section 69 of the Pensions Act 2004 which requires the reporting of the Regulator of a notifiable event in relation to certain non-money purchase schemes, with power to prescribe what constitutes a notifiable events in regulations.[163]

Following concerns expressed by the opposition and two House of Lords Committees, the Government amended the Bill at Report Stage to provide that these regulations would be subject to the affirmative resolution procedure in the first instance.[164]

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[161] Section 16
[162] Delegated Powers Committee, Pension Schemes Bill, November 2016, para 14
[163] DEP 2016-0849
[164] Section 16 (7)

A civil penalty can be applied to persons failing to comply with the reporting requirement. In a letter to Peers, Lord Freud explained:

> The decision to issue a civil penalty for breach is a power of the Determinations Panel and is subject to appeal in the same was as other Determinations Panel decisions. The power to issue a civil penalty is a power, not an obligation, and TPR, as a public body, must exercise its powers in a way which is reasonable.[165]

Also in response to a question from Lord McKenzie, Lord Young said it was the Government's intention that the provision of an annual governance statement would be dealt with in regulations.[166]

3.4 Triggering events

A "triggering event" is a type of "event that could put the scheme at risk."[167]

Section 20 provides for three sets of duties on trustees where there is a triggering event. These are to:

- notify TPR and employers (section 22);
- pursue a continuity option (section 23-25); and
- prepare and submit an implementation strategy to TPR (section 26).

The actual events that constitute triggering events are set out in a table in section 21**.** They include:

- The Pensions Regulator issuing a notice in respect of a decision to withdraw authorisation;
- An insolvency event occurring in relation to the scheme funder;
- A scheme funder deciding to end the relationship or arrangement with the Master Trust of which it is scheme funder;
- A scheme funder, strategist or trustees decide that a Master Trust should be wound up;
- An event occurs which is required or permitted by the scheme or its rules to result in the winding up of the scheme;
- The trustees decide that the Master Trust is at risk of failure and so it is necessary for one of the continuity options to be pursued.

Under section 21 (5), a triggering event ends on either:

- The date the scheme is wound up;
- The date the trustees receive notification that TPR is satisfied that a triggering event has been resolved (section 25); or
- The date on which it becomes clear that authorisation is not to be withdrawn (section 34).

Section 22 provided for **responsibility for notifying employers and TPR of trigger events** and other matters to be provided for in

165 HL Deb 21 November 2016 c1924; DEP 2016-0898
166 HL Deb 21 November 2016 c1821
167 HL Deb 21 November 2016 c1815

regulations and for a civil penalty to be applicable where there is failure to comply;

Section 23 provided that when a Master Trust has a triggering event, there are **two continuity options** available:

- **option one** under which trustees with transfer out all accrued rights and benefits in the scheme and then wind up the remaining structure (section 24); and
- **option two** which is for the triggering event to be resolved (clause 25).

Section 24 provides for **continuity option one** (transfer out of members' accrued rights and benefits and winding up). The trustees must identify one or more other Master Trust schemes able to accept the accrued rights and benefits. Members will retain the right to transfer to a scheme of their own choosing. Details of the requirements will be in regulations and there will be penalties for failure to comply.

Section 25 provides for **continuity option two** (the triggering event is resolved). Trustees are required to notify TPR when they consider it has been resolved and TPR must say whether it is satisfied. There will be penalties for failure to comply.

Section 26 requires the trustees to **submit an implementation strategy** to TPR for approval. This is a "document setting out how the interest of members of the scheme are to be protected following the occurrence of the triggering event." TPR would be able to approve it only if satisfied that it is adequate.

Section 27 provided for the content of the implementation strategy. It must include a section setting out the levels of administrations that applied in relation to members of the scheme (in a manner and as at the date prescribed in regulations). It must also include information about:

- the continuity option to be pursued;
- in the case of continuity option one (transfer of accrued rights and benefits and winding up), the scheme to which rights and benefits are to be transferred (if known) and when this is to happen;
- in the case of continuity option two (resolving the triggering event), how the triggering event is to be resolved; and
- such other information as may be prescribed in regulations.

Section 28 placed a **duty on trustees to a continuity option** once an implementation strategy has been approved by TPR. TPR may direct them to do so and civil penalties can apply. The requirements of this section override provisions any provisions in scheme rules or contracts that might conflict with it. The trustees must make the implementation strategy available to the employers.

Section 29 provided that a **Master Trust can only be wound up in accordance with continuity option one** and creates an override to any scheme rules that might conflict with this requirement.

Section 30 provided that a scheme must submit **periodic reports** to TPR during a triggering event.

Section 31 created a **new power enabling TPR to make a pause order** requiring certain activities to be paused once a Master Trust has experienced a triggering event. This includes: accepting new members; making payments; accepting contributions; and discharging benefits.

- Section 32 would prevent a Master Trust from **accepting new employers during a triggering event** period.
- Section 33 would place **restrictions on trustees increasing or imposing administration charges during a triggering event** period.

Section 34 provided for authorisation not to be withdrawn in certain circumstances following a triggering event.

Section 35 set out when a decision to withdraw authorisation becomes final.

These provisions are now in sections 20 to 35 of the 2017 Act.

