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CREATING THE MARKET THAT WILL DELIVER VFM

It is in everyone's interest to support the development of an efficient, effective secondary master trust market

John Greenwood
john.greenwood@definitearticlemedia.com

The ongoing drive by both regulators to develop metrics, standards and disclosures for the value for money (VFM) framework shows the government doing its bit to drive competition and reduce friction in the secondary master trust market.

The industry should do everything it can to support the competitive market that is the key to improving member outcomes.

Creating competition is one of the core objectives of the joint Department for Work and Pensions (DWP), The Pensions Regulator VFM policy initiative, to make it easier for employers to move their employees to a better provider if their existing one doesn't deliver, raise standards across all schemes and drive consolidation.

Advisers already conduct significant amounts of research into providers in the tendering process, and when disclosures from the new VFM regulations finally start to emerge, the wealth of available data will spiral. If the industry is unable or unwilling to take all this data and use it in tendering processes that truly result in switches to providers that deliver better outcomes to members, it can expect increasingly tough interventions from regulators.

Taking VFM seriously means all parties in the process acting in a fashion that promotes best outcomes for members. Unnecessary, egregious obstacles such as excessive charges for assessments should have no place in the market as it develops. And conflicts of interest where trustees or advisers are on both sides of potential deals need to be addressed in a thought-through way.

Similarly, the core message from the VFM consultation that provider selection should be about more than just charges, must be taken to heart. We can see from at-retirement decision-making, for example, that the massive variation in the functionality, choice architecture, communications and guidance support of different providers has a profound influence on the likelihood of members to draw their benefits in an optimal fashion. The data shows that schemes that might be cheap on charges but don't create sensible journeys for their members result in significantly higher levels of cashing out, for example.

For some time now the focus has been on own trust to master trust transfers. But as the regulators continue with their push for fewer, bigger, better run DC schemes, the drive to support employers in moving to more effective providers will grow.

This is an opportunity for advisers, and they should use their influence to support greater standardisation of processes and the removal of needless obstacles to a friction-free, competitive secondary master trust market.

INSIDE

IMPROVING THE SECONDARY MASTER TRUST MARKET

PRIMARY STEPS FOR THE SECONDARY MARKET

Basic standardisation of the process around master trust-to-master trust transfers is essential if the government's VFM agenda is to deliver good member outcomes. **Muna Abdi** reports

Demanding to know from a provider the process for leaving just when you are joining may sound contradictory, but a clear understanding of exit procedures is just one element of a standardised approach that needs to be developed to make the secondary master trust market more competitive.

That was the view of delegates at a recent round table on creating a low friction, competitive secondary master trust market.

Andy Parker, partner at Barnett Waddingham, said he wanted to know how he could get an employer out of a scheme before he put them into it.

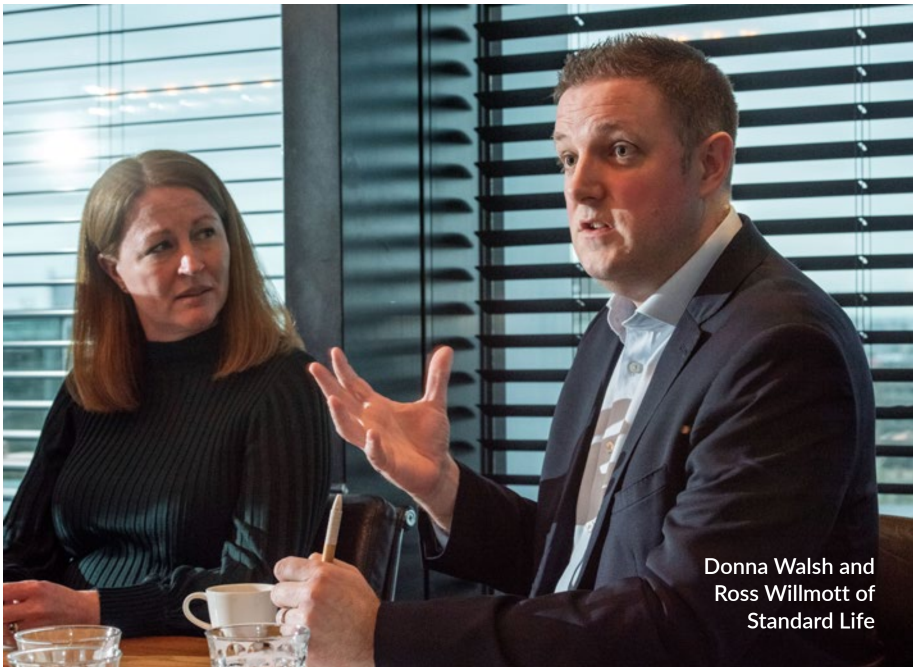
Professional trustee at Dalriada Trustees Paul Tinslay agreed, arguing that it was important to have clear contractual terms to ensure obstacles were not put in the way of employers looking to seek a better deal elsewhere. Where older agreements did not have such clauses, he was critical of the practice of providers improvising punitive exit terms, deeming it "egregious".

