ROYAL LONDON POLICY PAPER 32

Group Personal Pension or Master Trust? – A guide for employers

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INTRODUCTION

Since the introduction of automatic enrolment, employers have been given new duties with regard to workplace pensions. Broadly speaking, any employer with an employee who is aged 22 or above and who earns £10,000 per year or more has had to set up a workplace pension and make contributions into it[1]. But beyond that minimum requirement, employers have had a considerable amount of choice as to what pension arrangement to choose.

Now that automatic enrolment is well established and the three yearly cycle of 're-enrolment' is already underway, many employers are now reviewing their initial choice of workplace pension scheme. In some cases a scheme was chosen relatively quickly in order to meet statutory duties and there is now time to review that decision. In addition, employers now have several years' experience of how their pension provider has performed, whether in terms of how it has invested members' money, how much it has charged or how well it has engaged with members. As a result, a growing 'secondary market' is emerging in workplace pensions where employers begin to 'shop around' to ensure that they are getting the best outcome.

There are many factors which employers will wish to consider when choosing a workplace pension arrangement, but one where the differences may not be immediately apparent is the choice between a Group Personal Pension (GPP) or a MasterTrust. Both of these are multi-employer arrangements where employees join workers from hundreds or thousands of different employers in a single over-arching scheme.

In the case of a GPP, each individual member has a contractual relationship with an insurance company or other provider and builds up an individual pension, overseen by an Independent Governance Committee (IGC) for the whole scheme.[2]

In the case of a MasterTrust, each individual is a member of a trust-based occupational pension scheme overseen by a board of trustees.

In both cases there may be employer-level pension committees providing an additional tier of governance.

[1] More details of the legal obligations on employers with regard to automatic enrolment can be found on the website of the pensions regulator: www.thepensionsregulator.gov.uk
[2] For the purposes of this paper, we focus on Group Personal Pensions offered by insurers. Some employees will be members of Group Self-Invested Personal Pension schemes offered by investment platforms.

Since automatic enrolment began in 2012, millions of workers have been enrolled into GPPs and millions into MasterTrusts, and some employers will never before have had to think about the differences between the two arrangements.

The purpose of this short paper is to set out the main differences between GPPs and MasterTrusts and to identify a series of issues which employers may wish to consider when deciding between the two approaches.

In the interests of transparency, we should make clear at the outset that Royal London (the authors of this report) provides a GPP and not a MasterTrust, that some pension providers offer both GPPs and MasterTrusts and some offer only MasterTrusts. We believe that there are high quality pension arrangements of both types and our aim is to provide factual information for employers to help them to decide what is the right arrangement for them and for their employees[3].

[3] A joint policy paper produced by Royal London and pensions lawyers Eversheds Sutherland provides more detail on the legal duties of employers and the extent to which larger employers in particular might be expected to go beyond 'minimal compliance' with the legislation. The paper can be downloaded from https://www.royallondon.com/siteassets/site-docs/media-centre/policy-papers/policy-paper-royal-london-and-eversheds-sutherland-final.pdf

BACKGROUND – HOW DO GPPs AND MASTERTRUSTS WORK?

A. Group Personal Pensions (GPPs)

Group Personal Pensions (GPPs) are generally provided by insurance companies. The basis of the arrangement is a contractual one between the scheme member and the pension provider. These are 'Defined Contribution' (DC) or 'pot of money' pension schemes where an individual builds up a pot of money based on contributions from the employer and from the employee, topped up by tax relief from the government and with a return on the money which is invested. Charges for running the scheme are generally a simple percentage of the fund value, though in some cases employers will also pay a monthly charge to the provider for running the scheme.

Most GPP providers are insurance company PLCs, but a small number are run by not-for-profit mutual organisations. The only large-scale mutual provider of workplace pensions in the UK is Royal London.

B. MasterTrusts

For many decades, individual employers have run single-employer workplace schemes overseen by a board of trustees. But in recent years, largely driven by the introduction of automatic enrolment, there has been a surge in the number of multi-employer 'MasterTrusts' available to employers. These MasterTrusts allow employers to be part of a larger, pre-existing scheme rather than having to set up something for their own workplace.