Debate – continuity options

A scheme that experiences a triggering event can pursue one of two continuity options: i) the transfer out of accrued rights and the wind-up of the scheme; or ii) resolving the triggering event.[168] Lord McKenzie proposed preventing trustees from pursuing the first of these options where TPR was satisfied that continuity would be best achieved by the substitution of a new funder.[169] Lord Young responded that such decisions should be the responsibility of the trustees, not the regulator:

> Where the sourcing of a new scheme funder is the most appropriate resolution of a triggering event, as suggested by the noble Lord, it should be up to the trustees to identify this funder. It should not be TPR's responsibility to decide what the resolution method should be, that the method should be a new scheme funder or to source that funder. That is not the regulator's role and it would be overruling the trustees, who rightly have ultimate responsibility for the scheme and its members.
>
> We consider it important that any resolution of the triggering event and continuation of the scheme be subject to the full requirements of option 2. These requirements include the preparation of a comprehensive and detailed implementation strategy by the trustees, having certain safeguards in place for members and employers, additional support and assistance for them, and greater protection for members. Further, there is oversight of the adequacy of the strategy by the regulator.[170]

Lord McKenzie returned to the issue at Report Stage asking the Minister to confirm that he would routinely expect the option of a substitute funder to be considered before authorisation was withdrawn.[171]

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[168] Sections 23-25
[169] HL Deb 21 November 2016 c1824-5
[170] Ibid c1827
[171] HL Deb 19 December 2016 c1520

Lord Freud responded that the Regulator could encourage the scheme to substitute the scheme funder before it moved to withdraw authorisation. Adding a requirement that one option should be looked at before another would "probably reduce flexibility." The Government was satisfied there was adequate provision within the market overall:

> From our discussions with both master trusts and pension industry bodies, we are aware that they are keen to demonstrate the reliability of master trusts and for members to have confidence in them as a vehicle for pension saving, and there are therefore likely to be some available to take in transfers. For many master trusts, making themselves available to take a transfer would offer the opportunity to take in a number of members that they have not had to actively source—clearly, they get the benefits of scale.
>
> Employers and members also have reassurance provided by NEST. Although a master trust could not itself do a direct bulk transfer to NEST—as the employer must first establish a connection with NEST—an employer could chose to sign up to NEST and move its workers across. NEST is required to admit any employer and any worker enrolled by the employer to meet its automatic enrolment duties.[172]

Lord McKenzie still thought there was "still a bit of a gap in the Bill":

> As it stands, if you are in continuity 1 processes, you have to follow the route of transfer and wind-up; you cannot have a replacement scheme funder. The purpose of the probe is to try to understand why that is. One route to deal with it is that, before getting to a triggering event, 1, 2 or 3, the regulator will have a process with trustees and there can be a nudge which takes us into continuity 2. I understand that, but I think the Minister has confirmed that if it is just straight continuity then that is it, you have no hope of having a replacement scheme funder. I am still a little unclear as to why that would be so.[173]

In the Commons, Richard Harrington explained why continuity options were an important part of the new regime:

> Where a master trust experiences an event that could lead to its failure, there needs to be greater planning and control and more safeguards for members and employers. It is important that the scheme has done detailed planning so that what happens following a triggering event is thought through and the process is orderly and managed.[174]

Under the legislation as originally presented to Parliament, trustees pursuing continuity option one could only transfer members' benefits to another Master Trust. The Government amended the provisions at Commons Committee stage to enable trustees to choose another type of pension scheme, provided it meets certain conditions. Richard Harrington said:

> The non-master trust receiving scheme would be made subject to exactly the same restrictions on increasing or introducing the new

[172] Ibid c1522-3
[173] Ibid c1523-4
[174] PBC Deb 7 February 2017 c28-29

> charges as those to which master trust receiving schemes are subject.[175]

He explained that:

> Being able to increase the options in future might help reduce the risk that trustees of failing master trusts might not be able to find another master trust to take their members on.[176]

Alex Cunningham asked three questions:

- What conditions and regulatory standards the receiving scheme would need to meet?
- How the scheme funder concept would apply to a scheme that was not a Master Trust?
- Whether the prohibition on increasing charges would apply to any receiving scheme?[177]

He was concerned that providing the Secretary of State with broad regulation-making powers did not provide "a strong enough guarantee to scheme members that their benefits will not be eroded in the course of the transfer."[178] The Minister responded that the Government needed to retain flexibility to be able to respond to changes in the market. However, he was convinced that "this system will provide the most protection for members."[179]

When the Bill returned to the Lords, Baroness Drake asked for more reassurance:

> […] how will the Pensions Regulator apply the prohibition on increasing charges and police it after the transfer of members to a non-master trust, given that the receiving scheme will not be in its regulatory jurisdiction?[180]

Lord Henley responded that any receiving scheme would have to be regulated by the appropriate regulator. Furthermore, the Pensions Regulator would have "oversight and powers" of the exiting master Trust's implementation strategy for continuity option one.[181]