Standardised approach

Helen Dean CBE, CEO of Nest urged the sector to consider a simpler, more uniform approach to reviewing schemes. She said: "There's an opportunity for us as a sector to think about how we make things simpler, smoother, and perhaps more standardised."

Delegates debated the practice of incumbent providers lowering costs at the end of the tendering process to maintain business, switching the focus of the process to charges, at the expense of other equally important factors.

Ross Willmott, head of DC workplace new business, Standard Life said: "It isn't currently possible to get an aligned understanding of what VFM is across all parties because of the timing and sequencing of some of the discussions." He said that the adviser would do the VFM assessment, which might conclude that the scheme should move to a new provider, but then the incumbent provider drops their charges and so the switch doesn't happen.



Donna Walsh and Ross Willmott of Standard Life

Willmott said: "Obviously there has to be a feasibility study done at the outset, but we have seen some of these costs surfacing much later in the process and not being understood when the initial decision is made around firstly do we change master trust provider, and if so, who to. That decision is then inhibited by what's learned in future, often beyond the point that active members have already been moved and contributions have already started going into the master trust. That is a problem for the provider, for the incumbent and a bigger problem for the member. So the more we can do to bring awareness of relevant information to the front of the process, the better."

Tinslay said: "This should be made part of the contract – if you want to exit, this is

the service you will get. Lots of old contracts are silent to this, which enables providers to be able to make it up as they go along, which is egregious."

Experts at the event also debated whether it would ever be possible to get providers to give a definitive 'guaranteed best price' charge figure, to stop incumbents cutting their charges at the last minute to keep business.

But Gurmukh Hayre, director at Grove Trustee Services expressed scepticism about securing pricing stability guarantees from providers during tendering and suggested it was probably not feasible to ever stop providers trying to cut deals later in the process.

Hayre underscored the importance of conducting feasibility studies at the onset of any plan, emphasising the role of advisers in facilitating dialogue between employers and existing schemes to ensure alignment and prevent surprises later on in the process.

Tinslay suggested the DC sector could evolve an approach in the same mould as the industry template established by the Pensions Administration Standards Association (PASA) for changes to DB administrators. "That model says 'if you are a DB administrator and the scheme asks to move, here's the process'. Most decent administrators signed up to that process."

Shabna Islam, head of DC provider relations at Hymans Robertson suggested an evolution of the own trust to master trust model as a starting point for a new approach.

Islam added: "The Pensions Regulator needs to be really careful and do something here. They have been encouraging own trust arrangements to move to master trusts. But if some of the bigger master trusts start to say 'no, actually I am not happy with this master trust but now I can't get out of it,' who are they going to point the finger at?"

Tinslay suggested making master trusts be more open about their failings could support the market.

He said: "If master trust providers were required to disclose by way of their chair's statement or some other document in the public domain, how they treated the last three or four employers that wanted to exit their trust, it would create a certain amount of pressure, not just from the regulators, but also from the membership." ▶

But Jacqui Reid, partner and specialist pension lawyer, Sackers was cool on the idea of a formal industry best practice code. She said: "I'm a fan of regulation and codes, but I think the industry should put its best foot forward rather than prescribe, because if you prescribe stuff, there's always going to be exceptions."

Trust and contract

Donna Walsh, head of master trust, Standard Life expressed concern that master trust providers regulated by the FCA but also governed by trust law were subject to consumer duty rules when TPR-governed master trusts were not, and suggested all master trusts should be governed by the same rules.

Tinslay agreed, adding: "When employers are choosing master trusts, do they lean too much on TPR's authorisation? Do they truly understand what was assessed during the authorisation process and very importantly, what wasn't assessed? If you've got masters trusts in the market and they're not being measured in the same way - some with the consumer duty and some without the consumer duty - that's really important for an employer to actually understand."

Hayre also highlighted different concerns in the contract-based arena. He said: "At the same time there is still a very large value of assets stuck in contract-based providers where it is very difficult for the IGC or the provider to move them en masse to something better. There are solutions, but the bar is quite high."