In the early stages of automatic enrolment, the MasterTrust market was dominated by three large providers as well as by a small number of MasterTrusts set up by large insurers. The three largest MasterTrusts not run by insurance companies are:

- **The National Employment Savings Trust (NEST)** – NEST was set up by the government with a public service obligation to take on the automatic enrolment business of any employer; NEST is the largest MasterTrust and (as at March 2018[4]) had around 6.4 million members, of whom around 3.8 million were actively contributing to a pension, with the rest being 'deferred' members with pots built up in a previous job; the average NEST pot is currently under £500, reflecting the fact that NEST was set up primarily to provide automatic enrolment schemes and that most arrangements will have been set up since 2012; NEST currently benefits from a loan from the taxpayer to cover set-up costs and running at a loss in the early years of

[4] See NEST's 2017/18 annual report which can be found here: https://www.nestpensions.org.uk/schemeweb/nest/nestcorporation/news-press-and-policy/press-releases/NEST-Corporation-publishes-its-annual-reports-and-accounts-2017-18.html

operation, and the balance on this loan currently stands at around £600m; NEST expects to be covering its operating costs from charges income by 2027 and to have cleared its outstanding debt by 2039;

- **The People's Pension / B&CE** – B&CE was created in the 1940s to provide pensions to workers in the construction industry and operates on a not-for-profit basis; with the advent of automatic enrolment and with a view to serving a wider variety of industries and sectors, the scheme was re-branded as 'the People's Pension' and now has around 3.8 million members as at March 2018;[5]

- **NOW: Pensions** – **NOW**: Pensions entered the UK market in response to the opportunities provided by automatic enrolment and has its roots in the Danish pension scheme, ATP; as at January 2018, it had 1.5 million members;[6] as with NEST, the average pot size is currently under £500; it was recently announced that NOW: Pensions is to be taken over by Cardano;

Each of these three MasterTrusts has a different structure of member charges which we discuss more fully later in this document.

What was probably not foreseen by policy makers was the emergence of a much larger number of smaller MasterTrusts as automatic enrolment developed. One trend has been for larger employee benefit consultancies to set up their own in-house MasterTrust schemes, a development which has lead to some concerns over potential conflicts of interest, as we discuss later.

At one stage, the Pensions Regulator listed more than 100 different MasterTrusts which led to concerns about whether all of these schemes would have sufficient scale to be viable and about whether there was sufficient regulatory oversight of these schemes.

In response to this, the Government passed the 2017 Pension Scheme Act which provided a regulatory framework for all MasterTrusts. This sets a number of quality standards that MasterTrusts will have to meet, including ensuring that those who run the scheme are 'fit and proper' persons and that there is adequate capital backing for the scheme. It is assumed that the authorisation process will weed out some of the smaller and weaker MasterTrusts and that we will end up with perhaps 25-40 which pass through the initial authorisation process. It is possible that market forces will lead to further consolidation thereafter.

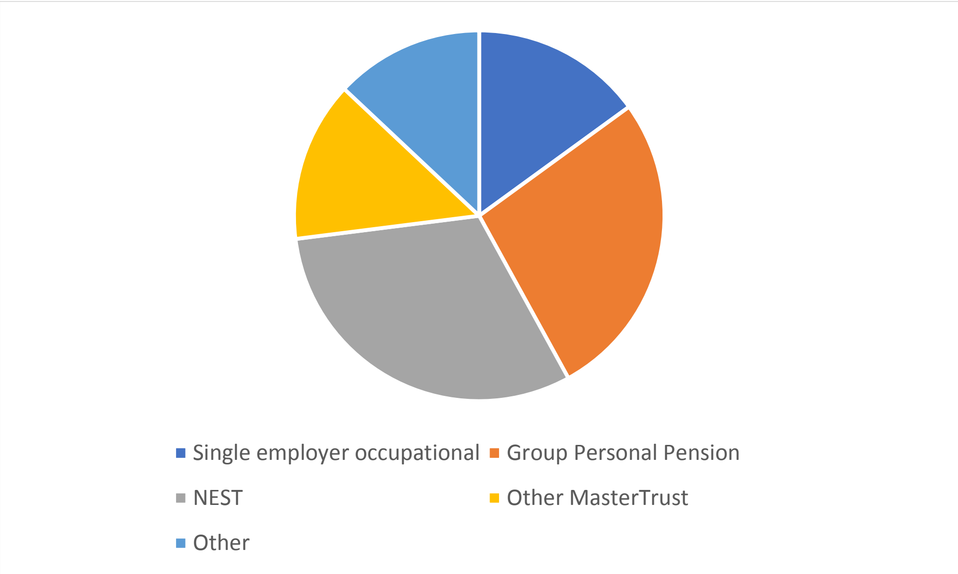
[5] The annual report of the People's Pension can be found here: http://thepeoplespension.co.uk/wp-content/uploads/2015/01/TPP-Annual-Report.pdf
[6] See: https://www.nowpensions.com/press-release/now-pensions-enrols-1-5-millionth-member/