Content of implementation strategy

Alex Cunningham proposed an amendment with the aim of requiring members to be given information about charges and any caps imposed on them.[182] The Minister responded that legislation already provided for a cap of 0.75% on the default fund of auto-enrolment schemes. This applied to Master Trusts in "exactly the same way as it applies to other pension schemes." The Government recognised that more needed to be done to improve transparency. It was consulting and would be:

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175 Ibid
176 Ibid c29
177 Ibid c29
178 Ibid c30
179 Ibid c30
180 HL Deb 5 April 2017 c1082
181 Ibid c1085-6
182 PBC Deb 9 February 2017 c75

> […] making regulations requiring charges and transaction costs for money purchase benefits in occupational pension schemes to be given to member and to be published.[183]

Debate – bulk transfers

Baroness Altmann asked if the Government intended to consider introducing measures that would facilitate bulk defined contribution transfers. In response, Lord Freud explained that there were two separate areas of legislation to mention: existing bulk transfer provisions and new measures provided for under option one where a Master Trust experiences a triggering event.

On the provisions in existing legislation, the Government published a Call for Evidence on provisions for DC to DC bulk transfers.[184] The intention was to see whether there was scope to simplify the arrangements without compromising member protection. The Minister explained that these provisions were entirely separate to those in the Bill. They might apply, for example, where a single employer wanted to transfer members to a Master Trust. For bulk transfers under clause 26, separate provisions would be made, appropriate to transfers in that context.[185]

Baroness Drake said that if Peers had draft regulations before them, they might have had many questions:

> Is it the Government's intention that bulk transfers will be able to take place during a triggering event before all past records are clarified? Post-transfer to the receiving scheme, who will bear responsibility for any administrative errors what existed at the point of transfer? Will there be circumstances where the regulations under this Bill will override other pension regulations in order to effect that bulk transfer? I have one small example. Under auto-enrolment, when members are in self-select funds and are transferred without their written consent, they are from then on treated as having been put in a default fund and the charge cap of 0.75% is applied. I do not want to go into too much detail, but that is to illustrate the question of whether there will be circumstances where the regulations under the Bill will override other pension-related regulations.[186]

Lord Freud responded that "master trust bulk transfer provisions will trump existing provisions on voluntary transfer."[187] He added that:

> When a transfer is made under the mechanisms of this Bill, after a triggering event when the regulator is looking at it, one of the main points is to make sure that there is adequate capital to fund such an event. […] What one would normally expect to see is a negotiation with the receiving scheme manager to ensure that it is able to fund the transfer because of the benefits of scale through putting together two systems.[188]

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183 Ibid c76
184 DWP, Bulk transfers of defined contribution pensions without member consent, 20 December 2016
185 DEP 2016/0898 5 December 2016
186 HL Deb 28 November 2016 c47
187 Ibid c49
188 Ibid c48

Debate - pause orders

The purpose of the provisions on 'pause orders' is to enable TPR to pause certain activities – such as accepting new members, making payments, accepting contributions and discharging benefits - once a Master Trust has experienced a triggering event.[189] To make a 'pause order', TPR needs to be satisfied that:

- It would help the trustees carry out the implementation strategy; or
- That there was an immediate risk to the interest of scheme members or assets and it was necessary to protect the interests of the generality of the members of the scheme.[190]

Baroness Drake proposed TPR should have greater discretion about when to issue one:

> The power to issue a pause order comes into effect only when there is a triggering event, when a failure of some kind has already occurred, which means that the likelihood of a risk to the assets or members crystallising is greater, so allowing a prudent approach in those circumstances seems sensible.[191]

Lord Freud said that because a pause order could have a significant impact on scheme members, it should only be used where necessary.[192]

Contributions during pause order

Baroness Drake, also proposed that any contributions due to the member over this period should be paid into an escrow account or some other arrangement until the pause order was lifted.[193]

Lord Freud was concerned that this would entail TPR having to hold the fund into which contributions were paid and was concerned about the cost and complexity of this.[194] Baroness Drake argued that the holder could be an alternative operator or provider.[195]

Baroness Altmann asked whether a pause order would put an employer in breach of its duties under auto-enrolment legislation and contract to pay employee pension contributions.[196] Lord Freud said a pause order would effectively trump these obligations while it was operating:

> Section 31 of the *Pensions Act 2008* makes provision in relation to freezing orders so that, in the event of such an order being made, the employee is still considered to be an active member of the scheme and the scheme is still a qualifying scheme notwithstanding that contributions are not being made into it. Schedule 3, paragraph 13 of the Pension Schemes Bill will amend section 31 of the Pensions Act 2008 to include reference to pause orders made under the Bill […] Under schedule 1 para 1 (3) (b) contractual obligations are treated as if they do not arise, so

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189 HL Deb 28 November 2016 c21
190 Section 31 (3) and (4)
191 HL Deb 29 November 2016 c15-6
192 Ibid c17
193 Ibid c16
194 Ibid c18
195 Ibid c22
196 Ibid c17

> employers will not breach their contractual obligation to the employee to make contributions to the scheme when a pause order directs that they should not do so.[197]

Lord McKenzie said that tax relief for the period of a pause order would still be payable.[198] Lord Freud responded that tax relief did not apply where contributions were not collected:

> Tax relief can only be paid on contributions that are collected to be paid to the scheme – tax relief does not apply where contributions are not collected and paid into the scheme.[199]