Walsh added that another blocker existed in the shape of some providers being unable to accept transfers of active members if they have crystallised benefits, for example where they have taken cash but are continuing to work.

Contract conundrum

Delegates debated the challenge of requiring member consent for the transfer of GPP assets to a new arrangement. Reid said that Sackers was working with insurers to move contract-based schemes into master trusts.

She said: "It is not always an employer-driven exercise. It can be done in bulk, without consent. There are quite stringent things that we have to look at. It is complicated, but it can be done, and people are doing it now and we are in the process of giving that advice. Could it be made easier? Absolutely."

She pointed to the issues raised when PS20.2 - Publishing and disclosing costs and charges to workplace pension scheme members and amendments to COBS19.8 – unveiled back in 2020.

"There was an idea around if the IGC decides that at a granular level the scheme doesn't offer value for money, they should go and tell the employer. That is all well and good where there is an active employer scenario. But where you have the majority of your assets in deferred contract-based arrangements, telling the employer the scheme doesn't offer value for money isn't going to do any good. Making changes that employers sign up to is fixing the problem for the future but not the past."


(Clockwise from this picture) Helen Dean CBE of Nest, Dalriada Trustees' Paul Tinslay, and Gurmukh Hayre of Grove Trustee Services with Jacqui Reid from Sackers


Shabna Islam of Hymans Robertson and Andy Parker from Barnett Waddingham

She added that involving the IGC blessing of a transfer is challenging because IGCs are not legal entities so the buck will ultimately stop with the provider.

"The problem in making any transfer where a member doesn't consent is that you risk the member complaining. But ultimately, if you know that what you're transferring them into is a well governed, much better environment, the better place for members to be, particularly consumer DC. I think the risk of the FCA complaining is greater, and that's why we look at those transfers."

Different dynamics

Delegates also discussed the difference in approach between own trust to master trust versus master trust to master trust. The former is driven by an employer's decision to reduce costs for their business, so the

trustees inevitably have to get on board. Master trust to master trust on the other hand, is based on very different reasons, for example service levels or commitment to the market.

In this latter scenario, said Walsh: "The ceding trustees don't get wind of the move until a decision has been taken, at which point they are asked to do their value for money assessment, or use their discretion to say we think there is no detriment to moving.

"So is there a way of bringing those trustees into the process earlier, so they can get on board with the move and do the assessment, possibly in line with the adviser?"

Reid highlighted the difference between the trustees' duty in managing the transfer of existing pots from a trust to a master trust and the employer's decision-making power over future contributions. She said: "The most successful provider selection or master trust selection exercises we have been involved in is where there was a joint working group between the employer and the trustees."

She noted that trustees keep an eye on transition expenses and make sure that members' retirement options and default and self-select alternatives are comparable, while employers prioritise investment performance, fees, and wider benefits.

Willmott questioned whether, in a master trust-to-master trust project, that working group would include the incumbent master trust from the start.

Hayre added: "This is where we need evolution in the market. If you're transparent from the start, you'd encourage trustee involvement from the existing master trust early on. They might not be able to participate in a joint working group for of all kinds of reasons. But involve them, get them on board and tell them what's been planned so you avoid the issue at the end."

Employee benefits

Dalriada Trustees professional trustee Paul Tinslay emphasised the importance of pension schemes as part of employee benefits. "They are part of what employers offer to differentiate themselves from their competitors in the marketplace, and that is vitally important."

He highlighted the way that automatic enrolment had resulted in a disengaged membership. He also stressed the significance of employer involvement in engaging employees and expressed frustration over behaviours that hinder member engagement and better outcomes.

Tinslay advocated removing obstacles and encouraging providers to focus on improving member outcomes, calling for a more collaborative approach towards achieving better member outcomes.

He said: "Numerous studies have shown the most trusted source of information for an employee is their employer. If you remove the employer from the equation, you'll never get members engaged.

"It's not just about value for money; it's about treating customers fairly. If there are barriers, they shouldn't be there. Because if, as a master trust provider, you're not performing as you should, and there are advantages in moving across to another master trust, then it creates better member outcomes. If you are putting barriers in the way of better member outcomes, you shouldn't be playing the game."

Hayre agreed and pointed out the challenges associated with legacy books in contract-based schemes and the limitations they pose for transferring employees into more advantageous arrangements. "Contract-based schemes were a positive thing because employers had influence, and their communications were good. But one of the problems is members are stuck, because they can't move en masse those employees to a master trust or a new own-trust scheme. Which is why a lot of leading providers have huge legacy books which are under the remit of IGCs.