1. HOW HAS THE MARKET DEVELOPED?

Automatic enrolment was introduced on a phased basis, starting with the largest employers in 2012/13 and gradually reaching the smallest employers by 2017/18. Different types of providers have targeted different parts of the market and it is only now starting to become clearer as to the choices which employers have made for their initial provider. However, it should be stressed that this is a moving picture as employers are free at any time to change their provider. There are growing signs of a modest 'secondary market' developing as employers shop around for a better deal or seek to move away from providers who have not provided them with the standards of service that they require. Further impetus for employer switching may come through the MasterTrust authorisation process being run by the Pensions Regulator. This is expected to lead some MasterTrusts to withdraw from the market altogether.

Some data on scheme memberships is available from the Employers Pension Provision survey, though this only takes us up to 2017 so will not reflect what has happened amongst the very smallest employers.

Figure 1. Active members of workplace pensions in 2017 by type of pension scheme



Source: Employer Pension Provision Survey, 2017, Table 2.4

Figure 1 provides a breakdown of all employees who were active members of a workplace pension scheme in 2017. In terms of order of most common arrangements:

- Just under a third (31%) of members have access to NEST, the National Employment Savings Trust;

- Just over a quarter (27%) are members of a Group Personal Pension scheme (GPP);
- Just under 1 in 6 (15%) is a member of a single employer occupational scheme, run on either a Defined Benefit or Defined Contribution basis;
- Around 1 in 7 (14%) has access to a MasterTrust other than NEST;
- The remainder (13%) is covered by a variety of arrangements such as Group Self-Invested Personal Pensions;

This data demonstrates that despite the regular focus by commentators on the role of MasterTrusts, slightly less than half of all active pension scheme members in 2017 were members of MasterTrusts, though this proportion will have grown with the further rollout of automatic enrolment since that date.

More recent data on the choices being made by employers with regard to automatic enrolment can be obtained from the Pensions Regulator (TPR) statistics on compliance with automatic enrolment duties during the last financial year. Note that this data is on numbers of *employers* whereas the previous data was based on number of members and that it will exclude the largest employers who will have completed their automatic enrolment compliance at an earlier stage.

Table 1. Type of pension arrangement being used by employers to satisfy automatic enrolment duties 2017-18

Scheme type	**Number of employers using schemes** (Declaration of compliance in 201718)		
	Small (<30 members)	Large (≥30 members)	Total
DB	3,262	8,442	11,704
Hybrid	877	1,467	2,344
DC Trust	545,478	52,667	598,145
DC Contract	69,981	33,498	103,479
Unknown	178	68	246
Total	619,776	96,142	715,918

Source: The Pensions Regulator, Automatic Enrolment commentary and analysis 2018 (https://www.thepensionsregulator.gov.uk/-

/media/thepensionsregulator/files/import/pdf/automatic-enrolment-commentary-analysis-2018.ashx)

Table 1 shows the very marked difference between smaller employers (those whose schemes have fewer than 30 members) and larger employers. For small employers, the balance is very much towards DC Trust based arrangements, almost all of which are MasterTrusts rather than single-employer arrangements. In many cases the smallest employers will have chosen NEST which has a public service obligation to accept all employers, including those which a commercial provider would not regard as being commercially viable.

For those with schemes of more than 30 employees however, the picture is much more mixed. Just over 1 in 10 of these employers had an existing Defined Benefit arrangement (or a hybrid of DB and DC). Of the rest, just over 60% have chosen MasterTrusts and just under 40% are using contract-based arrangements of which the majority will be GPPs. This suggests that for somewhat larger employers, the judgment between a MasterTrust and a GPP will depend very much on the individual needs and preferences of employers and their staff. The purpose of the rest of this paper is to highlight the key differences between the two approaches in order to assist employers in choosing the arrangement which is right for them.

2. SEVEN ISSUES FOR EMPLOYERS TO CONSIDER

There are many factors which employers will wish to consider when choosing a workplace pension arrangement. In this section we run through seven issues which will be of particular significance to employers and their employees and consider how GPPs and MasterTrusts compare.

1) Charges

An important issue for scheme members will be how much money is taken from their pension fund to pay for the running of their pension. Although legislation provides a cap of 0.75% a year on the member-borne charges in the default fund of a scheme used for automatic enrolment, charging levels and charging structures can vary considerably within this overall limit. Employers who are looking to choose a scheme which is right for their employees will want to look closely at charging levels and structures and also at value-for-money, as the cheapest scheme will not necessarily be the best.