Winding up the debate on the clause, Baroness Drake said she remained concerned about employees' rights to receive contributions and tax relief during the period of a pause order:

> […] the Government have not explained satisfactorily why the contributions cannot be held during the pause order without believing that this needs to be terribly complex. They have not addressed the issue that this will put individuals in a position where they are denied their statutory and contractual rights for a period, and an employer in breach of its statutory duties, and there remains a lack of clarity in thinking about the impact on vulnerable people in the manner in which the pause order is introduced.[200]

In the Commons, Ian Blackford moved an amendment aimed at ensuring that any paused payments were collected and held in a separate fund until the conclusion of the pause order.[201] Richard Harrington responded that this would be "extremely difficult in practice":

> Employers would have to negotiate with their employees to obtain their permission to take deductions from their pay and pay them into a different entity. The money would not actually be paid towards a pension scheme; it would have to go to a solicitor's client account, for example, or another account that had been set up. There are tax implications and many other implications.[202]

Mr Blackford responded that in terms of retaining confidence it was important that plan members continue to make payments, even after a triggering event. His amendment was defeated on division by eight votes to six.[203]

Mr Cunningham returned to the issue at Report Stage saying that:

> I have been assured that members' pots are protected in this situation, even in the event of a pause order. If that is the case, why would master trusts be unable to continue making payments to pensioners, who may be vulnerable and reliant on a regular payment from their pension pot? It is bizarre that the Government are so calm about the potential repercussions on the vulnerable if payments are stopped.

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[197] Ibid; DEP 2016-0898
[198] Ibid c20
[199] DEP 2016-0898
[200] HL Deb 28 November 2016 c23-4
[201] PBC Deb 9 February 2017 c81
[202] Ibid c82
[203] Ibid c85

> The Pensions Minister has also said that the stopping of payments would happen only in the rarest of circumstances. I hope he will take this opportunity to tell the House what those circumstances could be, and that he will provide scheme members with the assurance that they would not lose out during a pause order.[…]
>
> While I agree that the master trusts will be in no fit state to continue taking contributions, I do not agree that, as a result, members will simply get their contributions back into their pay packet and employers will be let off making their contributions. Our amendment would ensure that, despite the pause orders being in place, the contributions made by the employee and the employer would not be lost.[204]

Mr Harrington responded that:

> […] the Government's position is that employees should retain the contributions that have been made during a period, and receive a refund from their employer if those contributions have already been deducted but cannot be paid over to the scheme. We have been clear and everyone agrees that this is a rare and time-limited situation, which has a low risk of occurring, yet quite a big burden would go with it.[205]

Payment of benefits during a pause order

The Government made an amendment to provide that a pause order could be used to prevent benefits being paid out but that members retained their entitlement to any benefits affected.[206]

Baroness Drake said there was a lack of clarity on how those with serious ill-health or real income dependency would be dealt with in a pause order situation.[207]

Lord Freud replied that the pause was to allow TPR to "go in and make sure the situation is sorted" and that "setting up a large paraphernalia…would not be the point."[208] Baroness Drake remained concerned that the Government had:

> […] not addressed the issue that this will put individuals in a position where they are denied their statutory and contractual rights for a period, and there remains a lack of clarity in its thinking about the impact on vulnerable people in the manner in which the pause order is introduced.[209]

In the Commons, Alex Cunningham moved an amendment that would remove the provision for payments to stop during a pause order, arguing that:

> We understand that there may be circumstances in which a master trust should no longer collect contributions from an employer, but it is unacceptable that elderly, vulnerable people who are dependent on their pension do not receive it.[210]

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[204] HC Deb 22 March 2017 c891
[205] Ibid c901
[206] HL Deb 28 November 2016 c18-19
[207] Ibid c22
[208] Ibid c22
[209] Ibid c24
[210] PBC Deb 9 February 2017 c77-8

He asked what the Government would do "to ensure that those affected by a pause order will not face difficult and testing financial circumstances."[211] He was supported by Ian Blackford who said there was a "threat to confidence in Master Trusts and auto-enrolment if there is a pause in payments being made."[212]

Richard Harrington responded that a pause order would only be made in "very specific circumstances." It was intended to apply "in extremis". It might be used to concentrate people's minds on resolving the situation quickly. The length would be at the discretion of the regulator and "could also be for a short period – that is the intention."[213] The maximum period would be six months.[214]

Alex Cunningham remained concerned that there could be a failure in the system resulting in a loss of income to some of the most vulnerable people in society. His amendment was defeated on division by eight votes to six.[215]

Debate – notification of members

In the Commons, Alex Cunningham proposed that trustees should be required to notify members if there had been a "triggering event."[216] Richard Harrington responded that members would be informed well ahead of anything directly impacting on them:

> Our aim is for events to be resolved where possible. The scheme can then continue and members can keep saving in it. We have not required the trustees to notify members […]
>
> Remember, many members do not take an active decision to join; they join through their employer. They are not actively engaged in the scheme; their employer is the conduit, so providing incomplete information to members would cause undue distress and risk unintended consequences, such as members opting out of the scheme and stopping saving in a pension, when a resolution to the triggering event could very easily be agreed with the trustees or, indeed, opposed by the regulator […]
>
> If the scheme is going to wind up—I believe this is the relevant point—members will be informed well ahead of anything directly impacting on them, and will be given the information and options.[217]