"Speaking from experience sitting on an IGC, as I have done in the past, seeing that there are members in old legacy schemes where the value could be better, but you can't do anything about it, is not a good place to be." ■

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IMPROVING THE SECONDARY MASTER TRUST MARKET

REMOVING BARRIERS TO HEALTHY COMPETITION

Exorbitant value for money assessment costs, an excessive focus on charges and conflicts of interest of trustees all risk creating friction in the emerging secondary master trust market policymakers hope will drive better member outcomes. Muna Abdi explores the challenges and potential solutions

The Department for Work and Pensions' value for money (VFM) framework promotes increased disclosure by providers across a wide range of metrics in a bid to drive improvements in defined contribution (DC) pensions, shift the focus away from cost and accelerate industry consolidation.

The policy initiative aims to make it easier for employers to compare the value of their scheme and consider alternatives. But changes to industry practices and regulations could help improve processes, remove obstacles to switching and drive a more competitive market between providers. That was the view of experts gathered at a recent Corporate Adviser round table.

Delegates identified a range of challenges to DC bulk transfers, particularly in relation to master trust-to-master trust transfers.

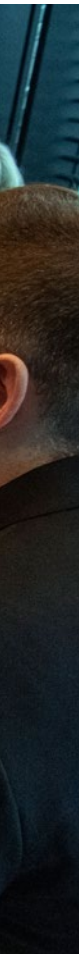
Exit cost

Ross Willmott, head of workplace new business, Standard Life highlighted several challenges his organisation had encountered, including potentially-ceding master trusts putting a very high charge on the cost of them carrying out their own value for money assessment on the transfer, a charge that employers would likely baulk at paying.

Paul Tinslay, professional trustee, Dalriada Trustees, shared his concerns at this, saying: "If the trustees of a master trust want to charge north of a six-figure sum for a VFM assessment to transfer to another master trust, that sets a precedent for trustees of own trusts to go to a similar level of due diligence. This would then act as a blocker to the primary market, let alone the secondary market."

Andy Parker, partner, Barnett Waddingham said he wanted to know there was a clear exit route from any master trust transferred to and stressed the need for defined criteria for leaving, especially in cases of mergers.

He said: "I believe that the decision-making process should be guided by the current master trust, focusing on value rather than solely on price, investment performance, or even administrative performance. Instead, the emphasis should be on the overall proposition and



Helen Dean CBE of Nest

Paul Tinslay of Dalriada Trustees

Standard Life's Ross Willmott

someone else's subjective assessment of value. We don't have one that's written down for us yet."

Speakers at the event agreed that the industry needs to raise standards in the switching process if friction on the journey to finding a better provider is to be reduced.

Helen Dean CBE, CEO, Nest added: "It's not just about removing friction, it's about creating impetus. We need to find a way in which schemes have to consider these things and make it clear at the outset who's going to pay."

Gurmukh Hayre, director Grove Trustee Services agreed: "We've seen some of these costs surfacing much later in the process and not being understood when the initial decision is made around, firstly, do we change the master provider and if so, who to? That decision from what we can tell is then being inhibited by what's learned in future through that process, often beyond the point that active members have already been moved and contributions have already started going into a master trust."

Trustee duties

Jacqui Reid, partner and specialist pension lawyer, Sackers pointed out that a VFM ▶

Gurmukh Hayre of Grove Trustee Services

assessment is not legally required as such, instead the requirement was that schemes be assessed annually.

Reid explained that trustees faced with a transfer request must address two key questions: Can they make the transfer based on trustee rules and transfer agreement terms, and should they make the transfer, involving a discretionary decision? She noted that while costs, charges, and investment performance are crucial, governance plays a significant role.

"You can have stellar performance and cheap charges but if the member takes all their benefits all in one go, that's because they haven't had proper engagement, education and comms," said Reid.

Beyond charges

Donna Walsh, head of master trust, Standard Life agreed that less tangible but very important factors such as engagement, vulnerable customer support and governance were often given a low priority. She said: "When looking at value, there is also the wider financial wellbeing part, which can mean helping people understand other unclaimed benefits they are entitled to. Our team recently shared an example where a member supported their mum in getting an extra £400 a month in unclaimed benefits. That's got nothing to do with the pension but from a value perspective, how much does that help that family?"

Dean added that fraud prevention and cybersecurity were also other factors that needed to be taken into account when considering the robustness of a scheme, as highlighted by a significant member data leak at one pension provider.