There are three main charging structures in operation in the workplace pension market:

a) Flat percentage charge

The vast majority of Group Personal Pensions (GPPs) will operate on the basis of a simple percentage annual management charge (AMC) deducted from a member's pension pot[7]. This is relatively easy for members to understand and makes it easier to compare between different pension providers. For automatic enrolment purposes, this charge has to be at or below 0.75% where members' money is invested in the 'default' arrangement, that is, where they have not made any active investment choice.

In addition to an AMC paid by members, some schemes will also charge a monthly fee to employers, particularly on smaller schemes or where the amounts being contributed are relatively modest, where AMC income alone would not make the scheme viable for the provider.

Recently the People's Pension (B&CE) has announced that it will have a tiered charge structure with a flat fee of 0.5% for the smallest pots falling to 0.2% for the largest pots.

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[7] In the particular case of Royal London, the AMC charge may be offset in part by any payment of 'ProfitShare' which is one of the benefits to members of mutuality. Whilst Profitshare payments are not guaranteed, the company aims to credit between 0.15% and 0.25% of fund values into a member's pension each year.

b) Contribution charge and annual management charge

NEST operates a two-tier charging structure with a one-off charge of 1.8% on contributions (excluding transfers in) followed by an AMC of 0.3% thereafter.

The background to this charging structure is that NEST was established on the basis of a loan from the taxpayer and it is expected to have to repay that loan by the end of the 2030s. An up-front charge on contributions helps NEST to 'front-load' its charge income which gives it additional revenue to pay back to HM Treasury. At present the outstanding balance on the loan to HM Treasury is continuing to increase until the late 2020s, but as NEST's assets under management grow this will increase charge revenue and enable NEST to begin to pay down the balance.

A positive way of looking at the NEST charging structure is that the ongoing AMC of 0.3% is highly competitive, and will benefit those who stay invested for the long-term. A less positive consequence of the charging structure is that those who are members of NEST for a relatively short period of time before drawing their pension (for example, those who are enrolled close to retirement) will pay a relatively high effective charge.

c) Monthly fee and annual management charge

Some MasterTrusts (such as NOW: Pensions) charge members a flat monthly fee as well as a percentage AMC[8]. As with NEST's charging structure, this structure means that the headline AMC figure can be relatively low, but there is also a fixed fee going out of the account each month. By definition, this will be a higher proportion of the pot of those with lower balances. The current charge made by NOW: Pensions is £1.50 per month (regardless of pot size) plus a 0.3% AMC.

One downside of a monthly charge is what happens when the employee leaves the firm and leaves behind a small pot with the MasterTrust. If the monthly fee continues unchanged, this could make a serious dent in the balance left in the fund and could, in extremis, reduce the balance in the fund to zero. This would create a considerable communications challenge. In response to this issue, NOW: Pensions reduces the overall charge for those who leave the scheme to the lower of 0.5% or the charge for active members (£1.50 per month plus 0.3%).

It is worth noting that different charging structures will involve varying degrees of cross-subsidy between different members. In broad terms, it is difficult to make a profit from running a workplace pension scheme for small numbers of lower paid workers making contributions at statutory minimum levels. Where charges are a simple percentage of

[8] This member-borne monthly fee is not to be confused with any monthly charges which may paid by employers in some pension arrangements.

amounts invested there will be quite extensive cross-subsidy from those with larger pension pots to those with smaller pots, whereas flat monthly fees for all members will tend to bear proportionately more heavily on those with smaller pensions.

2) Governance and Regulation

An important difference between GPPs and MasterTrusts relates to the governance and oversight of the scheme. In the best pension schemes, whether trust-based or contract-based, those overseeing them will have the necessary skills and expertise and will be acting impartially in the best interests of scheme members.

a) Governance in a Group Personal Pension

With a GPP there is an individual contractual relationship between the scheme member and the pension provider. But across all members of the scheme there will be various tiers of governance to ensure that member money is being well looked after. These will include:

- **The Independent Governance Committee (IGCs)** – firms operating workplace personal pensions are required by the Financial Conduct Authority (FCA) to have in place an Independent Governance Committee to oversee the scheme. The FCA describe the role of the IGC as follows:

"IGCs have a duty to scrutinise the value for money of the provider's workplace personal pension schemes, taking into account transaction costs, raising concerns and making recommendations to the provider's board as appropriate. IGCs must:

- act solely in the interests of relevant scheme members
- act independently of the provider

An IGC has a minimum of five members, the majority of whom must be independent, including an independent chair".