Administration charges

Section 33 provides a prohibition relating to member charges during a triggering event period. In debate in the Commons, Richard Harrington explained that it meant:

> Trustees must not increase charges above the level set out in the implementation strategy, introduce new charges on members or

211 Ibid c78
212 Ibid c80
213 Ibid c79-81
214 Ibid c84
215 Ibid c85
216 PBC Deb 7 February 2017 c62
217 Ibid c63

> impose charges as a consequence of a member leaving or deciding to leave the scheme during a triggering period.[218]

Regulations would set out how charge levels were to be calculated:

> The Government intend that those levels will reflect what members paid towards the normal running of the scheme before the event happened. The charge levels will be calculated by looking back at previous charges in the scheme, and controls will be built in to protect against cases in which schemes increase charges shortly before a triggering event, so a scheme would not be able to get away with that one before the extra scrutiny.[219]

The effect of the measures would be that:

> […] members will not pay any more during a triggering event period than when the scheme was operating normally. That will protect the members; even though a scheme itself is likely to incur additional costs, the money to pay them will not come from members' pension pots. I hope that everyone will agree that that is most important. It will preserve the value of members' rights during a triggering event.[220]

The clause would also restrict the charges that can be imposed by a Master Trust receiving new members under continuity option one:

> Such a receiving scheme—a new scheme—will be prevented from increasing charges above the levels set out in a statement that it will give the regulator before the transfer happens, or from imposing new charges to meet the costs incurred by the transferring scheme. That means that members can join another scheme and continue to save in another pension without their pot being depleted to pay for costs incurred as a result of that happening. The clause keeps normality of charges and prevents schemes from taking advantage of a triggering event, and protect members' pots and maintains their value.[221]

3.5 Supplementary

Section 36 (fraud compensation) was added at Report Stage on 19 December 2016. It provides a regulation-making power enabling the Secretary of State to modify sections 182 to 187 of the *Pensions Act 2004*, which relate to the Fraud Compensation Fund. The intention was to remove one of the existing eligibility conditions - that the scheme's sponsoring employer had gone out of business – as this was likely to be difficult for Master Trusts to meet.[222]

3.6 Transitional provisions

Section 37 and Schedule 2 made provision for Master Trusts already in operation before the prohibition on operating an unauthorised scheme comes into force. They introduce transitional modifications in respect of those schemes that were in existence before the commencement date. They include

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218 PBC Deb 9 February 2017 c86-7
219 Ibid
220 Ibid
221 Ibid
222 HL Deb 19 December 2016 c1508 [Lord Freud]

- A duty to comply with notification requirements on trustees of an existing Master Trust if a triggering event occurs on or after 20 October 2016 but before the commencement date;[223]
- If a triggering event occurs, notifying TPR of the annual level of administration charges, which must then not increase;[224]
- The scheme funder of a Master Trust experiencing a triggering event, or moving to wind up, is liable for the costs of winding the scheme up if those costs do not fall elsewhere (taking account the prohibition on increasing charges on members to pay for the costs of winding up);[225]
- Provision is made for existing Master Trusts to continue in operation until its application for authorisation is received by TPR or TPR determines that that the scheme should not be authorised;[226]
- The trustees of a Master Trust must, within a six-month period, either apply for authorisation or decide to wind up the scheme. TPR may allow an extension of up to six weeks if there is a good reason;[227] and
- If TPR is aware of a Master Trust operating after the application period and it has not received an application for authorisation or notification that the scheme is to be wound up, it must notify the trustees that the scheme is not authorised. This is a triggering event imposing duties on the trustees (see clauses 20 to 33).

At Committee stage, the Government made a number of amendments:

- To align the process of deciding whether to grant authorisation to an existing Master Trust with that for new schemes;
- Provide that if TPR refused authorisation, a scheme would not have to commence the process of transferring members out and winding up until any appeals were disposed of;
- Allow TPR to issue a pause order to an existing master trust at any point between the scheme submitting an application for authorisation and the decision on that application becoming final, regardless of whether a triggering event had occurred. The rationale was that once an application had been received TPR would have "a significant amount of new information about the scheme; and
- Make other changes to procedure.[228]

Debate

Lord McKenzie asked how long an existing Master Trust could continue to operate without authorisation. He was concerned that given the two years before the provisions could be commenced, followed by the six

223 Bill 125-EN, para 173
224 Ibid para 176
225 Ibid para 178
226 Ibid para 179
227 Ibid para 180
228 HL Deb 28 November 2016 c29

months allowed for applications and the six months for TPR to make decisions, an existing Master Trust could continue in operation for some time without being authorised. He suggested reducing the time allowed for applications to three months.[229] Lord Young responded that there was a "compelling case" for allowing six months for schemes to apply:

> My expectation is that some schemes will have relatively little to do in order to align their businesses with the new requirements and, as a result, will be in a position to apply for authorisation early in the six-month application window. Others may face more of a challenge and may need time to consider the final legislation in full—including, of course, the regulations, which will come out next year—before they determine whether to apply for authorisation or withdraw from the market. We do not want to risk losing good schemes from the market because they have not had sufficient time to make the necessary changes to meet these new requirements. Having consulted the regulator, our view is that six months will give schemes the time they are likely to need.[230]

There was additional protection if a scheme experienced a triggering event after 20 October 2016:

> As I think the noble Lord recognised in his remarks, an additional key protection for members is set out in the Bill, which will apply from the beginning of the application window. This is in addition to the retrospective provisions in the Bill, which mean that a scheme that experiences a triggering event from 20 October this year will be unable to increase charges on members to pay for scheme wind-up. The additional protection is that if a scheme experiences a triggering event during this period, and the regulator has reason to believe that there is an immediate risk to the interests of scheme members, the regulator will have the ability to issue a pause order under Clause 31, which we have just been discussing, regardless of whether or not the scheme has submitted an application for authorisation.[231]

Remaining provisions

Section 38 and Schedule 3 make minor and consequential amendments.

Section 39 provides for the interpretation of various terms.

Section 40 provides a power to make regulations modifying the application of Part 1, including the power to:

- Apply some or all of the provision of Part 1 to pension schemes that do not fall within the definition of Master Trust schemes in clause 1, and
- Disapply some or all of those provisions from schemes which do fall within the definition.

The Delegated Powers Committee concluded that the Department had failed adequately to explain the breath of the powers to be conferred.[232] In response, Lord Freud explained why the Government believed the

229 Ibid c27-9
230 Ibid c28
231 Ibid
232 Delegated Powers Committee, Pension Schemes Bill, November 2016, para 21

power was needed.[233] Peers debated this in connection with clause 1 (see section 4.1 above).

Debate – definition of administration charges

At Report Stage, Baroness Drake proposed an amendment related to the definition of "administration charge." Clause 39 (1) would provide for it to have the meaning given in the *Pensions Act 2014* (Sch. 18 (10) which states that:

> "administration charge", in relation to a member of a pension scheme, means any of the following to the extent that they may be used to meet the administrative expenses of the scheme, to pay commission or in any other way that does not result in the provision of pension benefits for or in respect of members—
>
> (a) any payments made to the scheme by, or on behalf or in respect of, the member,
>
> (b) any income or capital gain arising from the investment of such payments, or
>
> (c) the value of the member's rights under the scheme.

Administration charges are significant because Master Trusts are required to set out the level of administration charges that apply to members in their continuity strategy (section 12) and, if they have experienced a triggering event, in their implementation strategy (section 27). Section 33 provides for a prohibition on increasing charges during a triggering event period.

Baroness Drake's amendment would have provided for the definition to include transaction costs (i.e. the costs that a scheme incurs as a result of buying, selling, lending and borrowing investments). She said:

> […] insofar as the Bill addresses the authorisation, supervision and resolution regime for master trusts, this amendment makes it clear that any reference to administrations in any provision in the Bill can include transaction charges, so ensuring that the Secretary of State and TPR have the fullest powers of intervention needed to protect members; savings in master trusts, particularly during triggering event periods.[234]

Lord Freud responded that the charges intended to be caught by the administration charge definition were "fees on set-up, entry, exit and regular and ad hoc fees." Trustees did not currently have access to information about transaction costs. The Government had taken the power in the *Pensions Act 2014* to make regulations requiring the disclosure of transaction costs. However, work on how to define them was ongoing:

> […] I should explain that there has never been a single agreed definition of transaction costs nor a way of calculating them. We have made progress in defining transaction costs, but until recently we made less progress on a way of calculating them. This is because many transaction costs are not explicit costs which appear on a scheme's balance sheet but implicit "frictional" costs from trading, which need to be calculated. The wide variety of

233 DEP 2016-0849
234 HL Deb 19 December 2016 c1526

> approaches to calculating transaction costs are not simply disputes about the odd one-hundredth of a percent but quite significant differences in methodology, which can result in transaction costs differing by a factor of five.
>
> We clearly need to ensure that trustees of occupational schemes and the independent governance committees of workplace personal pension providers have complete, consistent and standardised cost and charges information before they can report it to members; at this point, they do not. The key stepping stone to putting this information into the hands of trustees and independent governance committees was laid down when the Financial Conduct Authority published in October of this year a consultation on proposals requiring asset managers to disclose information about transaction costs to trustees, and a detailed methodology for calculating those costs. Following the outcome of the FCA's consultation, we currently plan to consult on the publication and onward disclosure of costs and charges to members in 2017. In conclusion on this point, I can assure Peers that we remain wholly committed to discharging this duty in the course of this Parliament. We want pension scheme members to have sight of all costs and charges, regardless of how they are incurred, and to give members the confidence that there are no other hidden costs and charges.[235]

Baroness Drake said it was helpful to have this on the record.[236]

3.7 Member engagement

Alex Cunningham proposed a number of amendments (none of them accepted) on the broad topic of increasing member engagement.

