Who should advise employers on master trust issues?

"It makes sense for us to go the master trust route; doesn't it?" This is a question being raised by many sponsors of defined contribution plans following the introduction of the IORP II Directive last year.

JIM BROPHY
DIRECTOR
VERUS

The Directive requires trustees to implement significant additional governance changes by the end of this year, including appointing risk and audit key function holders, carrying out prescribed reviews of service providers and performing an own risk assessment. The cost of these changes, both financially and in terms of time input, will fall on employers and potentially on members. For many employers the additional burden will push them towards the master trust model where the responsibility for meeting the new governance standards will be outsourced and the costs involved potentially reduced by being spread over a number of different schemes.

So, for all employers providing defined contribution pension plans, it makes sense to consider the master trust option and, for many, a master trust will be the right choice. However, there are many difficult decisions to make before trustees can be satisfied that the supposed benefits of a particular master trust would apply in their case. These benefits ought to include:

- Access to leading global investment managers
- Lower cost through 'bulk buying'
- Full compliance with regulatory requirements

However, these benefits may not always materialise and can be difficult to assess. There can also be issues with the independence of the master trust trustees from the provider, difficulties with transition to and from the master trust, and a potential loss of ongoing oversight by the sponsor company.

This raises two fundamental questions for sponsors:

1. Who should advise us on whether we should adopt the master trust option?
2. If we decide to opt for a master trust, then who should advise us on which one to select?

Let's consider the first question. In a number of cases, particularly for small schemes, the weight of evidence towards moving to a master trust will be overwhelming. In these circumstances it may not be necessary for employers to seek independent advice. But for other pension plans the decision may not be so clear-cut. In such situations I would recommend that employers seek help from independent firms that have an expertise in understanding the governance/ costs/time input/controls trade-offs involved. For clarity, the author's firm, Verus, does not provide such advice but is aware of a number of independent firms that do. I believe, however, that any firm offering its own master trust option is conflicted in offering advice on this issue.

Moving to the second question of which master trust to select: In Ireland there are currently eight firms that offer this service. When considering the choice, employers need to take into account a number of issues, including the following.:

- Investment choices being offered
- Investment competence and past record of the manager
- Costs
- Overall governance of the trust including powers of trustees
- Level of independence of trustees from the provider
- Member communication facility
- Administration capability
- Exit terms that would apply when a subsequent switch to a different master trust is made.

Almost all employers will require help in assessing these issues. I would suggest such help is sought from independent firms with expertise across all the areas. It would not be appropriate for any firm that is offering a master trust to be involved in advising employers on this decision. (Again, for clarity, Verus does not provide such advice.) If your current investment manager or advisor offers a master trust then there may be the temptation to appoint them without considering alternatives. Indeed, there are providers who will arrange for the transfer to their master trust and offer to absorb the initial costs. This can seem very attractive in that it provides the immediate removal of the governance burden, there is no up-front cost involved and the provider can be reviewed in a few years' time if they are not performing well. Clearly, this can be very tempting, particularly as the clock is ticking towards the implementation deadline date, but I believe strongly that it is the wrong approach for two main reasons.

Firstly, it is appointing a provider without properly considering the options available and the long-term implications for employees.

Secondly, while it can be comforting to suggest that the employer will do a full review of their master trust in a few years' time, in practice is this really likely to happen? How probable is it that an employer will review and decide to move to another provider with all of the time, cost, member communications issues and potential transfer problems that could be entailed. In my view this is something that may not happen as often as it should in some cases, as the body that would have carried out such a review in the past - the original trust - will have disappeared along with its organisational capacity and supports. The provider appointed to handle your master trust could, then, end up being the provider for many years, adding to the importance of getting the initial master trust appointment right. Ideally, of course, frequent meaningful reviews will take place and the right time to establish the framework for these, including the level of independence required, is at the initial appointment.

The IORP II Directive is ushering in some of the most significant changes for Irish pension plans in many years. The move to a master trust model to address these changes may be the best approach for many employers. The decisions on whether to move to a master trust and, if so, which provider to select, will be among the most important and potentially long-lasting decisions that employers will face with regard to the pension benefits of their employees. I believe strongly that employers should seek expert, independent assistance to have the best chance of getting these decisions right.

ARTICLE AUTHOR
Jim Brophy
principal of Verus Advisory Limited