Source: https://www.fca.org.uk/firms/independent-governance-committees

IGCs publish annual reports which must be communicated to scheme members and placed on the website of the provider. IGCs have been established relatively recently and market commentators have suggested that they vary in their effectiveness. For example, in some cases IGC recommendations have led to substantial reductions in charges for scheme members or to innovations designed to improve member engagement with the scheme. But there has also been some criticism of the relationship between some providers and their IGCs, and some IGC reports have been explicitly critical of the failure of a provider to respond adequately to the Committee's concerns. Whereas in a trust-based arrangement the trustees are the decision-makers and are accountable for the scheme, the role of the IGC is an advisory (and whistle-blowing) one, and ultimately the Board of Directors of the insurer will make final decisions.

- **Workplace level pension committees** – the remit of an IGC is to act on behalf of all scheme members across all workplaces; but in many cases there will also be a firm-level pensions committee which looks at how the scheme is operating with specific reference to workers at that firm; the committee can, for example, seek to ensure that scheme communications are relevant and effective taking account of the particular circumstances of a particular workforce; it can also provide feedback to the IGC and to the scheme about any issues of concern;

- **Other governance structures** – GPPs use a mixture of in-house and external asset managers and each of those will have their own tiers of governance to ensure that money is being well invested in line with the mandate given to it; regulators are increasingly expecting those tiers of governance to have higher levels of independent oversight; where employers have used a financial adviser or consultant to help select a provider, the adviser will also be scrutinising the performance of the provider on an ongoing basis and may support the employer in reviewing their scheme to make sure that the current provider remains the most suitable;

In terms of regulation, GPPs are regulated by the Financial Conduct Authority and are subject to the standard range of FCA duties. These include obligations to 'treat customers fairly', to ensure that senior managers are 'fit and proper' and so forth.

b) Governance in a MasterTrust

A MasterTrust will be overseen by a committee of trustees who have a 'fiduciary duty' to act in the interests of scheme members. Some will have member representatives on the Trust body whilst others will seek to respond to members by having 'member panels' or similar structures.

MasterTrusts are overseen by the Pensions Regulator (TPR) which is currently in the process of implementing the MasterTrust authorisation process set out in the 2017 Pension Schemes Act. TPR will seek to ensure that those running MasterTrusts are 'fit and proper' to do the job and that the schemes are of sufficient scale to be robust and effective.

The trust body of a large industry-wide MasterTrust will generally include respected and experienced industry figures and will benefit from high quality professional advice. Such schemes will generally be well governed and well run.

However, a number of issues have arisen in recent years with regard to the operation of some trust-based pension arrangements:

- One large MasterTrust experienced considerable operational problems in recent years; NOW: Pensions announced on its company website in July 2017 that it was voluntarily withdrawing from the 'MasterTrust Assurance Framework' (a voluntary predecessor to the government's new statutory MasterTrust approval process); the company said: "NOW: Pensions has today chosen to withdraw itself from the master trust assurance list of providers for auto enrolment as it works to resolve historic issues processing contributions for a small percentage of clients".[9]

- The relatively recent establishment of advisers' own in-house MasterTrusts has raised issues around potential conflicts of interest arising from 'vertical integration'; employers would expect consultants to recommend the pension arrangement which best meets the employer's need but consultants may have an incentive to steer the employer towards their own in-house solution; the FCA, in its 2017 'Sector Views' publication raised concerns about vertical integration in a number of areas of financial services and warned:

  "The nature and structure of wholesale financial markets mean that conflicts of interest and information asymmetries remain inherent drivers of risk. High levels of horizontal and vertical integration give rise to numerous conflicts of interest, particularly where firms act both as principals and agents. Effective management of these conflicts is fundamental to firms meeting their regulatory requirements. In some cases, failure to do so may reflect deeper problems, such as an inappropriate culture". (FCA 'Sector Views', 2017, p63 - https://www.fca.org.uk/publication/corporate/sector-views-2017.pdf)

- The Pensions Regulator has expressed repeated concerns about the quality of governance in small trust-based schemes; these concerns relate primarily to single-employer occupational schemes, and not to large multi-employer MasterTrusts, but

[9] https://www.nowpensions.com/press-release/now-pensions-withdraws-master-trust-assurance-list-providers/

do highlight the increasingly demanding nature of the role of a trustee and the need to ensure that all trustees are of the highest calibre;

In regulatory terms, MasterTrusts are overseen by the Pensions Regulator (TPR) which regulates all occupational pension schemes in the UK. TPR is responsible for implementing the MasterTrust authorisation legislation contained in the 2017 Pension Schemes Act which imposes standards on those who run such schemes and which requires MasterTrusts to have minimum levels of capital.