Member-nominated directors

As discussed in section 3.5 above, the Government amended the Bill in the Lords to require TPR to take account of a scheme's systems and processes relating to communications and engagement when assessing applications for authorisation.[237]

Alex Cunningham proposed adding a new clause to the Bill, intended to ensure that "where companies hold the position of Trustee in a Master Trust, at least half of their directors are Member-nominated directors." He explained:

> The *Pensions Act 1995* introduced the requirement for company pension schemes to have member-nominated trustees, or MNTs. If the scheme's sole trustee is a company including the employer, rather than individuals, scheme members will have the right to nominate directors of that company, who will be member-nominated directors, or MNDs. In those circumstances, my references to MNTs apply equally to MNDs. Member-nominated trustees of pension schemes have been a part of UK pensions since the emergence of occupational pension plans in the middle of the last century.

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[235] HL Deb 19 December 2016 c1528
[236] Ibid c1529
[237] HL Deb 19 December 2016 c1487

> Under the *Pensions Act 1995*, following the Goode report, a rule was introduced that a third of trustees had to be nominated, although companies could opt out of that rule.[238]

He was concerned that Master Trusts lacked member input and that improving member representation could help to reassure members that they were "enrolled in schemes that are well governed by boards that have their best interests at heart." The Bill had nothing on a mandatory requirement for MNTs, but seemed the logical place to include it.[239]

Richard Harrington responded that the new clause was unnecessary. The Bill made alternative arrangements to ensure trustees act in the best interests of members:

> […]in many of the cases that the Pensions Regulator has dealt with, there have been plenty of member trustees, and they have been ignored, not listened to, not felt to be relevant or just bamboozled, so it is not a perfect system anyway. As he knows, the whole reason for the Bill is that master trusts, which are hugely complex, have evolved over a very short period in a very sophisticated way. They are not the same as individual trust-based pension schemes, which is why we need this extra legislation […]
>
> Although master trusts are exempt from the existing requirements for member-nominated trustees, they are subject to all other regulatory obligations. As I said, the scheme administration regulations ensure that the majority of trustees are non-affiliated trustees. The authorisation criteria in the Bill subject all trustees to a fit and proper person tests assessed by the regulator. Facts to be considered in that test include how the people running the scheme are connected with other companies or people.[240]

Mr Cunningham's amendment was defeated by ten votes to four.[241]

Alex Cunningham returned to the issue at Report Stage arguing that:

> The P*ensions Act 2004* enshrined the right to have at least one third scheme member trustees of a trust-based scheme. The pensions regulator is clear that master trusts are covered by this legislation, which is why some already have member-nominated trustees. What the pensions regulator offers in explanation is that there are exemptions that can be taken by master trust, giving the reasoning that having a pool of members greater than a single employer-based scheme poses problems of choice. We find that an inadequate reason for exemption. The greater the number of members, then surely the bigger the pool of choice.
>
> We do not agree that independent trustees can adequately represent the fiduciary interests of members if they have no stake in the investment process. What is more they are paid and chosen by the master trust. This exemption seems like a convenient way of denying the right to representation by those who do have a material interest in the performance of the master trust. We have returned today with an amendment that seeks to give the scheme members the law to which they should be automatically entitled.

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[238] PBC Deb 9 February 2017 c95
[239] Ibid c97
[240] Ibid c99
[241] Ibid c102

> In these circumstances, my references to MNTs apply equally to MNDs.[242]

Richard Harrington responded that:

> the majority of Master Trusts are subject to the rules on trustees and the regulations of governance. Those regulations require that the schemes must have at least three trustees, and the majority have to be independent to provide services to the scheme.[243]

Investment strategy

Mr Cunningham also proposed that Master Trusts should have an investment strategy which outlined what it should consult members on in areas of investment. He explained that:

> The new clause seeks to create a world in which people feel that their savings give them a positive stake in the economy and a voice in how the companies in which they invest are run.[244]

He said transparency was "necessary but not sufficient for a more accountable investment system":

> Savers must also have the right to engage directly with decisions about their money, in the same way that shareholders engage with companies.[245]

Ian Blackford asked what form the reviews of the investment strategy proposed in the amendment would take and what role investment advisers would play.[246]

Richard Harrington argued that the amendment would duplicate existing provisions:

> […] pensions legislation already includes requirements for investment decisions to be transparent and in the best interests of members. The Government fully recognise the possible impact of investment decisions on members' retirement outcomes. Even without the new clause, the Bill will add to those requirements. Clause 12(4)(d) already sets out that regulations made by the Secretary of State
>
> "may include provision about…processes relating to transactions and investment decisions",
>
> while clause 12(2) states:
>
> "In deciding whether it is satisfied that the systems and processes used in running the scheme are sufficient…the Pensions Regulator must take into account any matters specified in regulations".
>
> The new amendment would duplicate the provisions for master trust schemes that already exist under the *Occupational Pension Schemes (Investment) Regulations 2005*. The regulations require trustees of all schemes with 100 or more members to set out a statement of investment principles for their scheme. That statement must be made available to members on request and
>
> "must cover…their policies in relation to…the kinds of investments to be held…the balance between different kinds of

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242 HC Deb 22 March 2017 c885
243 Ibid c899
244 HC Deb 9 February 2017 c111
245 Ibid c113
246 Ibid c114