Reid said the industry struggles to define and quantify these elements, which include engagement tactics and weak customer service. She said that regulators recognised the complexity here but hadn't yet reached agreement on how to address it.

Who pays

Walsh said that different sets of trustees have different processes and mechanisms to deal with assessing transfers. She said: "Our trustees have a very clear process – they engage their legal advisers and their investment advisers, so there is a cost – a resource cost and an actual fee cost. Providers need to decide 'are we meeting that cost for those exits?', or is it a case of passing it on to the employer, when it then becomes a barrier to moving.

"The employer wants to move, the adviser has recommended a move, and you end up with a situation where all the new monies are sitting in the new master trust, and all

Shabna Islam of Hymans Robertson

Gurmukh Hayre of Grove Trustee Services with Jacqui Reid from Sacker

Donna Walsh of Standard Life

the existing money is sitting with the old master trust, and the only way to get that money across is by trying to engage those people through direct offers and transfers."

Walsh also highlighted the potential clash between potentially ceding trustees doing their VFM assessment and the adviser doing their own VFM assessment for their recommendation. She said: "Could there be a conflict if the adviser says 'we think you should move', and the ceding master trust says 'actually, no, we don't agree – we think that this offering offers better value for money'. What happens then? The employers have made their choice, the advisers have recommended it, and the current trustees say no."

Hayre said in an ideal DC market there would be one independent body doing VFM assessments that all parties would abide by. He said: "You shouldn't have the conflicts that we used to have in the DB world of employer and trustees. If you're trying to do the right thing by the members, surely there's a way where you can buy that advice for the benefit of the whole exercise, the whole project. That would be the ideal."

But Shabna Islam, head of DC provider relations, Hymans Robertson said: "That would be tricky. This reminds me of the bulk transfer regulations in place historically before authorisation came in. Those rules say you don't need to get advice on bulk transfer without consent if you're moving from own trust to master trust. So could those rules come into play for master trust to master trust?" Hayre said that in the previous regime any bulk transfer needed an actuarial certificate that said members' benefits are broadly unaffected by the transfer, and suggested something similar for the DC market could evolve.

But Reid said: "For bigger transfers it would be a brave set of trustees that took that decision without taking investment advice, which is required by legislation. You would still want something in your pocket saying, 'my professional adviser tells me that my members are going to be no worse off in the receiving scheme'."

Trustee conflicts?

Delegates debated the potential conflicts of interest where trustees sat on the board of more than one master trust, and a consensus emerged that there was a concern here.

Parker said: "With master trust trustees on multiple master trusts, they could find themselves on different sides of the battle for assets."

Dean said she would be uncomfortable about being a trustee to two master trusts. ▶

Andy Parker from Barnett Waddingham

Gurmukh Hayre of Grove Trustee Services, and (left) Shabna Islam of Hymans Robertson

Walsh said Standard Life's trustee recruitment process ensured that candidates were not affiliated with competitors of master trusts or the IGC. She noted that the DWP review of the regulatory regime for master trusts has highlighted concerns regarding conflicts of trustees. Walsh predicted possible rule changes from the DWP in response to these concerns. She said: "It's good to see that in the DWP review of the regime for their regulatory approach to master trusts called out potential conflicts of trustees as well. So we might see some change to the rules here."

All or nothing

Debate moved to the contentious subject of whether providers should be required to take all members with them when they moved, or whether they should target more profitable sections of the scheme, leaving others behind.

Walsh emphasised the discretionary nature of trustee assessments, stressing the need to ensure no detriment to any group of members during transfers.

Reid said: "From an employer's perspective, it's much more compelling to request a transfer where there are active members in the receiving trust due to consolidation. However, there are concerns about costs and responsibilities for managing 'true deferreds' who have never been part of the receiving trust. Employers may hesitate to transfer such funds as they don't want to bear the costs of managing pots for employees who are no longer with the company."

Parker drew attention to the possible disagreement that may arise between trustees and providers over the transfer of active members into a master trust and the retention of deferred members. He said: "I can see that the trustees could get themselves perfectly comfortable that retaining the deferreds was reasonable and the actives moving was reasonable. And I can absolutely see the organisation that priced that in the first place saying, we didn't price it based on that part of the membership, we priced it based on the whole. I guess the question is, is there anything that the provider can do about it if that's what the trustees decide? For me, there shouldn't be."

Walsh said: "It all comes down to open transparent processes for all parties, so the adviser and employer are both on the same page, that they want to move all actives and deferreds, and everyone quotes on the same basis.