3) Investment options and performance

It is a requirement of pension schemes used for automatic enrolment that they offer a 'default fund'. This means that if scheme members make no active choices about how their money is invested, there is a default investment strategy which will be used. Such default arrangements can cost no more than 0.75% per year by way of member-borne deductions. Given the passive nature of automatic enrolment, the large majority of scheme members have their money invested in a default fund, especially in the case of MasterTrusts.

In terms of the investment returns which have been achieved so far, there has clearly been considerable variation between different workplace pension providers.[10] However, given that workplace pensions are meant to be invested over a period of decades it is hard to draw meaningful comparisons as to whether a given provider is doing a good job based on the first few years' of automatic enrolment, especially given the extraordinary market conditions of recent years. What is noteworthy however is that some providers have so far delivered significantly lower risk-adjusted returns than others.

Employers will want to ask any potential provider to provide evidence of their investment performance to date (noting the regulator's warning that 'past performance is not necessarily a guide to the future') and of how they plan to ensure that members get a good risk-adjusted return for their money.

Where providers also vary is in terms of the investment choices available to members. In general, most MasterTrusts will offer only a limited range of investment options, designed to meet the broad needs of the majority of members. GPPs will generally offer a much wider range of ways for members to invest their money, allowing members to personalise the way in which their funds are invested. Partly as a result of this flexibility and partly as a result of a different mix of members in the different types of schemes, most GPPs will have a higher

[10] See for example the recent survey undertaken by Corporate Adviser magazine: https://corporate-adviser.com/deepest-ever-research-master-trust-defaults-shows-massive-disparity-performance/

proportion of members choosing to invest beyond the default investment arrangement compared to MasterTrusts.

In choosing between the two, employers may want to consider how far their employees would be best served by mostly being in a default investment arrangement with limited choice or whether they would be better served by a more tailored approach. A larger employer may feel that a standardised approach would best meet the needs of lower-paid workers whilst higher earners may wish to have greater freedom of investment options. This is difficult to accommodate within a MasterTrust arrangement and could mean some employers end up choosing to run two schemes – a MasterTrust for lower-paid workers and a Group Personal Pension or Group SIPP for higher earners.

4) Tax relief

There is a significant difference in the way that tax relief on pension contributions is delivered to members of GPPs and members of (most) MasterTrusts and this is an important issue which employers need to consider.

In brief, member contributions into workplace pensions attract tax relief, subject to various overall limits. To give a simple example, a worker paying income tax at thebasic rate of 20% who puts £100 into a pension benefits from a £20 reduction in their tax bill. As a result, it has only 'cost' the worker £80 to get £100 in a pension. For similar reasons, it 'costs' a worker paying the higher (40%) rate of income tax just £60 to get £100 in a pension and a worker paying the additional (45%) rate of tax just £55 to get £100 into a pension.

However, tax relief is delivered in two different ways – the 'Relief At Source' method and the 'Net Pay Arrangement' method – and the different ways have different implications for lower and higher-paid workers. We explain the two approaches below:

a) Relief At Source (RAS)

Group Personal Pensions deliver income tax relief through the Relief at Source (RAS) method. In simple terms, member contributions are paid into the pension fund out of take-home pay. No tax relief has been given at this point. The pension provider then contacts HMRC and claims tax relief at the basic rate for *all* members of the scheme.[11] To take our earlier simple example of a basic rate taxpayer, they would put (say) £80 out of their take-home pay into a GPP and the provider would claim an extra £20 in tax relief from HMRC, resulting in £100 in the member's pension pot. Higher-paid workers who are entitled to

[11] There are additional complexities arising from the separate rates of income tax levied in Scotland which we do not deal with here.

more tax relief than this can record their pension contributions on their annual tax return in order to claim additional tax relief.