> investments…risks, including the ways in which risks are to be measured”
>
> and other key issues. The trustees must ensure
>
> “that the statement of investment principles…is reviewed at least every three years…and without delay after any significant change in investment policy.”
>
> Most people who are automatically enrolled into pension schemes are likely to remain in their scheme’s default fund and will not actively engage themselves in the governance of the scheme. That is why legislation makes requirements about governance and oversight of these matters, and why most schemes, including master trust schemes, need to provide a default strategy that covers similar areas.
>
> Finally, multi-employer schemes have a legal duty under the *Occupational Pension Schemes (Scheme Administration) Regulations 1996* to make arrangements to encourage members of the scheme or their representatives to report their views on matters that relate to the scheme, including areas about which the new clause proposes that the trustees should consult scheme members.[247]

Ian Blackford suggested that the statement of investment principles should be “mailed to members as part of the annual report.”[248]

Annual member meeting

Alex Cunningham proposed that schemes should be required to hold an annual member meeting, as a way of ensuring that “trustees and administrators can be made human and accountable.”[249]

Richard Harrington said he sympathised with the drive for member engagement but did not believe that making AGMs mandatory was the answer. There was provision in the Bill to encourage member engagement and communication. Schemes were developing their own methods of communicating with members. Some would want to hold an AGM but there could be “complex and expensive logistics” involved - the cost of which would be passed on to members.[250]

3.8 Other issues

Asset protection for unincorporated business

Ian Blackford proposed an amendment to deal with issues facing plumbers in the Plumbers Pension Scheme, who are concerned about the way in which the employer debt provisions under section 75 of the Pensions Act 1995 apply to them. Richard Harrington agreed there was a problem but that it was a complex issue. The Government intended to consult on specific proposals in the very near future.[251]

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[247] Ibid c115-6
[248] Ibid c116
[249] Ibid c117
[250] Ibid c119
[251] Ibid c108

In response to further questions on the issue at Report Stage, Richard Harrington said it was a "complex and technical problem" but the Government would make progress.[252]

For more detail, see Library Briefing Paper CBP-07684 Section 75 employer debt and multi-employer pension schemes (June 2017).

Review of participation

Mr Cunningham proposed review options for widening participation in Master Trust schemes for groups currently facing barriers, in particular groups not currently covered by auto-enrolment. He said:

> […] we recognise that that the upcoming 2017 review of auto-enrolment present the Government with an opportunity to take seriously the problem that certain groups are excluded from master trust savings. The new clause would guarantee that the Government engaged with these vital issues in a proper way.[253]

Richard Harrington said the review of auto-enrolment would be "very comprehensive and will go far beyond what the statute calls for."[254]

Duty on employers

Alex Cunningham proposed that employers should be required to "conduct basic checks before signing up to a Master Trust scheme."[255] The Minister responded that there was already a significant regulatory hurdle – given that the employer needed to choose a scheme that met criteria set out in legislation.[256]

252 HC Deb 22 March 2017 c900
253 HC Deb 9 February 2017 c120-1
254 Ibid c123
255 Ibid c124
256 Ibid c127

4. Implementation and beyond

The new regulatory regime came into force on 1 October 2018. Existing Master Trusts have six months to file an application for authorisation to continue to operate in the market. New Master Trusts must be authorised before they open for business. TPR published a revised supervision and enforcement policy.[257] It published new figures showing that 30 Master Trusts had exited or were exiting the market, leaving 58.[258]

According to the *Financial Times* the five biggest master trusts, which together have more than 7.5 million members, are expected to apply for authorisation. These include: NEST, The People's Pension, Now Pensions, Smart Pension and the Legal & General Master Trust. TPR has not named those exiting the market or intending to apply but will publish a list of authorised Master Trusts in due course.[259]

On 11 October, TPR said it had issued a fine of £5,000 to four trustees who had failed to invest £1.4 million of savings promptly. The master trust had worked with TPR to address the problems and make sure all of the affected members were returned to the financial position they would have been in if this error had not occurred.[260]

[257] DWP, Master trust authorisation. Supervision and enforcement policy, October 2018
[258] TPR, The current master trust market, October 2018
[259] 'New safeguards for millions in master trust workplace pensions', *Financial Times*, 5 October 2018
[260] TPR press notice, PN18-53, 11 October 2018; Section 89 Report

5. Annex - glossary

Contract-based scheme - In a contract-based scheme an employer appoints a pension provider, often an insurance company, to run the scheme. The scheme members will sign a contract with the provider who will make the majority of decisions about the way the scheme is run.

Defined benefit pension scheme – a scheme in which the member builds entitlement to pension benefits based on fixed factors such as salary and length of service.

Defined contribution pension scheme – a scheme in which an individual builds up a fund based on contributions and investment returns. This is not defined in pension tax legislation, which instead refers to money purchase arrangements.

Group Personal Pension - an arrangement made for the employees of a particular employer, or for a group of self-employed individuals, to participate in a personal pension scheme with the same pension provider. Each member has a separate policy with the pension provider, but contributions are collected together.

Trust-based scheme – A schemes that is sponsored by the employer but managed by a board of trustees. The trustees have full responsibility for the management, administration and investment of the plan. The trustee’s fiduciary duty is to act in the interests of members.

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