

# Authorisation of master trusts

Problems ahead for non-associated multi-employer (NAME) schemes?

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Pension briefing

## HIGHLIGHTS

- New legislation will cause master trusts to be subject to a detailed authorisation process and ongoing scrutiny by the Pensions Regulator.
- Some requirements, including obligations to notify the Regulator of certain events, came into force with immediate effect on 27 April 2017.
- The new requirements are being brought in to reduce the risks for members of commercial master trusts should their scheme fail.
- The new provisions will catch non-associated multi-employer (NAME) schemes, including those which provide defined benefits with money purchase additional voluntary contributions (AVCs).
- The new requirements are not designed with NAME schemes in mind, and some will be difficult for NAME schemes to comply with.
- The extent of any future carve-out from the requirements for NAME schemes is currently unclear.



## INTRODUCTION

The Pensions Schemes Act 2017 was passed on 27 April 2017 and, as expected, makes provision for the authorisation of master trusts. Many details of the new requirements and procedures will be set out in regulations. The authorisation requirement is expected to apply from October 2018.

Concern has arisen that the market cannot support all the master trusts which have arisen and that the future failure of some master trusts is inevitable. The new authorisation requirements are intended to protect members of a failed master trust, in particular by ensuring that the costs of sorting out the insolvent trust are not passed on to members.

## BACKGROUND

Historically, the arrangement of choice for employers who do not wish to run their own occupational scheme has been a group personal pension (GPP). However, with auto-enrolment has come considerable growth in the number of "master trusts", established to meet the needs of employers who have to provide pension arrangements for their workers, in many cases for the first time.

A key difference between master trusts and GPPs is that GPPs are established and run by bodies authorised by the Financial Conduct Authority (FCA). In contrast, master trusts are typically occupational schemes, subject to regulation by the Pensions Regulator, but with no FCA authorisation necessary. Unlike traditional occupational schemes, established by one or more employers for the benefit of their employees, master trusts are usually set up by commercial providers with the intention of making a profit from the trust's activities.

## WHAT IS A MASTER TRUST FOR THE PURPOSES OF THE NEW REQUIREMENTS?

Under new provisions (already in force), a multi-employer occupational scheme is a "Master Trust" scheme if it:

- provides money purchase benefits (whether or not it also provides other benefits);
- is not used, or intended to be used, only by connected employers; and
- is not within a specified category of public service pension scheme.

For this purpose, an employer is "connected" to another employer:

- if it is (or has been) a "group undertaking" of that employer (broadly, a parent or subsidiary of the employer, or a subsidiary of its parent); or
- in circumstances set out in regulations.

Where a scheme provides money purchase benefits plus other benefits, the requirements of the Act apply only in relation to the provision of money purchase benefits. (An exception is that references in the Act to a scheme's accounts mean the accounts for the scheme as a whole.)

### What is a NAME scheme?

Non-associated multi-employer (NAME) schemes are occupational pension schemes, regulated by the Pensions Regulator. They do not have a commercial agenda and have not been established with a view to making a profit, unlike the commercial Master Trusts understood to be the intended subjects of the Act. Many NAME schemes were established by statute, as part of the privatisation of former nationalised industries and some give certain members additional statutory protection.

### ARE NAME SCHEMES ALSO MASTER TRUSTS?

The definition of "Master Trust" is wide enough to catch defined benefit schemes for non-associated employers, where the schemes provide money purchase additional voluntary contributions (AVCs). Many NAME schemes allow payment of money purchase AVCs and the provision of money purchase benefits will therefore be caught by the authorisation regime.

We are also aware that a few NAME schemes have added, or are planning to add, a money purchase section for members to accrue future benefits where the DB section is closed to new entrants, or to future accrual. These money purchase sections will also be subject to the Master Trust authorisation regime.

While the Act was a Bill being considered by Parliament, there was an attempt to remove NAME schemes from the scope of the new regime. Unfortunately, amendments to the Bill (drafted by Hogan Lovells) which would have removed many NAME schemes from being Master Trusts (and which would have allowed regulations to make further exceptions) were rejected by the government. Instead, the government pointed out that there is power under the Bill (now the Act) for some provisions to be disapplied in relation to specified Master Trusts. The Minister put on record that it intends to disapply some or all of the provisions of the regime for mixed benefit Master Trust schemes where the only money purchase benefits are AVCs.