One consequence of this arrangement is that it is particularly beneficial to the growing number of workers who fall within the scope of automatic enrolment (those earning more than £10,000 per year) but who are not taxpayers (because their taxable income is below the personal allowance, due to rise to £12,500 in 2019/20). Even though someone earning (say) £11,000 per year is not a taxpayer they still benefit from basic rate tax relief if their workplace pension provider uses the Relief at Source method.

b) Net Pay Arrangement (NPA)

Most MasterTrusts deliver tax relief using the Net Pay Arrangement (NPA). In this case, member contributions are deducted from a worker's salary *before* the income tax calculation is carried out. This means that the gross amount goes directly into the scheme with no additional claim being made by the pension provider. Because the member's taxable income is reduced by the amount of their pension contribution, they benefit from a reduction in their tax bill. For example, a basic rate taxpayer who puts £100 gross into their pension scheme will have £100 less in taxable income so will have a £20 reduction in their tax bill.

The upside of this arrangement for higher earners is that they get full tax relief at their highest marginal tax rate without the need to claim top-up tax relief via the tax return process. But the downside for lower earners is that if they are not income taxpayers they do not benefit from tax relief under the NPA process. In the case of the worker on £11,000 who puts £100 gross into his or her pension, there is no reduction in their tax bill because it is already zero. It has thus cost them more to get £100 into their pension than it would have done if their employer had chosen a scheme using the RAS method to deliver tax relief.

HMRC has estimated that in 2015 over one million workers were potentially affected by this issue, whereby they earned enough to be automatically enrolled but not enough to pay income tax and where they would miss out on tax relief if they were covered by the NPA process. Given the extra rollout of automatic enrolment since that date and the rise in the tax-free personal allowance since then, it is likely that many more workers are now affected.

RAS v NPA - discussion

It should be made clear that in addition to GPPs who all use the RAS method, a small number of MasterTrusts (notably NEST) also use RAS. In the case of NEST this reflects the fact that they were designed particularly with smaller firms and lower earners in mind and it would have been unacceptable for them to have used a method of delivering tax relief which was detrimental to a group of lower paid workers. Another MasterTrust (NOW: Pensions) does not use the RAS arrangement but tops up member pension pots to compensate them where they have missed out on tax relief as a result.

Whilst there are pros and cons of each method, employers with workers in the band between £10,000 and the income tax personal allowance threshold will want to think very carefully about how they can make sure that they do not inadvertently exclude some of their employees from the benefits of pension tax relief when choosing a pension provider.

Salary Sacrifice

The relevance of the distinction between RAS and NPA schemes will be affected by whether the employer offers pensions on a 'salary exchange' or 'salary sacrifice' basis. In such an arrangement, the employee agrees to forego a proportion of their salary and in return all of the pension contribution is paid by the employer. Such an arrangement can generate National Insurance savings for both employee and employer because NI contributions are not levied on employer pension contributions. Where salary sacrifice is in force, tax-paying employees immediately benefit from full tax relief on contributions because the employer pays them gross of tax into the pension[12].

5) At-retirement options

The focus of automatic enrolment at present is clearly on today's workforce and getting millions of people saving in a pension, often for the first time. But at some point, those savers will want to stop work and use their pension saving to support them in retirement. It is worth employers thinking about the at-retirement options that different types of pension arrangements offer to scheme members, even though in many cases these members will have long since stopped working for their current employer.

It would be fair to say that most GPPs have been designed to make the transition from a period of building up a pension ('accumulation') to a world of drawing down on past savings ('decumulation') relatively painless. Indeed, GPPs are particularly well suited to the world of 'pension freedoms' where individuals are no longer required (in most cases) to turn their pension pot into an income for life (an annuity) but have a broader range of options about what to do with their pension pot.

Whether in a GPP or MasterTrust, an individual can take their accumulated pot, seek appropriate financial advice or guidance (including using the Government's free 'PensionWise' service as appropriate) and then choose one of the range of options available

[12] It is worth noting that workers who do not pay income tax can still get tax relief in a RAS scheme if they make employee contributions, but if all contributions come via the employer, no tax top-up is applied. Salary sacrifice therefore needs to be focused on those employees who will benefit from it.

under pension freedoms. They should generally shop around different providers of retirement solutions and identify the best one for them. However, members may find that some MasterTrusts only actively facilitate a limited range of at-retirement options. This will often not include the most popular option of income drawdown, so MasterTrust members wishing to go into drawdown will have to move their money out of the MasterTrust.

In the special case of NEST, NEST is legally prohibited from providing post-retirement financial products, though there is political pressure for this restriction to be lifted. To access their funds, all NEST members will therefore have to move their money out of NEST and into other at-retirement products and/or cash out their pension.