Reid highlighted the complications around more complex DC arrangements which were linked to DB. She said: "I have seen providers quite understandably refuse to take members in if there's any kind of underpin, where members have DC benefits with DB elements to them. That is a problem, particularly if the DB goes to wind up.

"The other issue is around block transfers and transferring deferred benefits in. Trustees have got to have done that deferred transfer within a year for members to retain any protections around the minimum pension age and tax-free cash. This rule is also a blocker to transfers. The government could put legislation in to make this easier."

Parker added that if someone had been a member of a master trust for two years six years ago, they would lose their protection on a block transfer. This then necessitates a trustee buyout policy, which was not, Parker suggested, the intention of the rules.

As the secondary master trust continues to develop, it is clear the industry needs new approaches to managing conflicts of interest and ensuring tendering processes are effective. ■

OPINION

MASTER TRUST SECONDARY MARKET: WHAT'S THE ROLE OF CEDING TRUSTEES?

» **Donna Walsh** head of master trust, Standard Life

As more companies begin to review their master trust provider, the secondary master trust market is coming more into focus.

However, unlike the familiar single-employer trust to master trust market transition (with its well-oiled processes), the secondary master trust market is relatively untested. The role of ceding trustees, beyond the approval of any bulk transfer of members' assets, is therefore unclear.

There are similarities between moving from a single employer trust to a master trust, and moving from a master trust to another master trust. These include trustees approving the transfer of assets once they are satisfied there is no detriment to all members, and agreement on how to deal with transactions in process, such as the bereavements process.

However, there are also some key differences, which could hinder a seamless move.

Selection process – who's involved?

With single employer trusts, usually a decision has been taken by the employer to move, often to reduce the cost and resource needed to provide the independent governance. Once that decision to change has been made, the trustees will work hand-in-hand with the employer, normally through joint working groups, to agree a suitable master trust.

The ceding trustees are usually involved throughout the selection process, including meeting the master trust trustees. And ultimately they approve any transfer of assets, once satisfied that members will not be disadvantaged.

Moving from one master trust to another, however, is different. Here, the rationale for a review of master trust provider could be due to issues with the provider – including service levels, a lack of innovation or concern over their commitment to the market.

Or employers may simply decide to review to see what else is available in the market, and whether employees could benefit from a move. Either way, the employer is unlikely to engage the ceding trustees in the selection process.

Instead, the ceding trustees could be brought in at the end of the process, to agree that another master trust is likely to provide equal or better value to members than the one they have the fiduciary duty for. This could create unforeseen complications.

Untested waters

Imagine the scenario where an employer, working with their adviser, decides to move to a new master trust and the ceding trustees do not approve the transfer of the existing assets.

This could result in the members having two separate pots and needing to decide whether to consolidate into the new master trust. Inevitably, some members will be left behind, irrespective of how good the communications and process are.

There is also a question around which members to move to the new master trust. An employer might want to move just their employees (active members), if this can attract better charges. But the ceding trustees need to consider the impact on all members from the proposed transfer.

An increasingly important issue is the ability to accept crystalised benefits into a master trust, ensuring that no members are left behind. With many master trusts offering decumulation solutions, if the new master trust can't accept these members into the scheme and also allow them to continue to contribute, then you could be jeopardising an employer's employee reward proposition, not to mention a question around value for those members.

And what happens if there is a blocker to ceding trustees being able to do a value for money (VFM) assessment to make the judgement call? VFM assessments take time and have associated costs, given the work involved from the trustees and their advisers. Do providers absorb these costs? If not, then who pays? Some employers might not be able to.

Removing barriers

Many issues remain unresolved. With trustee discretion around the decision to approve the transfer, could the new VFM framework offer a solution to support the secondary master trust market?

And could regulations change, so that if you move master trust provider you need to move for all members and not pick and choose to get the best terms?

Perceived conflicts of interests aside, engaging the ceding master trust trustees much earlier in the process could also be helpful.

As Caroline Escott, one of our Master Trust trustees, says:

"As activity in the secondary market increases in the years ahead, it's vital that ceding trustees are fully involved and act independently. As they will have been doing previously, trustees need to have all members front of mind and avoid being influenced by the ceding provider in their decision to approve any bulk transfer. An open and transparent process across all parties will be critical.

"Ultimately, however, we need to look beyond the master trust trustees. To ensure a well-functioning secondary master trust market we, as an industry, need to work together to remove friction or barriers from the process." ■

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