### What are the implications for NAME schemes?

Unfortunately, a carve-out of some or all of the requirements may not be a satisfactory solution. NAME schemes will still be Master Trusts, and it is

unclear whether the government intends to disapply the authorisation requirement as a whole (and the obligations to meet the authorisation criteria – please see below), rather than just some of the ongoing obligations applicable to Master Trusts which have gone through the authorisation process. Some fundamental requirements for authorisation will be very difficult for NAME schemes to meet.

In addition, the Minister did not consider money purchase benefits, other than AVCs, provided by NAME schemes. It is to be hoped that industry pressure may persuade the government to widen the scope of the proposed carve out to include these benefits as well.

### AUTHORISATION OF MASTER TRUST SCHEMES

Once the authorisation regime is in force (expected from October 2018), a Master Trust may only be operated if it is authorised by the Pensions Regulator. A person will be "operating" a Master Trust if s/he:

- accepts money from employers or members (or prospective employers or members) in respect of fees, charges, contributions or otherwise in respect of the scheme; or
- enters an agreement with an employer in relation to the provision of pension savings for employees or other workers.

Before granting authorisation, the Regulator must be satisfied that the scheme meets the "authorisation criteria", which are that:

- the persons involved with the scheme (including the person who established the scheme, the trustees or manager, anyone with power to vary the scheme or to appoint or remove a trustee or manager (which may include one or more sponsoring employers), the "scheme strategist" and "scheme funder") are fit and proper ;
- the scheme is financially sustainable;
- each "scheme funder" meets specified requirements;
- the scheme's systems and processes are sufficient to ensure the scheme is run effectively; and
- the scheme has an adequate continuity strategy.

### Business plan

A Master Trust must have a "scheme strategist", who must prepare a business plan for the scheme (in relation to the provision of money purchase benefits) and must review the plan at least annually. The plan must be approved by the scheme funder(s), the trustees and any other scheme strategist. Specific

requirements for the business plan will be set out in regulations. The plan must be submitted to the Pensions Regulator when applying for authorisation, after any revisions of the plan, and at other times on request.

### Systems and processes

When deciding whether a Master Trust's systems and processes are sufficient, the Regulator must take into account matters specified in regulations, which may include:

- features and functionality of IT systems used to run the scheme;
- standards concerning the quality and security of data;
- records management;
- processes for investment decisions;
- risk management; and
- processes concerning the appointment of advisers.

### Continuity strategy

The scheme's continuity strategy must be prepared by the scheme strategist and must address how members' interests will be protected if a "triggering event" occurs – please see below. The strategy must set out the levels of administration charges that apply in relation to members, in a manner specified in regulations.

### What are the implications for NAME schemes?

Having to comply with the authorisation requirements for Master Trusts would cause difficulties for many NAME schemes and would result in additional expense for their participating employers. The trustee boards of the schemes we are familiar with are long-established, typically with one or more independent trustees and member representatives, and already ensure a good level of scheme governance. In general, the legislation is not drafted in a way which will work for schemes backed by employers, rather than by commercial providers.

### FUNDING REQUIREMENTS FOR MASTER TRUSTS

When considering a scheme's financial sustainability, the Regulator must be satisfied that:

- the scheme's business strategy is sound; and
- the scheme has sufficient financial resources to cover both its set up and running costs, and

additional costs of complying with duties following a triggering event (please see below).

The additional costs must include the expense of continuing to run the scheme after a triggering event for a period which the Regulator considers appropriate for the scheme (between six months and two years).

In Committee in the House of Lords, the government confirmed that when considering a Master Trust's financial sustainability, only resources relating to the money purchase part of the scheme may be taken into account.

### Scheme funder

In addition to meeting the "financial sustainability" test, a Master Trust must have at least one "scheme funder", which must be a separate legal entity. The scheme funder must only carry out activities that relate directly to Master Trust schemes in relation to which it is a scheme funder (or prospective scheme funder). This requirement was amended as the Bill passed through Parliament: as originally drafted a scheme funder could operate in relation to one scheme only. In addition, a regulation making power was added, enabling the Secretary of State to make exceptions to the requirement.

In debate in Parliament, the government explained that a scheme funder which carried out activities other than those relating to the Master Trust might be required to disclose additional information in its accounts, so that activities relating to the Master Trust would be distinct from its other lines of business. Where the scheme funder is part of a corporate group, disclosure might be required about the group's structure to the extent that it affects the financing of the Master Trust.