The recent 'Retirement Outcomes Review' published by the FCA in 2019 recommended that providers should offer 'ready-made drawdown investment solutions, within a simple choice architecture'[13], and at time of writing relatively few MasterTrusts would be able to deliver this in-house.

6) Protection against insolvency

In most cases, GPPs will be run by large household-name insurers who are financially robust and where the risk that the insurer goes out of business is very remote. Similarly, most large multi-employer MasterTrusts will be well capitalised, especially following the implementation of the new statutory framework for the regulation of MasterTrusts, and scheme members can have confidence that their money is safe.

However, in the unlikely event of a failure, employers need to be aware of the differences between GPPs and MasterTrusts.

In brief, member funds in a Group Personal Pension are held under an insurance arrangement and are protected in the event of company insolvency. Funds held in a MasterTrust are not similarly protected and this is why there is considerable Regulatory focus on the 'capital adequacy' of MasterTrusts. Those with inadequate capital reserves will not be allowed to operate under the new authorisation regime, and the Pensions Regulator will be seeking to ensure that capital adequacy is maintained on an ongoing basis.

7) Member Engagement and Communications

For larger employers considering moving from own trust to a MasterTrust or GPP the engagement and communication tools provided will be an important consideration. A general issue for employers is that employees often do not appreciate or sufficiently value the contribution that the employer makes into a scheme. Amongst both MasterTrusts and GPPs

[13] https://www.fca.org.uk/publications/market-studies/retirement-outcomes-review

there will be examples of schemes and providers who offer good member communications, online access to scheme information, modelling tools etc. and these features will be influential in employer choice of pension arrangement.

3. OTHER ISSUES

In the previous section we covered some of the main issues which employers will wish to bear in mind when choosing which type of pension scheme to offer to their employees. There are however some other factors which are worth noting:

a) *Facility to allow for adviser charging*

It is widely accepted that there is an 'advice gap' in the UK, with too few workers taking financial advice when planning for their retirement and when making other key financial decisions. One way to make advice more affordable is for the cost of ongoing financial advice to be deducted from a member's pension rather than having to be found out of the member's bank account. This is a process known as 'adviser charging'. Most Group Personal Pension schemes will facilitate adviser charging for ongoing advice, but MasterTrusts do not do so. If employees are enrolled into a MasterTrust they may therefore be less likely to find the ready cash to pay for financial advice, thereby resulting in potentially poorer retirement outcomes.

b) *Requirement for member consent*

Where individuals are members of a pension scheme there may be times when the scheme wishes to change the terms and conditions of the pension scheme. However, whilst such changes may be to the benefit of scheme members as a whole, they may produce less favourable outcomes for particular scheme members in particular circumstances.

In a MasterTrust, the power of trustees to act in the best interest of the membership means that they can generally make changes to the scheme (such as the default investment pathway) without obtaining consent from individual members. This can only be done in the case of a GPP where the way in which the GPP is set up gives the scheme power to make such changes, but this is exceptional.[14] This power to make changes is generally advantageous if the scheme wishes to respond to regulatory change (such as the 2015 introduction of 'pension freedoms' which changed views about the best investment path in the run up to retirement).

c) *Integration with other workplace financial products*

Historically, a pension might have the main or only financial product offered to employees through the workplace. Over time however, more employers have sought to offer other financial products such as access to ISAs and other savings vehicles. At the same time, growing numbers of employees, including higher-paid employees in particular, have become

[14] The Royal London GPP *does* allow for changes to be made without member consent, but most GPPs do not.

interested in topping up their pension saving through other savings vehicles, especially where they have already exhausted annual or lifetime limits on pension tax relief. Whilst GPPs and MasterTrusts offered by insurers may be able to offer an integrated suite of pensions and other financial products which can meet this need with a single provider, freestanding MasterTrusts may be at a disadvantage as employers will then need a separate provider for other workplace financial products.

4. CONCLUSIONS

As we indicated at the outset, we believe that the UK benefits from high quality pension provision in both the Group Personal Pension sector and in the MasterTrust sector. The challenge is for each employer to choose the type of pension arrangement which is right for them and for their employees. Prior to the introduction of automatic enrolment, many employers may never before have had to consider the relative merits of GPPs as against MasterTrusts but now find themselves having to make a decision which could have far-reaching consequences for the financial well-being of their employees.

We hope that this report has helped to explain the key differences between Group Personal Pensions and MasterTrusts and in particular has highlighted some of the key issues which employers will need to consider. At the very least, we hope that it will have better equipped employers to know what questions to ask both advisers and providers in order to ensure that they choose the pension arrangement that is right for them.