### What are the implications for NAME schemes?

Most NAME schemes also provide defined benefit (DB) pensions, and so are subject to the scheme specific funding requirements of the Pensions Act 2004. It is usual in schemes like these for the participating employers to be liable for the expenses of running the scheme. Of course, when relying on employers to fund the scheme (and to pay expenses) there is the risk of employer insolvency – this is a risk faced by trustees of all occupational pension schemes, except in cases where there is a government guarantee. However, as part of compliance with the scheme specific funding regime for DB benefits, the scheme trustees will be in regular contact with the participating employers and will monitor the employers' covenants.

In debate in Parliament, the Government confirmed that NAME schemes will have to comply with the

requirement to have a "scheme funder". This led to concern that although a typical NAME scheme will be backed by its participating employers, it would not have support from an entity which would satisfy the requirements for being a scheme funder, unless an exception is made in regulations.

## TRIGGERING EVENTS

The Act introduces the concept of a "triggering event" in relation to Master Trusts. Triggering events include:

- the Regulator giving a warning notice or determination notice relating to the withdrawal of the scheme's authorisation, or a notice that the scheme is unauthorised;
- a scheme funder undergoing an insolvency event, being unlikely to continue as a going concern, or terminating its relationship with the Master Trust;
- a decision being made to wind up the Master Trust;
- an event occurring which will or may result in the Master Trust being wound up; or
- the trustees deciding that the Master Trust is at risk of failure.

The scheme's continuity strategy must address how members' interests will be protected if a triggering event occurs and must set out the administration charges which will apply.

## Continuity options

When a triggering event occurs, the trustees must comply with any notification requirements which apply and must pursue one of two "continuity options".

Continuity option 1 must be followed when the Regulator has made a final decision to withdraw authorisation of the Master Trust or has issued a notice that the trust is unauthorised. In other cases, the trustees must decide whether to pursue continuity option 1 or 2.

### Continuity option 1: transfer and wind up

Under continuity option 1, the accrued rights of all members must be transferred to one or more other Master Trusts (subject to a right for the members to opt out and take a transfer value) and the scheme must be wound up. In response to industry concern that a Master Trust willing to take on the new liabilities might not be found, regulations may set out circumstances in which the liabilities can be

transferred to an alternative scheme which is not a Master Trust but which meets prescribed conditions.

### Continuity option 2: resolution of triggering event

Under continuity option 2, the triggering event must be resolved. The trustees must notify the Regulator when they consider that the triggering event has been resolved and the Regulator must in turn notify the trustees of whether it is satisfied that this has happened.

### What are the implications for NAME schemes?

The Master Trust requirements mostly apply only in relation to the money purchase part of a scheme and therefore, for many NAME schemes, will apply only in relation to their AVC arrangements.

Given the nature of NAMES schemes, it would be preferable for trustees to have flexibility in how they deal with DC (including AVC) arrangements should continuity option 1 be invoked.

## EXISTING MASTER TRUSTS

Existing schemes falling within the definition of Master Trust must apply for authorisation within six months of the prohibition on operating an unauthorised Master Trust coming into force (known as the "commencement date"). Indications are that the commencement date will be in October 2018.

However, some parts of the Act apply from 27 April 2017, the date of Royal Assent when the Bill was passed and became an Act. These include provisions concerning the definition of "Master Trust"; triggering events; notification requirements; and powers of the Regulator to request information.

In particular, trustees or managers of existing Master Trusts should be aware that certain notification requirements already apply to them. Where a triggering event occurs on or after 20 October 2016 (the date the Bill was published in Parliament) but before the commencement date, the Regulator must be notified within seven days of the triggering event occurring. This is a very short notification period and would present problem in respect of any events occurring before the Act was passed.

In contrast, where a triggering event occurs after the commencement date, the time limit for giving notification will be set out in regulations.

## What are the implications for NAME schemes?

Unless exempted by regulations, NAME schemes will need to apply for authorisation within six months of the requirement to be authorised coming into force (expected to be October 2018). As discussed above, satisfying the authorisation criteria will involve additional expense and, potentially, reworking of schemes' governance structures. In addition, the timescales for notifying triggering events before the commencement date are not practical.

It is disappointing that this was not addressed and amended as the Bill passed through the Parliamentary process.

## NEXT STEPS

Although the final version of the Act is now settled, details of the requirements will not be known until regulations are finalised. So far, the government has indicated that draft regulations may be issued in autumn 2017.

Hogan Lovells pension team is actively engaging with interested bodies in the pension industry to ensure that the concerns of NAME schemes are not overlooked. If you would like to discuss any of the issues raised in this note with us, please speak to your usual Hogan Lovells contact or to one of the pension partners below.

This note is written as a general guide only. It should not be relied upon as a substitute for specific legal advice.

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